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LEGISLATIVE AND REGULATORY OPTIONS FOR MINIMIZING AND MITIGATING MORTGAGE FORECLOSURES

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

SEPTEMBER 20, 2007

Printed for the use of the Committee on Financial Services

Serial No. 110–61

U.S. GOVERNMENT PRINTING OFFICE

39–540 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) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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LEGISLATIVE AND REGULATORY OPTIONS FOR MINIMIZING AND MITIGATING MORTGAGE FORECLOSURES

Thursday, September 20, 2007

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

The committee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Present: Representatives Frank, Kanjorski, Maloney, Gutierrez, Velazquez, Watt, Sherman, Meeks, Moore of Kansas, Capuano, Clay, McCarthy, Baca, Lynch, Miller of North Carolina, Scott, Green, Cleaver, Bean, Davis of Tennessee, Sires, Hodes, Ellison, Klein, Wilson, Perlmutter, Murphy, Boren; Bachus, Baker, Pryce, Castle, Royce, Lucas, Paul, Manzullo, Biggert, Shays, Miller of California, Capito, Feeney, Hensarling, Garrett, Barrett, Pearce, Neugebauer, Price, McHenry, Campbell, Roskam, and Marchant.

The CHAIRMAN. The hearing will now come to order.

I want to express my appreciation to these three very busy officials. Members will remember that the President announced the plan just before Labor Day. We understand that things are still evolving, but it is important to us in light of the great public interest that we begin this conversation today.

I also want to note that I understand Secretary Paulson, who has been traveling—due to all of his airplane travel, he is suffering from back pain. I do want to note that the Secretary has a pain in his lower back and he brought it here. He would not have acquired a pain in his lower back here, at least not a physical one. The pain may cause him to stand up at some point, or otherwise behave in a way that he might not ordinarily behave.

Mr. Secretary, we appreciate you informing us about that. We will now begin the statements. Let me start the clock.

I mentioned Mr. Greenspan. I want to say that I note in Mr. Greenspan's discussion of things, he said that with regard to both the stock market effervescence and the mortgage one that he was constrained from acting because he did not want to diminish the whole economy, that he did not want to restrain economic activity in general.

I agree with him in both cases. I think it would have been a mistake to have deflated the economy in general both because stock prices were going up or because there was excessive activity of a not fully responsible kind in the mortgage market.

My difference with Mr. Greenspan is that he implicitly assumed there that the choice was between deflating the economy, raising interest rates and slowing activity down, and doing nothing. And this notion that there are only macro economic responses to potential abuses, I think, is problematic.

In fact, there are micro responses, specifically thoughtful regulation, and to a great extent what we are talking about here is how to take that principle of regulation and apply it.

I think it is very clear that if only entities regulated by the bank regulators and the Credit Union Administration had made loans, had originated loans, we would not be in a crisis situation. Most mortgage brokers are reasonable and responsible, but to the extent that there were irresponsible people making loans in that sector, they were not subject to appropriate regulation. I think that this shows that regulation done well can be helpful.

The argument that regulation would necessarily mean that you would be choking off loans, I am not aware of people coming and saying, "My credit union wouldn't give me a loan, and they should have given it to me." Or "my thrift." So I do think that we learn that sensible regulation can work well.

Going forward, I think our job is to take the regulatory principles that have been applied by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the NCUA, and the State Bank Supervisors and put them into a body of law that will cover all mortgage originators.

I also believe that we should do something about the secondary market, not the same degree, but here is another argument for regulation. One of our major problems today is the lack of investor confidence. I think there is a general agreement that investors having once been too reckless are now to some extent too cautious; this is not going to go away instantly.

Appropriate regulation, sensible market-oriented regulation can help there because that can restore investor confidence. The ability that we have to talk people into being more confident, I think, is limited. So sensible regulation—and I think the secondary market is a very useful addition, but an unregulated secondary market is not a necessity. And, in fact, in an appropriately secondary market can give investors who would be buying that stuff some confidence that they were buying things that had been appropriately vetted. I think we can do that.

That is going forward. If we talk about the current situation, it does seem that there is a logical pattern in the current situation to try to help people who have pre-payment penalties that prevent them from refinancing and getting out of excessively—loans where the rate is going to go up. That is what we should do.

I am grateful that the regulators, jointly with the State regulators—there has been a lot of effort to persuade the holders of mortgages that they would be better off helping people get out from under prepayment penalties so they can refinance where that would make sense for them rather than become the owners of a lot of vacant property in America's cities.

To do that, I think we need the full participation of the FHA and of the TSEs. I want to say at this point I thought that what

OFHEO did with regard to Fannie Mae and Freddie Mac was the recognition of the problem but not a sufficient response to it.

I would like to go further. It is clear to me, too, that we should at this point be raising the cap at both the FHA and the GSEs. That has to be done statutorily. The House has now passed GSE bills, a GSE bill and an FHA bill, with a great deal of consensus and some disagreement.

I believe there is a good deal of agreement between us and the Administration on much of this. There are differences that are negotiable. At this point, the single most important thing is for the United States Senate to take up and act on FHA and GSE legislation so we can get into what would be a genuine three-way conference because we are looking for a bill to be signed, not for an issue.

I do want to just say now, and I've spoken to Ranking Member Bachus, that if the Senate were to send us a cherry-picked bill dealing only with the caps, or only with the jumbo mortgages, we would not want to go along with that. I do want to deal with both of those, but only in the context of the overall legislation, and I hope the Senate will be working with us on that.

The ranking member is now recognized for 5 minutes.

Mr. BACHUS. Thank you, Mr. Chairman, for convening this hearing on both legislative and regulatory proposals to address the recent spike in subprime mortgage foreclosures. We are fortunate to have with us a distinguished panel, and I extend a warm welcome to Secretary Paulson and Secretary Jackson and Chairman Bernanke.

We are here today largely because of a problem in a specific and relatively narrow segment of the U.S. mortgage market which quickly spread to other areas of the financial markets. These are serious issues now affecting our entire economy and they deserve our careful oversight.

As we proceed with this hearing, I believe we should be keenly aware that the regulators and markets are already addressing mortgage foreclosures. Market participants and regulators are working to assist homeowners to mitigate the distress resulting from the resetting of adjustable rate mortgages. Lenders and GSEs are offering replacement loans with lengthened terms and other options to lower payments and keep families in their homes.

We should take note and legislate where appropriate but avoid getting in the way of regulators and market forces which are performing their functions with the tools already available to them.

This injunction to act cautiously should not be misunderstood to mean legislative action is inappropriate in all instances. There is general agreement that abuses have occurred in the subprime market. In July, several colleagues and I introduced H.R. 3012 to address these abusive practices. There is widespread agreement that these are practices that should not be tolerated. A better regulation of mortgage brokers and other originators is clearly required, but we do not need a bail-out or other legislative action that overreaches and impedes the market self-correction we are witnessing.

In responding to the market turmoil we must not lose sight of the essential fact that the subprime lending market has been very

successful in providing housing, especially for low-income Americans.

I recently heard it described as having brought "the miracle of global liquidity to low-income neighborhoods all over America." The secondary market and securitization have greatly benefitted middle- and low-income Americans.

Preserving this dream of liquidity and homeownership should be a high priority of this committee as we work together on this issue. We should remember that while there have been defaults and foreclosures, there have been many more families who have seen their dream of owning a home successfully realized. In fact, a new study just published shows that if California, Florida, Nevada, and Arizona are excluded, there has actually been a nationwide drop in the rate of foreclosure filings in the most recent period.

Last month we saw what happens when investors make decisions based on heightened emotions and minimal facts. Similarly, as we have learned in the 5 years since Sarbanes-Oxley was enacted, rushing to do the right thing in an unsettled market environment can yield unwanted consequences.

We look forward to your testimony and expert analysis. I thank you for your attendance here today.

The CHAIRMAN. The gentlewoman from New York, the chairwoman of the Subcommittee on Financial Institutions, is now recognized for 3 minutes.

Mrs. MALONEY. Thank you, Mr. Chairman. I welcome all the witnesses, particularly Secretary Paulson, a former constituent. New Yorkers are very proud of you and, Chairman Bernanke, we thank you for your leadership and guidance not only on safety and soundness but also consumer protections.

We are really at a critical juncture and this committee is working incredibly hard to prevent foreclosures and to help borrowers stay in their homes. The chairman, I believe it is his top priority, and this article appeared in The Boston Globe this week and I would like unanimous consent to place it in the record.

The CHAIRMAN. Without objection.

Mrs. MALONEY. Just this week, Tuesday, the House passed legislation to modernize FHA to serve more subprime borrowers. We also worked to help servicers be more able to engage in work-outs with strapped borrowers. We have worked hard and pushed FASB to clarify its Standard 140 rule to allow for modification of a loan when default is reasonably foreseeable, not just after default. But there is much more we can do. If there was ever a time when there should be more liquidity put in the market by Fannie and Freddie, we should be doing it. We should raise the cap on these entities' portfolio limits at least temporarily and direct all of those funds to help borrowers who are stuck in risky adjustable rate mortgages refinance into safer mortgages. We should eliminate the cruel law under Chapter 13 of the Bankruptcy Code which allows judges to modify mortgages on a borrower's vacation home but not the home they actually live in; this would allow families to stay in their homes while new loan terms are worked out.

We need reforms to contain this crisis for the future. Our regulatory system is in serious need of renovation to catch up to the financial innovation that has surpassed our ability to protect con-

sumers and hold institutions accountable. Even though the Fed regulators have put out interagency guidance on subprime loans to improve standards, some three-quarters of the subprime market does not have a Federal regulator. We need to extend the guidance to create a uniform national standard to fight predatory lending and a single consumer protection standard for the entire mortgage market.

I like very much the idea proposed by Professor Elizabeth Warren to create a financial product safety commission, and I really support the simple one-page form as proposed by Andrew Pollock of the American Enterprise Institute, which could provide the basic facts about mortgage loans to borrowers. I would like to put his form in the record.

The CHAIRMAN. Without objection, and the gentlewoman's time has expired.

Mrs. MALONEY. I look forward to the testimony.

The CHAIRMAN. The Chair now recognizes the gentlewoman from Illinois, Mrs. Biggert, for 2 minutes, pursuant to the Minority request.

Mrs. BIGGERT. Thank you, Mr. Chairman, for holding this hearing today. And thanks also to our distinguished witnesses on both panels. I would like to associate myself with the remarks of Ranking Member Bachus and add just two quick points.

While the headlines succeed in pressuring everyone from the local to the Federal levels to do something to address the credit crunch and foreclosure crises, it is critical that the something that we do does not cut off credit, damage the housing market, or deny the dream of homeownership to millions of Americans.

The good news is that at the Federal level, prudent action to both stem the rise in foreclosures and stabilize the housing sector and economy is being taken: The Fed cut interest rates; OFHEO raised Fannie and Freddie's investment portfolio caps; Treasury is working with Members of Congress to change the tax code; the Fed, the OCC, the FDIC, the OTC, and the NCUA have issued guidance on subprime lending; and the House has passed FHA reform and legislation to crack down on fraud and increase credit counseling.

In addition, the Administration launched the FHA Secure Initiative to expand its assistance to help more qualified buyers refinance and avoid foreclosure. HUD, Neighborworks America, the Ad Council, and others are working to infuse funding and resources into the army of 2,300 HUD certified housing counseling agencies across the country.

Today it is important for us to turn our attention to the larger issues of how problems with subprime mortgage lending have rippled through the credit markets. What many of us will want to know is your view on how this credit crunch will play out, how and when investor confidence will be restored, and how we can strike the right balance between allowing the market to sort itself out and disallowing a repeat of distortions in the future: Too much action and we worsen the problem; too little action and we will allow it to happen again. So, again, I thank you for your participation. I yield back the balance of my time.

The CHAIRMAN. And finally, the gentleman from Texas is recognized for 2 minutes.

Dr. PAUL. Thank you, Mr. Chairman. I ask unanimous consent for my complete statement to be put in the record.

The CHAIRMAN. Without objection.

Dr. PAUL. Thank you, Mr. Chairman.

A lot of concern now has been expressed about the collapsing of this housing bubble. It is a shame that we had not talked about this 10 or 15 years ago when many free market economists predicted it would come and worried about it and wished we could have prevented it.

But the irony of all this now is that everything that caused the financial bubble, the housing bubble, we are resorting to doing the same thing. You cannot solve the problem of inflation with more inflation. The debasement of the currency, which is a continual process, is the reason we get financial problems and financial bubbles. Whether it was in the 1920's or the NASDAQ bubble or the housing bubble, we have to deal with the cause. We are dealing and we talk so much about our solutions but nobody is talking about the cause.

The cause literally is the excessive credit created by the Federal Reserve System and we cannot deny this. Then we add fuel to the fire by credit allocation. We come in with the CRA, the Community Reinvestment Act. We come in with insurance by FHA. We come in with the GSEs and the line of credit and the guaranteed and implied bail-outs. And then when the collapse comes, all we have—what do we do? We ask for more regulation, more credit, more debasement of the currency. That to me—we have heard expressions about going over the line and engaging in moral hazard. Well, the moral hazard has been going on for years. Here we are now at a point where we are destroying savers and the poor. We literally destroy people by lowering interest rates. People cannot save. And who suffers the most? The middle class and the poor whose cost of living goes up because we deliberately and purposely devalue the currency. That is all we resort to is the depreciation of currency which in itself should be an immoral act.

So to me if we do not look to the cause of these problems we are going to have more—and patching it together will do nothing more than what we did in The Depression when we patched things together. We just delay the recovery.

The CHAIRMAN. The testimony will now begin, and we will first hear from the Secretary of the Treasury.

STATEMENT OF THE HONORABLE HENRY M. PAULSON, JR., SECRETARY OF THE TREASURY, UNITED STATES DEPARTMENT OF THE TREASURY

Secretary PAULSON. Thank you, Chairman Frank, Ranking Member Bachus, and committee members for the opportunity to present the Treasury Department's perspective on recent events in the credit and mortgage markets. We have been experiencing capital markets' turbulence that will take some time to work its way through the economy. It is significant that this is happening against the backdrop of strong U.S. and world economies. The U.S.

economic fundamentals are healthy. Unemployment is low. Wages are rising and core inflation is contained.

Although the recent reappraisal of risk coupled with the weakness in the housing sector may well result in a penalty, the fundamentals point to continued U.S. economic growth. Unlike similar periods in the past, current events were not precipitated by problems in the real economy but by excesses in the credit markets.

We should put the current situation in perspective. Innovation in housing finance has made credit more widely available, allowing millions of Americans to buy homes they can afford. Homeownership in America has increased from 64 to 69 percent since 1994. Even in the current environment, the vast majority of new homeowners will not have difficulty keeping their homes.

The President has announced an initiative to help those homeowners who are struggling. He called for the FHA Modernization Act, which Secretary Jackson will describe, and he called for tax relief to prevent homeowners from being hit with a tax bill due to debt forgiveness on their primary residence. I am pleased to see progress on the FHA bill and urge action on the tax bill as well.

President Bush also tasked us to work with mortgage counselors, servicers, and lenders to help as many Americans as possible keep their homes. We have learned a great deal from our meetings so far. First, it is clear that while adjustable rate prime mortgages are the most at risk, some prime borrowers with solid credit histories are also struggling.

Second, we learned that lenders are proactively contacting homeowners facing an interest rate reset that they likely cannot afford, but those calls often go unreturned because many homeowners mistakenly think that their lender wants to repossess their home in foreclosure. In fact, the opposite is true. No one likes foreclosure: It is tough for families; it hurts neighborhoods; and it is also unprofitable for lenders in most situations.

Finally, we learned that 50 percent of foreclosures occur without borrowers ever talking to their lender. When borrowers do not seek solutions until after they have missed payments, they will have far fewer financing options. And so the most crucial message we can send to the borrowers who are missing, or concerned that they will miss, their mortgage payments is to call their lender or a mortgage counselor today. And when all of you are in your districts, when you talk to the local media and your constituents, please, please send that message. The earlier borrowers reach out, the greater the possibility that they will be able to modify their mortgage into one that allows them to stay in their home.

The GSEs play a significant role in the mortgage market. We should examine their authorities and ability to assist. However, the extent of possible GSE assistance is complicated by the unique structure and the need for regulatory reform. Currently, the conforming market in which they operate is performing well. That should not be a surprise. Investors avoid the credit risk of the underlying mortgages when they buy agency-guaranteed mortgage-backed securities. Therefore, if the GSEs are to assist in the markets that are not operating normally it would involve an expansion of their authorities.

The GSEs are an unusual construct. They answer to shareholders and have a congressionally mandated mission. As we consider any change in their role, we must always balance these imperatives: The temporary needs of today's market; the legitimate policy question of how much of the mortgage market should be directly or in directly influenced by GSEs, which are misperceived as being backed by the Federal Government; and issues of size, systemic risk, and longer term market distortions that will occur by inserting perceived government-backed intervention.

Because of the size of the GSEs and these related issues, any legislative expansion of their role must also correct the inadequate GSE regulatory structure. The current GSE regulator has less authority than a Federal bank regulator but the solution is not to regulate the GSEs as if they are banks. The GSEs' regulators should have more tools available than does a bank regulator to take into account the unique characteristics' intentions of the GSEs.

This committee and the House of Representatives passed a bill that goes a long way in addressing these regulatory issues. I congratulate you all for working this through. The case cannot be stronger for the Senate to also pass GSE reform legislation. Congressional debate about expanded GSE authority should take place within the context of comprehensive GSE reform. It would be irresponsible to expand GSEs' business without addressing the fundamental problems of their regulatory structure.

The mortgages facing the greatest stress today are those with the weaker underwriting standards where borrowers have imperfect credit and little equity in their homes. Legislation will be required to allow the GSEs to purchase mortgages that are above 80 percent loan value and have no credit enhancement. This would require that the GSEs take on significant credit risk beyond their traditional experience. Legislation that encourages them to take on more risk must also create an appropriate regulator to exercise necessary oversight.

The GSEs can expand down the credit curve without legislation if they reevaluate their underwriting standards and develop new products. Again, this would mean taking on more risk. A GSE guarantee for these products would increase the liquidity available to refinance some subprime borrowers and we are encouraging the GSEs to do more in the subprime area.

However, we recognize that the GSEs must fully evaluate the business risks associated with any new initiatives balancing their private and public missions. Some have suggested that the GSEs should be permitted to inject some liquidity into the jumbo mortgage market. There is no doubt that raising the loan limits somewhat to allow the GSEs to guarantee jumbo mortgages would be helpful to a segment of the market which has shown some recent improvement but is not yet functioning as normal.

The GSEs' limited entry into the sector would likely improve liquidity and would clearly be attractive to the GSEs from a business perspective. Traditionally this has been a profitable part of the mortgage market with low default rates. For that reason, it seems logical that this market will right itself in the weeks and months ahead. Therefore, consideration of this issue should be limited only to a temporary provision that is part of legislation

strengthening the regulatory structure. We agree with you, Mr. Chairman, on that.

We should also recognize that lifting the loan limit for even a short period has the potential to detract from GSEs' affordable housing mission and displaced private sector participation.

Recently there have been calls on the Administration and the Office of Housing Enterprise Oversight, OFHEO, the GSEs independent regulator, to lift the temporary caps on the GSEs' retained portfolios. The business motivation for this request is clear and sound. Whether this request will have a positive impact on the mortgage market is much less clear. There is already ample liquidity in the prime conforming marketplace, the marketplace in which the GSEs concentrate their investment portfolio business.

The securitization efforts of Fannie Mae and Freddie Mac have been a huge contributor to this liquidity. The more efficient use of their capital to ease current market strains is in the guarantee business where each dollar of capital goes further in adding liquidity.

Yesterday, OFHEO announced steps to adjust Fannie Mae's investment portfolio cap and to provide more flexibility to both enterprises in managing their investment portfolios. If the GSEs want to be helpful, I hope they will use this new flexibility to provide liquidity to parts of the market experiencing the most strain.

Again, I welcome congressional debate about an expanded role for the GSEs as part of a broader GSE regulatory reform discussion. Today's solution should not create tomorrow's problem. Treasury and the President's Working Group are also examining broader market issues including mortgage origination, the role of credit rating agencies and securitization, the decentralized mortgage process, and the need for simple, clear disclosure so borrowers can make informed financial decisions. Because these issues have global economic consequences, the Financial Stability Forum in addition to the PWG will examine some similar issues involving the policy implementation for financial institutions including supervisory oversight principles for regulated financial entities with off-balance sheet contingent obligations.

I urge caution, however, as we examine the implications of recent market events and consider corrections. Owning a home is a cherished part of the American dream, and we do not want to unreasonably deny that dream by restricting credit for people who can afford it. Thank you and I welcome your questions.

[The prepared statement of Secretary Paulson can be found on page 184 of the appendix.]

The CHAIRMAN. Thank you, Mr. Secretary.

Next, a frequent visitor to this committee, and our collaborator in the housing part of this, Secretary Jackson. Mr. Secretary, please.

STATEMENT OF THE HONORABLE ALPHONSO JACKSON, SECRETARY OF HOUSING AND URBAN DEVELOPMENT, UNITED STATES DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Secretary JACKSON. Thank you very much, Chairman Frank, Ranking Member Bachus, and distinguished members of the com-

mittee. Thank you for inviting me to testify this morning. I want to recognize my colleagues, Secretary Paulson and Chairman Bernanke, for their valuable actions and partnership over the past few months. I am pleased to join you today.

Mr. Chairman, as Fed Chairman Alan Greenspan once said, the subprime market is democratizing credit and this results in homeownership for millions of Americans. Mr. Chairman, some borrowers were not ready for homeownership, resulting in foreclosure for tens of thousands of people. Our ongoing concern is that more Americans may face foreclosure within the new round of resets anticipated in 2008. So far I have been speaking about 20 percent of the subprime market and not all of these loans will result in foreclosure. It is important that we note this.

The lesson here is not to throw out the subprime loans. Most people with subprime loans will be fine and their homeownership adds wealth to our economy and gives equity and financial stability to our communities. Our estimate is that 80 percent of the subprime loans made in 2005 and 2006 will not be problematic, but borrowers need to be informed as soon as possible, which is one of the reasons we are strongly urging that we use the Nation's 2,300 HUD-approved housing counseling agencies in this country. Information leads to wise borrowing, manageable loans, and more economic security.

Market corrections may escalate in this catastrophe unless we act now, and so we must act now. Already the FHA has stepped forward within the full extent of its legislative and regulatory abilities. By the end of Fiscal Year 2007, we will have helped more than 100,000 borrowers refinance with FHA loans. We have worked with other Federal and State authorities to prosecute predatory lenders. But in order to assist more Americans, the President has proposed a series of actions. Some of them did not require congressional action while others do.

Earlier this month, the President announced a new FHA product called FHA Security. Under this proposal, borrowers who are otherwise creditworthy but have recently become delinquent on their mortgages as their teaser rates reset, may now receive FHA help. In the past, FHA did not allow borrowers who were delinquent. Eligible homeowners will be required to meet our strict underwriting guidelines and pay the corresponding mortgage insurance premium. This offsets the risk for FHA and costs the taxpayers no money. I want to repeat this again. It costs the taxpayers no money.

We estimate that with FHA Secure, we can help an additional 80,000 delinquent yet otherwise creditworthy borrowers refinance and save their homes. This is in addition to the 160,000 delinquent borrowers we already expect to help by fiscal year 2008. This will bring the total number of new borrowers assisted by FHA existing financial efforts to 240,000 by the next fiscal year.

I have already directed FHA to prepare a new regulation for risk-based pricing. This makes sense. Safer borrowers should pay less; riskier borrowers should pay a little bit more. I am hopeful that we will be able to implement the changes in January so that we can reach an additional 20,000 borrowers. So of the 2 million loans expected to reset by 2008, we estimate about 500,000 will ac-

tually foreclose. Through FHA, we estimate that we can help save about half of those homeowners. That is what may be done through administrative actions. But this country needs FHA modernization which President Bush has asked Congress to pass and I want to thank Chairman Frank for getting the bill passed in the House and we look forward to the Senate.

I know you appreciate this sense of urgency. Again, I am pleased that you passed the bill. We need to raise the loan limits so we can help low- to moderate-income and first-time homebuyers in expensive housing markets. We need to give families more flexibility and downpayment options, something we cannot do today.

The legislative change would help some 200,000 families, if not more, purchase or refinance into safe FHA-insured mortgages. It will allow the FHA to be more responsive to the housing market.

Mr. Chairman, every day places thousands of homeowners at greater and greater risk. Working together, the President, our Congress, we can continue to make changes that will address the subprime crisis. Foreclosure is not good for anyone, the homeowner, the community, the local tax base, or the lender. Today we have a chance to make a powerful and positive change that will reflect statesmanship and good sense. Again, I thank the committee for the opportunity to appear today. Thank you, Mr. Chairman.

[The prepared statement of Secretary Jackson can be found on page 136 of the appendix.]

The CHAIRMAN. Thank you. We very much appreciate the Chairman of the Federal Reserve coming before us and I will say as a mark of appreciation, I am prepared to rule out of order any questions about Alan Greenspan's book.

[Laughter]

The CHAIRMAN. Mr. Chairman, please proceed.

STATEMENT OF THE HONORABLE BEN S. BERNANKE, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. BERNANKE. Thank you, Mr. Chairman. Chairman Frank, Ranking Member Bachus, and members of the committee, I am very pleased to appear before you today to discuss developments in the subprime mortgage market and possible policy responses including those that have been taken or are under consideration by the Federal Reserve.

Mr. WATT. Mr. Chairman, we are having a little trouble hearing you.

Mr. BERNANKE. How about now?

The CHAIRMAN. The problem is that since we sit by seniority, the oldest members are furthest away from you, so that's why you have to talk loud.

Mr. WATT. Speak for yourself, Mr. Chairman.

[Laughter]

The CHAIRMAN. What did you say?

[Laughter]

Mr. BERNANKE. Lending innovations and the ongoing growth of the secondary market have expanded mortgage credit and the benefits of homeownership to many households perceived to have high credit risk. However, in the past few years, a weakening of under-

writing standards together with broader economic factors such as the deceleration in house prices has contributed—

The CHAIRMAN. Will you suspend for a second, Mr. Bernanke? There is a vote. I think we have enough time for you to complete your testimony, and we will then break to vote and come back. I apologize, but we have no other option. So if everybody will shut off their pagers, the Chairman can complete his testimony, and we will break, vote, and come back.

Please go ahead.

Mr. BERNANKE. Thank you. During the past 2 years, serious delinquencies among subprime ARMs have risen sharply, reaching nearly 15 percent in July. This deterioration contrasts sharply with loans in the prime mortgage sector of which less than 1 percent are seriously delinquent. Higher delinquencies have begun to show through to foreclosures. About 320,000 foreclosures were initiated in each of the first two quarters of this year, just more than half of them on subprime mortgages, up from an average of about 220,000 during the past 6 years.

As many borrowers are recent, and vintage subprime ARMs still face their first interest rate resets, delinquencies and foreclosures are likely to rise further. In response to these developments, the market for subprime mortgages has adjusted sharply and originators now are employing tighter underwriting standards. But that still leaves many borrowers in distress.

To help them, the Federal Reserve, together with the other Federal supervisory agencies, has encouraged lenders and loan servicers to identify and contact borrowers who, with counseling and possible loan modifications, may be able to avoid entering delinquency or foreclosure.

The Community Affairs Offices in each of the 12 Federal Reserve Banks have also provided significant leadership and technical assistance to foreclosure prevention efforts. For instance, a public-private collaboration initiated in part by the Federal Reserve Bank of Chicago produced the Homeownership Preservation Initiative in 2003. Since then, the program has counseled more than 4,000 people, prevented 1,300 foreclosures, and reclaimed 300 buildings.

Beyond the actions underway at the regulatory agencies, I am aware that the Congress is considering statutory changes to alleviate foreclosures possibly including modernizing the programs administered by the Federal Housing Administration that Secretary Jackson has just described.

Prospectively, the Federal Reserve is actively working to prevent these problems from recurring while still preserving responsible subprime lending. In coordination with other Federal supervisory agencies, we issued guidance on underwriting and consumer protection standards for non-traditional mortgages last year and for subprime ARMs earlier this year.

To help potential borrowers make more informed choices, the Board is engaged in a review of the Truth in Lending Act rules to provide mortgage lending disclosures. We are considering proposed changes to rules to address potentially deceptive mortgage loan advertisements and to require lenders to provide mortgage disclosures more quickly.

We are also planning to use our rulemaking authority under the Homeownership and Equity Protection Act to propose additional consumer protections later this year. We are looking closely at some lending practices including prepayment penalties, escrow accounts for taxes and insurance, stated income and no-documentation lending, and the evaluation of a borrower's ability to repay.

Additionally, more uniform enforcement of the fragmented market structure of brokers and lenders is essential. With other Federal and State agencies, we have launched a program to expand and improve consumer protection reviews at non-depository institutions with significant subprime mortgage operations. This project should also lay the groundwork for various additional forms of interagency cooperation to help ensure more effective and consistent supervision.

In recent weeks, as committee members are well aware, disruptions in financial markets have increased uncertainty surrounding the economic outlook. In August, the Federal Reserve took several steps to address unusual strains in the money markets and to improve the availability of backstop term financing for banks through the discount window to help forestall some of the adverse effects on the broader economy that might arise from the disruptions in the financial markets. And to promote moderate growth over time, the Federal Open Market Committee this week lowered its target for the Federal Funds Rate by 50 basis points.

Thank you, and I look forward to addressing your questions.

[The prepared statement of Chairman Bernanke can be found on page 71 of the appendix.]

The CHAIRMAN. Thank you, Mr. Chairman. We will now take advantage of this and break. And we will come back I should say—Secretary Paulson has an appointment that he cannot break at the White House, so we are here until 1:00. I just want to say now we are going to break. On our side, I intend that we will get as many questions in as possible. Not everyone will be able to question this panel, but when we get to the second panel, my intention will be to pick up the questioning where we left off. So, Members who did not get to question the first panel will get to question the second panel before we go back and the Minority intends to do the same thing. And even though the House may finish at 3:00 this afternoon, we intend to stay with the second panel through the afternoon so we can finish this.

We are in recess.

[Recess]

The CHAIRMAN. The hearing will reconvene. I apologize for the delay. Secretary Paulson has to leave at 12:35, so we have an hour for questions. We will get done what we can. I will recognize myself for 5 minutes.

Let me ask you first, we have been urged not to do very much because of moral hazards, the fear that by lowering interest rates, or helping people out of prepayment, we will somehow be encouraging this behavior in the future.

Now one way we can prevent this behavior in the future is by appropriate rules and I think we have an agreement that there are a set of rules that should apply to all mortgage originations that will go forward.

But let me ask all of you, because my own view is that nothing being contemplated is going to rise to the level of making what people have been through so much fun that they will decide it is worth doing again. That is, I think the notion that there is a moral hazard here gravely underestimates this. And I do not know anybody who has any proposals to make anybody whole including the borrowers who are going through this emotional anguish, the lenders. The notion that there is moral hazard, it seems to me, is one we ought to deal with.

Let me ask each of you briefly, do you see in anything being contemplated congressionally or administratively any moral hazard? Mr. Paulson?

Secretary PAULSON. Mr. Chairman, I am not sure what various people may be contemplating, but I would say that in terms of the things that are on the table, and in terms of the President's initiative foreclosure avoidance, I do not see a moral hazard.

The CHAIRMAN. Let me tell you what we are talking about. One is more liquidity in the system generally and, secondly, trying to give people an ability to get their mortgages rewritten so they can refinance without a step-up at a reasonable rate going forward. I think that is basically what we are talking about.

Secretary PAULSON. Yes. And I would agree with you. The tax relief for people who are going through this very difficult process, I cannot see someone is going to—

The CHAIRMAN. Let me get a chance to speak to Mr. Jackson.

Secretary JACKSON. No, I do not. Let me say this to you, Mr. Chairman, is that clearly there are some people we are not going to be able to help especially and I always said the yuppies who had this extravagant decision to have two or three cars and a huge house they cannot afford. But the people that we are looking at basically are middle-income people, firemen, police, teachers, nurses, and I think that these persons get one shot. And we should do everything in our power to make sure—

The CHAIRMAN. Mr. Bernanke.

Mr. BERNANKE. Fiscal subsidies to lenders would be a moral hazard. We are not contemplating that.

The CHAIRMAN. No one is contemplating those.

Mr. BERNANKE. So I see no problem in trying to help people refinance.

The CHAIRMAN. Thank you and obviously putting liquidity into the system as a whole, I do not understand how that creates a moral hazard.

Mr. BERNANKE. We are trying in particular to make sure the economy is stable and that is the ultimate objective that we have.

The CHAIRMAN. Right. And nobody is bailing out any lenders. Nobody is—I think that is one we can put to rest. Let me now say, and I want to respond, my own view is that the model that I hope we can deal with and we have the future to deal with. We have the current situation. Some people are in situations where it will be very hard to help them because no direct subsidy is coming. But to the extent that we can get people out of prepayment penalties and into a situation where they can refinance with an FHA guarantee and with Fannie and Freddie available to provide liquidity for the purchase, that seems to be the maximum that we can do.

And with tax relief, so that getting out of prepayment is in there. That is the package that we are examining.

My own view is that can be aided particularly by a stronger role for Fannie and Freddie and it is one where I agree that—but somebody said, "Well, if you let them go up that might come," somebody said, "at the cost of going broke."

No. I think you get balance. Remove the jumbo and let them do some higher loans and they make some money and then I will feel a little—and at the same time they have to go lower. I think the same with the FHA.

But I just want to say this. It is a statement. I disagree. I do not think it went far enough. I do not think there is a safety and soundness issue on behalf of the portfolios. I am daily conscious and I am not the President of the United States or even the Secretary of the Treasury or even the Director of OFHEO, but as much as I would like to change that, I am not confident that I will be able to do that.

[Laughter]

But the point I want to emphasize is this. I believe that the bills that were passed by very large votes in the House and the Senate—in the House on the FHA and GSEs, there were some differences, but there was a common agreement on a lot of them.

If the Senate would pass some version of those bills and send them to conference, I am confident that with the Administration participation, the House and the Senate, within a few weeks we could have a package that would greatly enable our ability to do what we are talking about.

And it would result in much more relief for people who are facing foreclosure and I think some other general things. I just want to reiterate, and I have reaffirmed this with the ranking member, we will be pushing for that. And if our colleagues in the Senate were to send us even things that I would agree with like raising the cap on the jumbo, or mandating an increase in the portfolios, I would not go along with that piecemeal approach because I want to get this done in the best possible way. So I hope that we will get something from the Senate that will be passage of both bills with what I think are a lot of progressive things and go from there.

The gentleman from Alabama.

Mr. BACHUS. I thank the chairman.

Chairman Bernanke, I and many of my colleagues have introduced a fair mortgage practices act to address some of the subprime lending issues. And some of the things you mentioned this morning about escrow and taxes and insurances on subprime loans we have included in that.

We have also included what Chairman Maloney mentioned earlier, basically a one-page disclosure. But another thing that we have included, and I will ask the Treasury Secretary, but I would also like your feedback and input on the various provisions of our bill.

We created a national registration and licensing standard for mortgage originators which even the industry, the mortgage brokers, most people have said to us that this is a very necessary tool to enhance accountability and professionalism in the industry. We

have done a similar thing with appraisers and the Appraising Institute is in support of that.

Would you comment, Secretary Paulson, on that provision?

Secretary PAULSON. Yes. Let me say that I believe what you are trying to do there in terms of having some uniform standards on mortgage originators, education, licensing, those kinds of things, I think that sounds to me like a constructive step.

And I also believe very much in the steps that the Fed has taken to take a hard look at disclosure and come back with recommendations and a very hard look at, you know, as the chairman said, OFHEO.

Mr. BACHUS. So you are favorably inclined towards the provision?

Secretary PAULSON. Yes.

Mr. BACHUS. Thank you. Secretary Paulson, you know risk is inherent in markets. In fact, in financial markets you are supposed to—credit products are supposed to be priced according to the amount of risk. Do you see any constructive result to the repricing of risks that we have seen in the markets going forward?

You know, the fact that we are doing it during a period of a strong economy, I welcome that as opposed to during periods of a weak economy.

Secretary PAULSON. Yes. Risk is being reappraised/repriced. I remember at the, even a month ago, I remarked to some colleagues when there was all this focus on risk that there is less risk in the market today or at that time than there was a month or two earlier. People just were not as aware of it.

Now, so when you look back on these things with 20–20 hindsight it is always agreed that it was constructive. Obviously when you are going through the situation right now, we are, we are much more focused on getting through this period of stress and strain and do it in a way which limits the penalty to our economy. But, yes, I do agree risk being repriced, reassessed is ultimately healthy.

Mr. BACHUS. Chairman Bernanke, would you like to comment? I certainly think some of the risks are being wrung out of the market—I mean some of the excesses are being wrung.

Mr. BERNANKE. Yes, sir. There has been a repricing of risk and to some extent that is a good thing. It has been interacting with some concerns about the evaluation of credit products, structured credit products and the like. And so it has been a fairly sharp adjustment that we have seen in the financial markets.

As Secretary Paulson said, repricing risk, getting a better evaluation of risk, is a good thing in the longer term. We at the Federal Reserve are mostly concerned with making sure that markets continue to function normally and that the tightening of credit that has happened does not have undue adverse effects on the broad economy. Thank you.

Mr. BACHUS. Secretary Jackson, you are helping homeowners who have not been able to pay their mortgages. Your FHA has a program now you have outlined where you are going in and offering them a new mortgage and new mortgage payment.

The only concern I have there is that you are taking them from one market and you are placing them in an FHA insured product.

And I am wondering, are you being careful to see that these, you know, howeowners who did not pay their mortgages before, did not meet their obligations, some of them because of the product, but that they are going to have—is there any assurances that they are going to be able to pay these and not fail and, therefore, create liability on the cost to the FHA and the taxpayers?

Secretary JACKSON. Ranking Member Bachus, that is an excellent question. What we are doing, which is very important, is we are looking at risk-based premiums, and the other thing that is very important that we are doing is that we are looking at the credit history of many of these persons. And many of these persons have paid their mortgage religiously until the teaser rate kicked in.

The best example that I can give you is a family just across the river in Prince George's County who had not missed a payment and, in fact, made two of the teaser rate payments, then had a serious problem. And they had steady jobs for the last 20 years and had no credit problems at all.

Well, we refinanced their loan and we saved them $350 a month. They have no problems today. In fact, it is a plus because they are able to do a lot more for their children than they were before they had this refinancing. So we are very serious. We are not going to make the same mistake that some of the subprime lenders made in the sense that they did not really look at the creditworthiness of the person. We are not going to do that.

The CHAIRMAN. The gentleman from Pennsylvania.

Mr. KANJORSKI. Thank you, Mr. Chairman.

Gentlemen, I guess I will direct this primarily to the Secretary of the Treasury and to Mr. Bernanke. I am here long enough—I think there are about five of us left on the committee to remember the S&L crisis. And I remember the pre-S&L crisis of the late 1980's when the regulators with the assent of Congress if not by activity but at least we were happy to see them clean up the problems that appeared to be out there, invented a new terminology, supervisory goodwill. Do you all remember that great methodology of getting out of the S&L crisis?

When, if we had acted at the time, would have cost us about $15 billion. In a short period of 2 to 3 years, because we contaminated the good S&Ls and caused them to collapse also, it became a $200 billion problem, in which I happen to give a lot of credit to George Bush the first as an act of courage when he recognized that and sent the appropriate legislation up here to really solve the problem.

But having watched what we are doing, it seems to me I am hearing shallow echoes in the Administration, in the regulatory community, that we can find another easy fix and not necessarily have to face the consequences. And I happen to agree that's possible, probably more than 50 percent likely, except if we hit a recession or we do something or something occurs that we are not prepared to meet within the formula.

So, as a result, Mr. Bernanke, I wanted to get some sense from you. I was surprised at the 50 percent Fed rate change. I had anticipated 25 percent. I had not anticipated that you would go to a full 1 point on the open door or the open window area.

Was that done just for the purpose of getting rid of this problem very quickly or is there something more serious out there that we

are not even aware of and so many people who thought it was only going to be 25 base points should be more aware. I am not and I do not want to plant any seed one way or another. I would like your comment on that. What do you anticipate? This was not an overreaction. Was this just a firm statement on the part of yourself and the Fed that you are going to take very strong action if there is any chance of a recession or a disruption of the markets?

Mr. BERNANKE. Congressman, as we said in our statement, over the month of August the financial market turmoil has effectively tightened credit conditions that has the risk of making the housing correction more severe, and it may have other effects on the economy. So we took that action to try to get ahead of the situation, to try to forestall the potential effects of tighter credit conditions on the broader economy.

Ultimately, our objective is to try to meet Congress's dual mandate of maximum sustainable employment and price stability, and we took that action with that intention. There is quite a bit of uncertainty, so we're going to have to continue to monitor how the financial markets evolve, how their effects on the economy evolve, and try to keep reassessing our outlook and adjusting policy in order to try to meet that dual mandate.

Mr. KANJORSKI. Very good. Mr. Paulson, just one question for you: Are you satisfied that everything has been done now or is in the process of getting done to solve this immediate problem that we face in the credit crunch, or are there other things that we will have to participate with the Administration on?

Secretary PAULSON. Let me say that as was mentioned earlier by the ranking member, credit is being repriced, reassessed, across a broad range of markets. There are a reasonable number of the credit mark. It's the capital markets that still aren't functioning as normal. They are operating under strains, stresses of one sort or another. Now, there has been improvement in many of them, and so there has been gradual improvement and that is a very good thing to see. We're going to work through some. It's going to take us a while. We're going to work through some much quicker than others.

In terms of the subprime, which this hearing is on, a number of those and some of the mortgages with the most lacked standards, and with the teaser rates, we'll be resetting over the next 18 months or 2 years. So it will take us a while longer to work through that, and that is not an important part of the overall economy, but believe me it is very, very important to everyone who is in danger of losing a home.

So, again, I can't tell you that every action has been taken that needs to be taken. I think we're doing the right things for now and we're watching this very carefully and we need to be vigilant.

The CHAIRMAN. The gentleman from Louisiana, Mr. Baker.

Mr. BAKER. Thank you, Mr. Chairman.

Mr. Bernanke, in a correspondence with Chairman Frank on September 17th, you were specific in a response relative to the advisability of increasing the conforming loan limit and you had three elements in that response: One was that the change must be explicitly temporary; two, it must be promptly implemented; and, three, it would be ill-advised if it has the practical effect of reduc-

ing incentives to meaningful GSE reform. Acting on the belief that Fed testimony is not casually constructed, I read very carefully your statement on page 11 addressing the same, general subject matter. And you repeated two of the three, "explicitly temporary," "sufficiently promptly," but you did not include the language relative to the necessity, if we act, to tie that expansion of portfolio to GSE reform.

I just want to make clear with understanding, is it still your view that any modification the portfolio would be ill-advised unless done in concert with an appropriate GSA reform?

Mr. BERNANKE. Yes, first of all, let's be clear.

We're talking about the conforming loan limit and not the portfolio.

Mr. BAKER. Correct, I'm sorry.

Mr. BERNANKE. There are several concerns as I describe in my letter expanding the implicit government guarantee into a new area at the mortgage market and so on. But I think the primary concern I have is that if this goes ahead without any reform that somehow reform may not ever happen or be effective, so I do believe it's important that this be done, if it is done in the context of meaningful GSE reform.

If it is done as I indicated, I think it needs to be temporary. And if it's not prompt, it's not going to be productive, because these markets will recover over the next few months. And if this comes online in March, it will be counterproductive.

Mr. BAKER. Thank you. Secretary Paulson, in market observation it appears that much reaction in the marketplace was in response to improperly identified risk and their great risk aversion in worldwide markets where there was not a certainty that the mortgage origination process or review processes were in all cases done with appropriate due diligence, and therefore there was a withdrawal by some investors from those mortgage obligations, whether they be securities or whole mortgages, and I hope you agree with that observation.

And, secondly, I have the concern with regard to proposed reform in assigning liability. And that is to a reasonable man, if you look at a document and fraud is not apparent on the face of the document, or you look at the security which you are acquiring, and there's no apparent fraud easily detected to you, the inappropriateness of assigning liability to that investor in that security or holder of that mortgage in the process of the secondary market and beyond, when there is no contribution to the unprofessional or inappropriate conduct which led to the predatory behavior, and the consequence of that, I believe, would be to have a withdrawal from the market from those unwilling to take improperly identified risk, thereby, actually hurting the very individuals that we are trying to assist with enhanced assignee liability.

Do you agree with those perspectives?

Secretary PAULSON. Congressman, I do agree with that. Just to expand a bit, we've had great innovations in the capital markets. This has helped our society, helped homeowners. The history is innovation moves ahead of regulation or policy, so when we go through a period like this, we need to readjust and say what things should we do differently? Where do we need some additional regu-

lation? Where do we need some additional policy measures? But we need to get the balance right and not go too far.

I do believe that in terms of assigning liability to those investors who purchased the mortgage, that would have the negative of being a very big damper on securitization and would thereby curtail product to those who need it.

Mr. BAKER. Let me, if I may.

Secretary PAULSON. So, there would be some things I would do and that I probably wouldn't.

Mr. BAKER. I want to get in before my clock runs out.

And that is with regard to data already mined, it appears that it's the subprime market, lower-income households, modest price housing, where the delinquencies have bounced up a bit. Whereas, in the jumbo market, although recognizing there are some liquidity concerns, the problems are not as evident, so that in our effort to help people with the triggering questions and other mortgage aberrations, we should be focused on the lower-priced homes and the lower-income individuals. I would be interested if anyone has data given the fact that on the FHA side, we just go on to about a $700,000 house. We're about $500,000 on the GSEs, where there's any data to indicate that poor people are having trouble getting access to $500,000 houses, because that portfolio increase seems to be a problem.

Secretary JACKSON. We have a limit. Let me say this to you, Congressman. FHA is limited. That's why I'm very pleased again that you all passed the FHA modernization legislation which will eliminate the present cap that we have. So we are dealing with people, really, at a moderate income. But I want to say something, and I think both of my colleagues will say.

It's not just the low-income, middle-income market. The jumbo market where we had a number of what we call today, "yuppies," purchasing homes and cars that we have a serious problem with too. So, we can't minimize at the level of middle-income people, basically firemen, police. We have some serious problems too at the top.

The CHAIRMAN. The gentlewoman from New York.

Mrs. MALONEY. Thank you, thank you, very much.

Chairman Bernanke, thank you for your guidance on the subprime prices, but according to Secretary Jackson, the initiatives we put in place will only keep 260,000 people in their home. Some economists are projecting two to five million Americans may lose their homes, so I am interested in further guidance on what we can do to keep these people in their homes. It helps them. It helps the economy, either in writing or in building on your suggestions that you gave today. But the question that I hear from my constituents the most on the subprime crisis is the credit crunch.

The credit crunch in the financial markets that literally shocked investors this Summer, some of the most sophisticated investors in the country were really caught off-guard with this credit movement. And even now there seem to be lots of questions about who holds subprime's mortgages in their portfolios and what the impact is going to be going forward. Specifically, what is the role that hedge funds have played in this and are we at more risk today

than before, because of the proliferation of these sort of exotic financial instruments.

Some economists have suggested that the financial markets could actually melt, and what could we do to prevent that. Related to the question is, do you believe that regulated institutions have proper evaluation policies in place?

How could the credit rating agencies be so wrong consistently—wrong on Mexico, wrong on Asia, wrong on Enron, wrong on subprime? Do you think we need more of a focus on how we are rating these products? Do these questions about valuation policies reflect why the LIBOR spreads over treasuries remain at unusually really high levels? And why is there that spread?

Mr. BERNANKE. Congresswoman, there are a number of questions there. On helping more people, I think that FHA reform could be pushed even further. I think risk-based premiums would help differentiate among different lenders, and I think more flexibility in designing mortgages would allow for more affordable mortgages, say, with a shared appreciation with a variable maturity.

My sense is that as we go forward, lenders are not going to want to be in the position of foreclosing if they can avoid it, because it's very costly to do so. If the FHA can provide affordable housing products that would be attractive alternatives, then the lenders will themselves be willing to forgive principle, assist the homeowner to move into those products, because it's cheaper for them as well. So I am somewhat more optimistic, I think, than my colleague here as to what the FHA could possibly do if these conditions worsen.

On the question of hedge funds, hedge funds have not been for the most part a major component of this recent problem. In particular, we have not had any significant counterparty losses arising from the hedge funds. And so in that respect the market-based regulation that the President's Working Group described in its principle seems to be working reasonably well.

Where the issues have arisen more is in the so-called structured credit products, which are complex instruments that combine many different types of credit, and many different types of credit guarantees. We are finding that they are somewhat opaque, and it has been difficult for investors to evaluate exactly what those products are worth and where part of what's taking so long here is for this process to go forward as banks and investors work through these products and figure out what's in them and what they're worth.

The credit rating agencies raise a number of issues. There has been some recent legislation, of course, by the Congress to try to make their ratings more transparent. We'll see how that works in the future. But I only want to add, and perhaps Secretary Paulson would amplify, but the President's Working Group is going to make it a high priority to be looking at that issue and try to understand if there are improvements that can be made.

Secretary JACKSON. Let me augment this Congresswoman.

The CHAIRMAN. Quickly, Mr. Secretary, please.

Secretary JACKSON. You said that we said that FHA secure will save somewhere between 200,000 and 260,000 families, but once the legislation has passed modernization, it will be much higher

than that. We will be able to save somewhere between 500,000 and 700,000 families, but we have to have the legislation.

The CHAIRMAN. The gentleman from California, Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman.

I wanted to ask Chairman Bernanke a question.

Chairman Bernanke, both you and your predecessor, Chairman Alan Greenspan, have gone on record describing in detail the systemic risk that you believe was posed by Fannie Mae and Freddie Mac portfolios. On March 6th, you said about GSA portfolios and systemic risk, and I'll just quote your remarks, you said: "Financial crises are extremely difficult to anticipate, but two conditions are common to such events. First, major crises usually involve financial institutions or markets. They are either very big or very large or play some critical role in the financial system. And, second, the origins of most financial crises can be traced to failures of due diligence or failure of market discipline by an important group of market participants." And, you said: "Both of these conditions apply to the current situation of Fannie Mae and Freddie Mac."

Now, given the past accounting problems experienced by Fannie Mae and Freddie Mac as well as the potential financial risk associated with their portfolios as you have said in the form of credit risk, interest rate risk, prepayment risk, lack of market discipline by a duopoly that works off this implicit government guarantee, I was going to ask you, do you believe they're best suited to address the problems we're witnessing in the mortgage market by changing the approach to Fannie and Freddie? Or are the actions taken by the Fed in reducing the discount rate and the Fed Funds rate to push liquidity into the system and make liquidity available, make cash available for financial institutions to loan to other banks and loan to homeowners, and so forth, is that the best approach? I'd like your thoughts on that.

Mr. BERNANKE. Congressman, you put it very well. I think there are systemic risks associated with the portfolios. They arise not only from credit risk, but also from operational risk and interest rate risk. That is why it is so imperative to have strong GSE reform, so that the GSE regulator can assure the sufficient capital behind those portfolios and make sure that receivership and, you know, other elements of oversight are in good shape.

I don't think that the portfolios are the most productive way forward in terms of addressing the current housing situation, even putting aside systemic risk. The conforming loans, which are the primary part of their portfolios are easily traded now. There is no liquidity problem in conforming loans. If the portfolios were to be used to purchase more subprime loans, first I would not recommend that they reduce their credit standards. There is some capacity to buy those loans within their existing credit requirements. I don't think it's safe to reduce the credit quality of those portfolios, but if they choose to do that, they could easily do it by selling off the existing conforming loans that they hold and make room under their caps to buy these alternative loans.

So I do have concerns about the portfolios, and they underscore my belief that there needs to be a strong GSE reform bill that will ensure the safety, soundness, and lack of systemic risk associated with them.

Mr. ROYCE. Thank you, Chairman Bernanke.

Thank you very much, Chairman Frank.

The CHAIRMAN. I thank the gentlemen. Let me just say at this point, the gentleman will have to admit it in 17 seconds, and I've neglected to say one thing. If there is no objection, I would just direct to Mr. Jackson. Later, we're going to hear from Judith Liben from the Mass Law Reform.

One of the problems that has not gotten enough attention here are the people who rent in properties that were foreclosed upon, and they have found that their leases were wiped out. We need to work on that, and I hope we can work together on some suggestions that she hasn't asked the HUD people, to look at the recommendations in Ms. Liben's testimony and we want to work together with you on that.

Mr. ROYCE. I am reclaiming my time, Mr. Chairman, if I could.

And the other aspect that I just thought I'd mention is the Fed setting the interest rate at one percent from June of 2003 to June of 2004, if we look at this bubble and what helped to create this bubble long-term, would you concur that perhaps in retrospect, one percent effective Fed fund's rate might have been a cause of some of the action subsequently that we saw in the market and people take.

Mr. BERNANKE. Well, I think economists will have to make that assessment in the long term. I think that there are other factors associated with the housing price increases, including very low, long-term interest rates around the world, which were associated with big increases in housing prices in many countries around the world, not just the United States. In particular, as the Fed Reserve lowered interest rates to one percent and then raised them gradually, mortgage rates did not respond very much to those short-term rates. They were in fact primarily determined by the long-term rates, determined international capital markets.

Mr. ROYCE. So you don't think that was a contributing factor?

Mr. BERNANKE. Well, monetary policy works to some extent by effecting asset prices of all types, but again, I think the primary factor leading to increases in house prices, not only in the United States, but in many countries around the world, was the generally low level of long-term, real interest rates in global capital markets.

Mr. ROYCE. Thank you, Chairman Bernanke.

The CHAIRMAN. I would also ask unanimous consent at this point to put into the record the statement from the Independent Community Bankers of America, the National Association of Home Builders, and the National Association of Realtors.

The gentleman from Illinois is recognized for 5 minutes, without objection.

Mr. GUTIERREZ. Chairman Bernanke, in your testimony, you cited the HOPI program administered by Neighborhood Housing Services of Chicago as an example of a model foreclosure prevention program. I agree. And I can tell you that we will need this program and others like it in Chicago over the next 6 to 12 months.

And participation in this program by the private sector is vital, both in terms of a willingness to work with borrowers and to donate the capital to keep the program going. As you probably know, two of the principal institutions that provide capital to keep HOPI

going are Bank of America and LaSalle Bank. LaSalle support for the HOPI program and its long history of philanthropy and community involvement are primary reasons that I wrote the Federal Reserve in June of this year and requested a public hearing meeting on the Bank of America, LaSalle merger.

The response letter I received from the Federal Reserve indicated that the Board would carefully consider my request for a public hearing, and then of course not grant any. The next correspondence I received from the Board on this topic was a notice of order of approval of the merger. Now, I know that while considering the Bank of America/Fleet Boston merger in 2003, and JP Morgan Chase/Bank One merger in 2004, the Federal Reserve held public meetings.

In fact, the Board held two meetings for each merger. Ironically the last meeting for the Chase/Bank One merger was held at the Chicago Federal Reserve Bank on LaSalle Street. In the Bank of America/LaSalle merger, we had the largest U.S. bank acquiring a dominant regional bank with a significant deposit market shared locally and regionally. Beyond that, LaSalle is an intricate part of the Chicago community in terms of philanthropy and community development, supporting hundreds of projects like the HOPI program for which we are both fans.

So, my question is, in a major market like Chicago where Bank of America really does not have much of a retail presence, why no public meeting Bank of America/LaSalle merger did the Board consider LaSalle's participation and programs like HOPI, and increasing needs of these types of programs and approving the merger without a hearing? Mr. Chairman, my concern is not that Bank of America will pull out of programs like HOPI, but that they will not match their current level and LaSalle's level of funding. If that happens, programs like HOPI will not be able to serve the number of people who need assistance.

Mr. BERNANKE. Congressman, I appreciate your comment and I assure you we will look carefully at each of these cases and holding public meetings as required. In the particular case you mentioned, we actually got relatively few comment letters. I know yours was among them, and the issues that were raised were fairly readily resolved directly with the banks and with the people who submitted the letters.

I apologize if we didn't respond to you adequately, but in that case we felt that the issues were sufficiently circumscribed at a public hearing wasn't necessary. But, I agree with you that in cases where there are substantial effects on local communities that there should be a presumption to look to a public hearing to make sure that all views are heard, and continue in that direction.

Mr. GUTIERREZ. Thank you. And I appreciate your words. It's just that Bank of America is already the largest. In their application as I read it, they exceeded 10 percent of deposits, and that's a rule that apparently you guys have there that no one bank should have more than 10 percent.

So there were a lot of issues, Mr. Bernanke, that I think, especially given the reason that you're here this morning along with Mr. Paulson and Mr. Jackson, to have a public hearing, because people are concerned, LaSalle Bank just wasn't another institution

in Chicago that was brought up. It was a Chicago institution, not because of the marathon, but because of much of its participation. And I don't think we should take the past as necessarily what the future will bring. Now we're going to continue in the absence of any public hearing, which I think was essential. And I find it just rather ironic that we would have two hearings on other mergers on LaSalle Street at the Chicago Reserve and not have one for such a gem of an institution when there's a merger of this significance going on in Chicago.

So I encourage you and others at the Federal Reserve to watch what goes on here, because really now the onus is on you. There was no public hearing. You approved it without one, a rather large merger, which seemed to me to violate some of your rules, if at least a 10 percent deposit standards, I know they're making amends. I'd like to know which 10 percent they're going to get.

You know, in order to reach the 10 percent, who are they going to get rid of? How are the going to get rid of a billion-and-a-half dollars? Where are those loans and assets going to be distributed from?

I thank you very much for looking into this matter.

The CHAIRMAN. Next, the gentleman from Texas, and perhaps larger places, Mr. Paul.

Dr. PAUL. Thank you, Mr. Chairman.

I want to follow-up on the discussion about moral hazard. I think we have a very narrow understanding about what moral hazard really is, because I think moral hazard begins at the very moment that we create artificially low interest rates, which we constantly do. And this is the reason people make mistakes. It isn't because human nature causes us to make all these mistakes, but there's a normal reaction when interest rates are low that there will be overinvestment and malinvestment, excessive debt, and then there are consequences from this.

My question is going to be around the subject, how can it ever be morally justifiable to deliberately depreciate the value of our currency, and that is what we do constantly. I mean, we're in the midst of a crisis today and efforts have been directed toward propping up financial markets in Wall Street. First, the crisis is noticed. There's a panic. We dump in tens of billions of dollars into reserves and that reassures the market, and Wall Street feels a little bit better, and it is still not enough.

Then, we take a discount window and we lower the rates, and we don't look at our problem from what caused it. What we say is, let's make it a door. Let's open up and lower the rates. And again Wall Street says, oh, this is wonderful. Do the poor people like this, and do they respond, and is this going to help get houses when some of them couldn't even afford a house, because even with the low interest rates that were available, because the costs are going up, and cost goes up because the dollar goes down.

Then, even this week, what did we do. Our Federal Reserve lowers the interest rates by 50 basis points and the poor people and the middle-class people say, boy this is wonderful. My cost of living is going to go down. I'm going to get a job. No. Wall Street goes up 350 points, so it looks like everything is directed toward a bailout. Whether it's done deliberately or not, the American people see

this as a deliberate bailout of the financial markets. The poor people are losing their houses.

There's every sincere effort made to try to correct this, but it's inevitable that it's not going to work because the monetary system is such that there's so much misinformation. We talk about market discipline. You indicate, Mr. Chairman, that we should have market discipline, and didn't have enough market discipline, but there's no possibility to have market discipline when all the information is erroneous.

Today, with this concept and during this testimony, we see oil prices soaring, over $82 a barrel. We see wheat and corn soaring. We see other commodity prices soaring: gold, $730, $740 an ounce. There's a great deal of concern out there. This is all reflecting the fact that the dollar is going down in value, and if we don't deal with that we can't solve the problem. And we look at this and think, well, we've created all these problems because we've had this malinvestment, all this credit going into the system, and we have all this correction that needs to come about, and we think we can solve the problem of inflation with more inflation. But really the bottom line is what moral justification do we have to deliberately devalue the currency and the dollars that people save. This forces the cost of living up for the people who don't even have a chance to buy a house, so there's a moral consequence of the system that we have today, and I can't see how we can avoid this moral obligation we have.

The responsibility to Congress should be to maintain the value of the currency, not deliberately tax the people by creating new money and passing on the high cost of living to the people who can least afford it. Wall Street never suffers from that, and we know of all these things out in the open, the Federal Reserve does. But we don't know the details of what the Working Group on Financial Markets does to prop up markets, because I'm sure they're very busy and have been very busy in these last several months.

But, is there any moral justification for deliberately devaluing the currency?

Mr. BERNANKE. Thank you, Congressman. The value of the currency can also be expressed in terms of what it can buy in domestic goods, that is, the domestic inflation rate.

That is part of the Federal Reserve's mandate, to maintain price stability, which to my mind means the value of the dollar. The inflation rate is something we paid close attention to, we continue to pay close attention to, but over the last year it's been a little over 2 percent.

We will continue to pay very close attention to the inflation rate. It's an important part of our mandate, and I agree with you that an economy cannot grow in a healthy, stable way when inflation is out of control. And we will certainly make sure that doesn't happen.

The CHAIRMAN. The gentlewoman from New York, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Chairman Bernanke, some experts suggest making originators or assignees liable if the underwriting standards or mortgage origina-

tions are found unsuitable. Do you feel that this is an adequate solution to curbing unscrupulous securitization activity?

Mr. BERNANKE. I'm not sure what you mean by "adequate." There are of course many different ways we can go about addressing these issues, including some of the rulemaking that the Federal Reserve is doing about the subprime lending and some of the disclosures we're working on as well.

With respect to assigning liability, I would say that there may be circumstances where it might prove a useful adjunct to some of these other methods, but I think it is extraordinarily important that we make sure that if that exists, if assigning liability exists, that the rules be very, very clearly delineated, the responsibilities of the investors be very, very clearly delineated, and that there not be some uncapped damages or unspecified damages that they would be liable for because if you do that then the investors will simply consider it too risky and they will pull out and you simply will not have any investment in this whole sector.

Ms. VELAZQUEZ. So where you're turning today is that they are not clearly defined.

Mr. BERNANKE. Well, we've seen from different States different experiences. And there have been examples where assigning liability provisions have driven lenders out of the State.

Ms. VELAZQUEZ. In your testimony, on page nine, you recognize that the values that FHA has been able to ensure have failed to keep pace with rising home values in some areas of our country. However, when evaluating the GSE's loan limit you raised concerns about the effect it could have on market discipline.

Can you explain how raising FHA loan limits is different from raising the GSEs and why would the market discipline effects be different in the GSE's case and not for FHA?

Mr. BERNANKE. Well, I prefer the FHA as a vehicle for addressing these problems. It's specifically addressed towards lower- and moderate-income home buyers. It is a government explicit—has an explicit government backstop. It's not an implicit government backstop. It's on budget and it has an explicit mission, which is to help homebuyers and not to make profits for any stockholders.

It's a very different kind of operation, so I think if we're going to be using a government agency to help people refinance their mortgages, that we need one that is accountable and is explicitly budgeted for, as the FHA is.

Ms. VELAZQUEZ. Secretary Jackson, I want to focus on the development of affordable rental housing, which is particularly difficult and costly to finance, especially in urban areas like New York.

In addition, many homeowners facing foreclosure might need to move to rental units, which might increase the demand for those units. With Fannie Mae and Freddie Mac approaching their portfolio caps and unable to play a significant role in this market because of the size of the loans how do you suggest we ensure that multifamily rental developments continue to thrive in this environment?

Secretary JACKSON. Congresswoman, I think in certain areas of this country that's going to be very difficult to do and I'm not going to tell you it will be easy, especially when you look at the area that

you represent in New York City. We see the prices consistently rising.

And I think that if we can implement both FHA secure and FHA modernization to save a number of the families they will not have to go to the rental market, but it's still going to be very difficult.

We see serious problems from Virginia all the way back to Maine and from Utah all the way back to California. I think what we can do is basically begin to work with these States to try to find a situation where we have affordable housing, as the case in Starrett City, we don't lose that affordable housing, we do everything in our power to maintain it.

And that's what we've set out to do and will continue to do, but it's not going to be a very easy task, especially when the HAP payments of 30 years leave and these landowners realize that they can get a much bigger profit for their property.

Ms. VELAZQUEZ. Mr. Paulson, would you mind commenting on that very same issue?

Secretary PAULSON. Excuse me. You will have to repeat the question.

The CHAIRMAN. Quickly.

Ms. VELAZQUEZ. That's fine.

The CHAIRMAN. Thank you, and let me just say that—for a second, if the gentlewoman would yield, Mr. Secretary, I was glad to hear you say that.

Trying to preserve the existing affordable housing will be a very high priority for us, and we look to working—it clearly from every standpoint makes more sense to preserve the existing housing, preempt all the zoning and other issues than to start from scratch. So we're glad to hear that, and you tell us what we need to do.

Next, the former ranking member of the Housing Subcommittee, now the ranking member of the Subcommittee on Financial Institutions, the multitasking gentlewoman from Illinois.

Mrs. BIGGERT. Thank you very much, Mr. Chairman.

First of all, it seems like there has been a lot of—we've heard a lot of criticism that the regulators didn't do enough and should have acted sooner. And I know, Chairman Bernanke, that your predecessor was on 60 Minutes the other night and he said that he had missed the significance of practices that were going on and not until late did he react to that, 2005 or 2006.

What are you doing to ensure that these practices, what's happening are not overlooked or not managed—what, I know that you spoke about monitoring but can you give us some other methods that you will use to take a good look at these practices?

Mr. BERNANKE. As I discussed in my testimony, we are approaching this from a whole different range of ways. We are looking at our rulemaking authority. We have promised to promulgate rules by the end of the year that will address subprime lending practices.

We are looking at disclosures, trying to improve, for example, advertising and the timeliness of disclosures to potential borrowers. We are working on a pilot program where we try and coordinate with State and other Federal agencies to make sure that we are working together to make sure that some lenders don't fall between the cracks, between the Federal and the State and the different regulators that we have.

And we're doing what we can, as I described, to try and assist those who are already in trouble, for example through our community outreach efforts. So we are very much aware of the seriousness of this problem. Within the limits of our tools and authorities, we are going to do all we can to try to help improve the situation.

Mrs. BIGGERT. Thank you. I appreciate that.

Secretary Jackson, it's nice to see you here, and I have a question that I probably have asked you several times before.

In 2002, HUD attempted to reform RESPA, but never issued a final rule. Much of the discussion of the 2002 proposed rule revolved around the guaranteed mortgage package, which has provided, which would have provided lenders an exemption from the Section 8 anti-kickback provisions of RESPA.

Is there something that we can expect to see from the Department in the new RESPA rule?

Secretary JACKSON. Yes, Congresswoman. I can project that we would probably come back to you by the end of the year, no later than December 31st, as I promise you, with some suggestions as to how we approach this issue.

I made a commitment to this committee that we would not move forward without your input, and we will have that for you by the end of the year.

Mrs. BIGGERT. And I thank you. But the White House summary of the President's Homeownership Initiative stated that one of the RESPA regulations main goals will be to limit settlement cost increases. And that probably is a laudable goal, but are there different ways of accomplishing that other than directly regulating prices?

Secretary JACKSON. You know, Congresswoman, I don't want to speculate how we're going to approach this. I would much rather bring it to you all, get your input as to what approach we're going to—what approach is best to take. I think that's probably the best way to answer it.

Mrs. BIGGERT. Can you shed some light onto what the meaning of the phrase is?

Secretary JACKSON. I would prefer to, if possible, have that discussion with you personally.

Mrs. BIGGERT. All right.

Then, Secretary Paulson you—in your testimony, and you didn't have a chance to get to something on the importance of disclosure—could you just talk about that briefly?

Secretary PAULSON. Disclosure is obviously very important, but we have an overload of disclosure. Consumers have pages and pages and pages of things to look at, so they tend to think of it as being boilerplate or they don't read it or it's the fine print.

So I very much appreciate the role that the Fed is taking because they're looking at this in a very, very thoughtful way, discuss that with the chairman. They're doing consumer surveys, understanding how to best reach people and they're going to report back later in the year.

From my two cents worth, the idea that I like a lot is every mortgage having one page, very simple, big print, you know, your mortgage payment is "x" dollars today and it could be as high as "y"

dollars or whatever, signed by the originator and the mortgage holder.

But again, people who are much more expert than I am are now looking at this very carefully, and I think too often we just say, oh, we write it all down and have someone sign it; that's the disclosure. And the onus, I think, has to be to come up with disclosure that's going to be simpler, clear and more meaningful.

Mrs. BIGGERT. Thank you.

The CHAIRMAN. Panelists, the Secretary has to leave, and I think that will be the end of the panel, but the last questioner on this panel will be the gentleman from North Carolina.

Secretary PAULSON. Can I just say one thing?

The CHAIRMAN. Yes.

Secretary PAULSON. Mr. Chairman, I think when I do leave, I just want to say to everyone here that I apologize. I will deal with any of you one-on-one if you call with questions, and of course if you want to just submit a question, I'll give you the answer for the record.

The CHAIRMAN. Thank you, Mr. Secretary. The gentleman from North Carolina.

Mr. WATT. Thank you, Mr. Chairman. And I'm not sure whether Secretary Paulson is leaving before or after but—

The CHAIRMAN. After your questions.

Mr. WATT. I just want to follow up on something that Mr. Baker said earlier to Mr. Bernanke.

My experience in 15 years of serving on this committee is that particularly in prepared comments and in off-the-cuff public comments of any kind neither the Fed nor the Secretary or any of you make comments that don't have some intent.

And I guess this is not necessarily a question unless you all want to respond to it. I detect a level of animosity, Secretary Paulson and Mr. Bernanke, in some of your comments, both prepared and this morning, toward the GSEs.

Even, Mr. Paulson, at the bottom of page five and top of page six, your statement that, had you to do this over again you wouldn't have GSEs structured like this. And I guess my comment—I hope this is not an intent. It seems to me that there are degrees of public involvement in a number of levels. Everything that we do at the Fed is public involvement at some level in structuring and shaping our economy, and the government has made a judgment that we will inject ourselves through the GSEs in a particular segment of our economy.

So I guess my general comment is I hope you all will be a little more careful in projecting this because I perceive a level of animosity here that I hope is not—

Secretary PAULSON. I would like to comment on that, and I'll be brief.

I feel no animosity. I have a high regard for the people who run these institutions and for what they're doing. What I said is—which I think we all need to recognize, is that this is an unusual construct.

It is an unusual construct when you have for-profit institutions with boards that need to be focused on earnings per share and their shareholders while there's a public service mission.

Mr. WATT. And I acknowledge that, Secretary Paulson, but that same perceived conflict, I guess, would be in any responsibility that we imposed on shareholder institutions. CRA has that—carries that responsibility. Our involvement in raising or lowering the discount rate has some impact in those private markets.

And I don't know when you start singling out one institution or one set of institutions that—

Secretary PAULSON. The reason I did it—and I think it's important for people to understand this—is I—when we look at an institution like this we need to understand and think through very carefully all the issues.

And for instance I'll just give you one example, okay. There's been—

Mr. WATT. Can I—I really had a question that I wanted to ask. Maybe you could give me your other construct that you would do if you were doing it over in writing and we could have a conversation another time. I didn't even really—wasn't even seeking a response from you all on this—and Mr. Bernanke, I'm sure he wants to do it too.

Let me quickly ask a question. One of the proposals that has been under consideration is in the bankruptcy code. Bankruptcy judges don't have the capacity to deal with mortgage adjustments when folks go into foreclosure, they go into bankruptcy in fact. One of the proposals that is being kicked around is the prospect of changing that. Do you all have any particular responses or reactions to that, any of you?

Mr. BERNANKE. I first want to say that I have no animosity whatsoever toward the GSEs.

Dick Syron used to be in the Fed system, and so he's a Federal Reserve veteran and he's a good friend of mine. It's just a question of public policy and what is the best way to achieve the government's goals without creating risks in the financial system.

On the bankruptcy code, it's ironic in a way that the rules about separating the house from the rest of the obligations was originally intended to protect the borrower not the lender. So there are some complicated issues there. I'm not prepared unfortunately this morning to give you an insightful comment on that subject.

The CHAIRMAN. Mr. Jackson, any comment?

Secretary JACKSON. The only comment is I feel the same way as my colleagues. I have no animosity. In fact—

The CHAIRMAN. We're beyond that. We're into bankruptcy now.

Mr. WATT. Can I just ask you all to take a look at—I think there are going to be some proposals fairly shortly on that issue.

The CHAIRMAN. And I would say too, just because you would have done something differently if you could do it over again doesn't mean you won't work with them because I'm going to work with the Senate; if it was up, to me there wouldn't be one.

[Laughter]

The CHAIRMAN. Mr. Paulson, do you have anything on bankruptcy?

Secretary PAULSON. Oh, I have nothing down on bankruptcy. My biggest focus on the strong regulator, which I just think is essential, is that we not have it be bifurcated, that there is more flexibility with regard to their powers on capital—

The CHAIRMAN. Let me just say then because you're going to leave, I want to acknowledge here mentioning the Senate was a little outdated because yesterday—we got an article dated yesterday in which Senator Dodd says he promised to move quickly on a bill to overhaul Fannie Mae and Freddie Mac and says he will keep those things along with the FHA. I agree with him on that; it's a very encouraging article.

And again I think we have a great deal of agreement among the three parties, House, Senate and the Administration. I congratulate Senator Dodd, he's—frankly he's had a full committee membership now with Senator Johnson back. So I'm rooting for it. We've already sent the word. We all plan to work together.

This panel is now dismissed, and the next panel can please come forward. Let's do this quickly.

Hey, express your lack of animosity outside, guys. I have to get a new panel started. Please clear the room quickly so the new panel can get here.

Please, please. We need to clear the room. Please don't hinder that. People, please allow the witnesses to leave. You can talk in the hall.

Would people please stop obstructing Senator Jackson's ability to leave?

The second panel, and in the order in which I have it, which implies nothing other than the way we got it typed up, we'll begin with Mr. Daniel Mudd, who is the president and chief executive officer of Fannie Mae, and will someone please close the door?

Mr. Mudd, please start with your statement. All of the written material that any of the witnesses want to insert into the record will be inserted with unanimous consent, and you may now proceed for your 5 minutes, plus a little bit.

STATEMENT OF DANIEL H. MUDD, PRESIDENT AND CEO, FANNIE MAE

Mr. MUDD. Chairman Frank, Ranking Member Bachus, and members of the committee, thank you for the opportunity to testify.

I want to focus my testimony on four points today. One, investors have fled the market and liquidity has dried up in many sectors of the mortgage finance industry. Two, what that means is that many loans won't be there for those who need them the most. Those refinancing out of subprime or Alt-A loans, affordable apartment financings, rescue bonds and yes, as discussed, even some jumbo mortgages. Three, Fannie Mae is working well, and is in good shape to play a constructive role, but we can do more. And four, in all of this, I hope we can keep our focus on the long-term goal, a stable, available system of affordable housing and mortgage finance in the United States.

Congress charted Fannie Mae, and I quote, "to provide liquidity, affordability and stability in the low, moderate and middle income mortgage market and to do so under all conditions." That is what we do. That is all we do, and we do it only in the United States.

As a number of observers have pointed out, the mortgage market operated smoothly through the financial crunches before such as 1998 and in other times of distress, but not so this time because liquidity is not returning. In fact, if you want an example of a mar-

ket where the GSEs did not provide that stability, the subprime market from 2003 to 2007 is your case study.

If you want an example of a market where the GSEs did not provide long-term liquidity, that case study is happening now. We think more can be done, and we want to do our part consistent with the charter Congress assigned us to help provide stability and liquidity across the mortgage market.

And accordingly, since this crisis started, we have helped lenders refinance about $6.5 billion of subprime ARMs into prime loans through our HomeStay initiative. This has helped more than 33,000 homeowners avoid subprime payment shock.

We have committed to fund $450 million in mortgage rescue packages from State housing finance agencies. Through August, our loan servicers have renegotiated more than 750 loan workouts per week, keeping about half of our seriously delinquent borrowers out of the foreclosure process.

Our mortgage-backed security business is currently operating at record volumes as demand for conforming product increases, but packaging loans into securities isn't the cure for all parts of the conforming market and it can't address all the liquidity needs.

So where possible under the limits of our portfolio ceiling, we have sought to fund affordable multifamily housing mortgages and affordable single family loans in instances where other buyers have exited the market.

One of our primary tools since our creation in 1938 has been buying and holding mortgages and mortgage-backed securities in our portfolio. However, as you know, our portfolio has been capped since May of 2006, under a consent agreement with our regulator OFHEO while we fixed our accounting and internal control weaknesses and caught up on our financial reports with the SEC.

OFHEO's decision to give us some limited flexibility to increase mortgage market liquidity is helpful but we believe having the flexibility to increase our portfolio by at least 10 percent would actually allow us to be a more active long-term investor in subprime refinance loans, affordable multifamily loans, and other critical sectors of the market where capital has dried up.

We are fast closing in on the time when the terms of the OFHEO consent agreement will be satisfied, although this market crisis did not wait for us. The fact is we have made tremendous progress. We have reissued audited financials. We have vastly reduced our control weaknesses. We expect to file our 2007 quarterly SEC reports by year end and our 2007 10K will be on time.

As we get current, we would anticipate the cap being removed, thus allowing us full flexibility to respond to the needs of the market and fulfill our mission.

I am confident we can provide liquidity to help the home finance market without taking any risks that we're not capable of managing. Our purchases will comply with all relevant regulatory guidance and be consistent with the internal controls framework we have established with OFHEO.

We think the President's foreclosure initiative is an important step. We look forward to working with the Administration to make it successful. Increasing the conforming limit above the $417,000 cap to increase liquidity in the jumbo market would also be helpful.

Were Congress to pass it, we would support such an increase and be ready to act.

And finally, to be sure, while I have spoken mostly about Fannie Mae and the role we should play, I want to emphasize that there are important roles for many institutions in this crisis. Steps can be taken now to improve the long-term health of the home finance system.

The bad actors should be prosecuted. Transparency and clear disclosures can be put in place for both consumers and investors. But my fear is that amidst all this turmoil and change we will lose sight of what has brought us so far, which is a commitment to decent, affordable housing for all Americans.

That housing is beyond the reach of two-thirds of the low- to moderate-income families in America. And the difference between what families can afford and what a home costs is growing; it is not shrinking.

The need is great and through this period and in the years ahead Fannie Mae is committed to doing our part.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Mudd can be found on page 180 of the appendix.]

Mr. WATT. [presiding] Mr. Syron.

STATEMENT OF RICHARD F. SYRON, CHAIRMAN AND CEO, FREDDIE MAC

Mr. SYRON. Chairman Frank, Ranking Member Bachus, and members of the committee, thank you for the opportunity to appear today. Let me on a side note just say that these are obviously complicated issues, and there are some contentious issues involved here. And I very much appreciate the efforts of Chairman Frank to generate an honest intellectual discussion of just what the issues are here and to get past philosophy, in some cases, and talk about what we can do to help people in this country.

Since I testified last in April, the problems in the subprime market have worsened, and there are indications they are spreading to the broader economy, and I dare say, as my friend Chairman Bernanke said, that I don't think they would have done what they did earlier this week if they didn't believe that was the case.

Outside the market supported by Freddie Mac and Fannie Mae, mortgage money is either unavailable or available only at high rates. Just yesterday, I met with the originators of approximately 70 percent of mortgages in the United States, and they told me that the only markets in which mortgages are being freely originated are the markets in which the product can be sold to the GSEs.

Amid this turmoil, we are taking concrete steps. We can do more. But we're taking concrete steps to stabilize markets and help borrowers within the boundaries of current regulatory prescriptions.

In February, we were the first secondary market participant to announce tightened lending standards to limit future prepayment shock for subprime borrowers, helping ensure these borrowers can indeed afford the homes they are in.

In April, we committed to purchase up to $20 billion in more consumer-friendly mortgages that will better offer choices for subprime

borrowers. We began delivering on that commitment this summer. We have also seen a very substantial increase in our purchases of mortgages to credit-impaired borrowers. Based on our experience so far this year, we expect this year to buy 25 billion of those mortgages, and the lion's share of that I would consider to be in the subprime category, somewhere in the $15- to $20 billion dollar range.

Finally, we remain very dedicated, as I think a number of people are, to helping borrowers avoid foreclosure. Year-to-date, we have worked out about 30,000 mortgages, for a total of about 200,000, since the beginning of 1994.

Now these efforts will cushion the negative effect on borrowers and communities, but they're not by far a panacea. Certain regulatory and legislative matters are needed to alleviate the credit crunch, restore confidence, and help more borrowers. The President's plan for modifying FHA is a good start, as well as enhanced borrower education and beneficial tax code changes. But the GSEs can and should play a larger role. Meaningfully lifting the caps on GSE portfolio growth would provide a needed backstop for mortgages, sending a positive signal. On that note, the recent OFHEO moves, I think, are beneficial in the sense that they raised Fannie's cap, which I think is good, by about 2 percent. But I can tell you, averaging over a year, it has no effect on us.

Similarly, a temporary lifting of the conforming loan market would enable us to provide needed liquidity to the jumbo market where rates have spiked to nearly a full percentage point above the conforming market. In high-cost areas in particular, a temporary lifting of the conforming loan limit might help prevent declines in home prices that could lead to additional defaults.

In closing, let me say that a bipartisan Congress chartered Freddie Mac to keep mortgage markets stable and functioning in all periods. Freddie Mac can't solve the whole problem, but we can be and should be a part of the comprehensive solution. Our job is to provide stable and affordable mortgage financing for families in U.S. cities, towns, and rural communities. Actually, that is what we are doing, and that's what we want to do more of.

Thank you very much.

[The prepared statement of Mr. Syron can be found on page 222 of the appendix.]

The CHAIRMAN. Ms. Liben.

STATEMENT OF JUDITH LIBEN, MASSACHUSETTS LAW REFORM INSTITUTE

Ms. LIBEN. Thank you. Good afternoon. My name is Judith Liben, and I am a housing lawyer at the Massachusetts Law Reform Institute.

I thank you very much for this opportunity to testify about the mortgage crisis that has hit not only homeowners but also another large and growing group of people to whom very little attention thus far has been paid. These are people across the country who never took out a mortgage but are also losing their homes to foreclosure, and at an increasing rate. I'm talking about tenants in foreclosed rental properties, properties that are typically but not always smaller buildings, condominiums, and single-family homes lo-

cated in low-income and indeed in more upscale neighborhoods across the country.

Many times a lender, who in this testimony I'm going to call the banks, because that's what they're called on the street, whether they're originators or servicers or other things. Many times the banks end up owning rental properties after foreclosure, just as they do other properties. And then what happens to the families, the individuals, the elders who live in the building? We have in the last 2 weeks since we received this very kind invitation to testify here, collected stories and articles from around the country in many States. In our testimony we've listed those States. And those stories have turned out to be remarkably similar.

The CHAIRMAN. And under the general—they'll be part of the record, the package you gave us will be inserted in the record.

Ms. LIBEN. Thank you very much. And, Mr. Chairman, one more article came in last night which I'm going to talk about, and if I could give that to the committee, I would appreciate it.

The CHAIRMAN. Okay.

Ms. LIBEN. The stories are remarkably similar. From State to State, here's what happens. First, the banks typically evict all the renters in the building, for various reasons, but out they go. And they evict them very, very quickly. Often tenants don't even know there has been a foreclosure. They are the last ones to find out, and that there's a new owner, until some guy—it's usually a guy—comes around and says the bank now owns your building. Here. We have a program called Cash for Keys. We'll give you $500 if you get out in a week or 5 days, it obviously varies. Or we'll give you $800 or maybe even $1,000. And many tenants do just that. They've already lost their security deposit. They take this small amount of money. They have no place to go and they leave. And as the Congresswoman from New York says, they go into a rental market where they may now be competing with the foreclosed homeowners who are looking to rent.

If a renter doesn't take this Cash for Keys pittance, they will then go through the legal process where they'll be put out within 3 to 30 days in most States, with no defenses that you're allowed to present in court. And the banks are evicting even in those few jurisdictions and States where it is unlawful, it is prohibited from evicting tenants after a foreclosure. So, mass evictions are one enormous problem, and I can tell you how widespread that problem is later.

Second, while tenants are living in the buildings, the foreclosing banks typically refuse to maintain, make repairs, and very often don't pay the utility bills so that people are left without water, without heat, etc., to the point where some communities are starting to get alarmed. One of the articles we attached is from Oakland where the city attorney got together a group of people, and he said that in his city, it is becoming a humanitarian crisis.

Of particular concern to this committee is what's happening to Section 8 tenants. This is in the housing side of your committee. I've brought with me an article from Atlanta in which over 200 tenants have been evicted from their Section 8 housing in the last—I'm sorry, I don't remember the period of time—and this is housing in which the owners took the Section 8 subsidy and yet somehow

didn't pay their mortgage, and those tenants are out, and now the housing authority is struggle to see how on earth can we help them.

And, of course, vacancies lead to a downward spiral of neighborhoods, obviously crime problems, and the properties become less attractive. So even when it would make good business sense for banks to try to keep the buildings occupied, bring in a rental stream, make it more attractive to buyers, they usually refuse to do so.

How widespread is this problem? Well, perhaps there's some study out there that gives nationwide statistics, but we haven't been able to find them, although I do think some of the databases collect foreclosures by owner occupied and non-owner occupied. But let me give you one very revealing example. In Minnesota, they keep good track of foreclosures. And in Hennepin County, which includes the Twin Cities and the nearby surrounding suburbs, there were about 3,000 foreclosures in 2006, which was a 100 percent increase over 2005. Thirty-eight percent of those foreclosures, city and suburb, applied to rental properties. And remember, when we say rental properties—excuse me. I'm sorry. My time is up.

The CHAIRMAN. You can take another 30 seconds to finish up.

Ms. LIBEN. Rental properties may be many, many units within a building, so we don't know how many families are affected. Thirty-eight percent applied to rentals, and in the City of Minneapolis itself, 56 percent. This is very common in cities where you have a higher proportion of rentals. It's not an isolated case, and you'll find this replicated in other places.

And at some point, if someone wants to question us, we have—

The CHAIRMAN. Yes. That's the general rule.

Mr. LIBEN. Thank you.

[The prepared statement of Ms. Liben can be found on page 140 of the appendix.]

The CHAIRMAN. All right. Next, Mr. John Robbins, who is chairman of the Mortgage Bankers Association.

Mr. Robbins.

STATEMENT OF JOHN ROBBINS, CHAIRMAN, MORTGAGE BANKERS ASSOCIATION

Mr. ROBBINS. Mr. Chairman, and Ranking Member Bachus, as you know, the Mortgage Bankers Association has been in constant dialogue with this committee since the credit crisis unfolded. The present proposals are a welcome addition to the debate, and let me start by saying that we support them. While they are not a silver bullet, they offer additional options to distressed borrowers. We have long advocated many of these changes, such as FHA modernization, RESPA reform, and financial literacy. We encourage other actions not addressed by the President and would be happy to discuss those with you as well.

We strongly agree with the President's proposal to modify the RESPA rules to promote better comparison shopping by consumers to provide clear disclosures, limit settlement cost increases over their initial quotes, and require better disclosure of broker fees. The mortgage settlement process today is flawed. It floods borrowers with so much paperwork that predators can easily hide in

plain sight. The right RESPA reform will leave predators far fewer places to hide and make it easier to shop for a good deal on a mortgage and lessen surprises at the closing table.

The President supports State regulator-based efforts to create a mortgage broker registration system. This will be an important improvement for consumer protection. In fact, we believe all loan originators need to be registered regardless of their parent company's charter. It's the only way we'll ever be able to hunt down and punish bad actors.

Borrowers should also receive improved and timely disclosures from mortgage brokers. These disclosures should clearly explain the broker's compensation and their relationship to that borrower. The MBA has always championed financial literacy. Our home loan learning center receives over a million inquiries a month currently from consumers who are looking to educate themselves. If an educated consumer is the best defense against predatory lending, then an uneducated consumer is a predator's dream. We must devote resources to help people help themselves.

The President supports efforts to fight fraud and vigorously enforce existing consumer protection standards. We welcome this scrutiny and think it is long overdue. We also agree with the chairman and others that in order to have a smoothly functioning regulatory system, we must have a strong regulatory enforcement system.

The President proposes to exclude forgiven mortgage debt from a borrower's gross income. While we support this effort, any change must be done in a way that preserves the incentive for borrowers to work with their lender on loss mitigation, and does not encourage foreclosures.

The House has already taken significant steps to enact FHA modernization. We urge you to work with the Senate to complete work on this important bill and send it to the President. Empowering FHA will give distressed borrowers another important tool and help provide more options for first-time home buyers in the future.

The President's plan includes a new foreclosure initiative. Mortgage servicers are already today working through problems with their customers. Several CEOs from our largest member companies met with Secretary Paulson last week to discuss their efforts. We are working with NeighborWorks, the Housing Preservation Foundation and other community, consumer and civil rights groups to ensure that our customers are receiving the maximum amount of help we can provide.

One issue that the President did not address is how the GSEs can be an active partner in addressing the credit crunch and helping distressed borrowers. Subject to appropriate safety and soundness considerations and investment parameters, we support an increase in the GSE portfolio caps to immediately inject liquidity into the housing market. We welcomed OFHEO's action yesterday in this direction and hope they will move further soon.

Finally, we believe that finishing GSE reform legislation would help add confidence to the secondary market and protect the mortgage market into the future.

Thank you.

[The prepared statement of Mr. Robbins can be found on page 207 of the appendix.]

The CHAIRMAN. Thank you, Mr. Robbins. And now Mr. Harry Dinham, who is the past-president of the National Association of Mortgage Brokers and runs the Dinham Companies.

Mr. Dinham.

STATEMENT OF HARRY H. DINHAM, CMC, PAST-PRESIDENT, NATIONAL ASSOCIATION OF MORTGAGE BROKERS, THE DINHAM COMPANIES

Mr. DINHAM. Thank you, Mr. Chairman, Ranking Member Bachus, and committee members. I appreciate the opportunity to testify before you on what can be done to minimize and mitigate foreclosures for both today and tomorrow.

First we would like to commend Chairman Frank and Ranking Member Bachus for requesting a GAO study on the causes of foreclosure. We look forward to the findings of this study. I have been in the mortgage business for 40 years. Like most of my fellow NAMB members, I am a small business owner living in the same community where I work. We are witnessing firsthand the severe impact that the current credit crunch is having. Thousands of borrowers are facing resets on their loans but unable to either refinance or sell their home in this slumping housing market. To put it simply, people are losing their homes, and there's no way to measure the harm that it's causing. In fact, my home State of Texas has one of the highest foreclosure rates in the country.

Unfortunately, hundreds of large lenders are closing their doors, shutting down their warehouse lines of credit, shifting their business in-house, and forcing retreat from those communities where they need help the most. Because of this, there are fewer participants in the market, which means less competition, less choice, and increased cost for consumers who are already struggling to find affordable loans.

I want to say that NAMB also supports sensible legislation and supports efforts to accomplish this. There are a number of steps that Congress can take to help struggling consumers. The first of these steps was taken by the House just 2 days ago when it passed H.R. 1852. We applaud the committee for pushing forward FHA reform, and we urge the Senate to act swiftly so that this important legislation can go to work.

But more can be done. The turmoil that was once confined to the nonprime market has now spread into the nonconforming and prime market. The widening spread between conforming and jumbo loans, one could say a panic premium, is calling for increased loan limits, lifting of portfolio caps, and a return to stability in the market.

While we are in favor of OFHEO's recent policy change, we urge OFHEO to further restore confidence in our markets by lifting GSE portfolio caps more broadly. If the regulator cannot and will not act, we support legislative action to make this happen.

We also firmly support increasing the GSE's conforming loan limits to make financing more accessible and affordable for homeowners, especially those living in high-cost areas, as was accomplished by the House and this committee earlier this year.

In addition, we support initiatives to provide temporary tax relief on canceled or forgiven mortgage debt, and believe the bankruptcy code should be amended to give borrowers a chance to work out their mortgage. Homeowners should not be punished because they reached out to their lenders to restructure their loans to keep their home.

While these are essential solutions for today, other measures can also be taken to offer meaningful consumer protection for the generations of future borrowers:

Raising the bar to entry for the mortgage profession by establishing uniform minimum standards for education, testing and criminal background checks for all mortgage originators;

Establishing a national registry for all mortgage originators, such as the one put forward by Ranking Member Bachus, along with several other leading members of this committee in H.R. 3012;

Requiring escrow accounts for taxes and insurance on all first lien, nonprime loans, regardless of LTV;

Strengthening enforcement actions against deceptive and misleading advertisements;

Reforming the mortgage disclosure system, and moving forward with RESPA reform, so long as it does not confuse consumers, pick market winners and losers, or unfairly and unlawfully harm small business; and

Improving consumer financial literacy. Clearly the best investment we can make for the future is taking measures designed to educate consumers so that they can comparison shop and make informed financial decisions.

NAMB has been dedicated in its efforts to move forward many of these proposals, and looks forward to continuing to work with this committee as well as respective regulators on accomplishing these effective solutions.

Thank you. I am available to answer any questions.

[The prepared statement of Mr. Dinham can be found on page 84 of the appendix.]

The CHAIRMAN. Thank you. Next, Mr. Bruce Marks, who is the chief executive officer of the Neighborhood Assistance Corporation.

Mr. Marks.

STATEMENT OF BRUCE MARKS, CHIEF EXECUTIVE OFFICER, NEIGHBORHOOD ASSISTANCE CORPORATION OF AMERICA

Mr. MARKS. It is good to be here, Mr. Chairman. Thank you very much. And I want to also thank you for focusing on the tenants, because that's important, and the rental housing.

I'm not going to actually read the comments that are presented in my written statement because I want to respond to some of the issues that I've heard and the comments that I've heard over the last 2 or 3 hours.

The first thing we should be clear about is that the subprime lending crisis was never about homeownership; it was about generating billions of dollars in fees for brokers, for investment bankers, for lenders, and for the rating agencies. There are six major players out there, those four plus the borrowers and the investors. Right now the two who are holding the responsibilities and are being

hurt financially are primarily the borrower, but to a lesser extent, the investors.

So let's be clear. Because how could you say it provides homeownership for working people when you have the products which are, one of the products is a strangulation ARM. A strangulation ARM is not the traditional adjustable rate mortgage which goes up and down as either the prime rate or the LIBOR rate goes up or down. These are loans structured to fail. They start out at an affordable mortgage payment, usually at 6 or 7 or 8 percent, and then they double. Well, who can afford an interest rate of 10 or 11 or 12 percent? They're structured to fail.

But if that's not bad enough, then you have option ARMs—negative amortization mortgages. Well, that means that when you make your payments every month, you owe more. You owe more. That's also a predatory loan.

Thirdly, if that's not bad enough, we have no docs. No verification. Put down anything and you can get a mortgage. Why did the lenders and investment bankers do that? Because they generated billions and billions of dollars in fees. And that's where we are today. So, please, don't say that the subprime lending market provided homeownership for working people or for minority home buyers. It did not.

And we're talking about a crisis out there. It's nice to hear all these things we're nibbling around the edges. We're talking about two, three, and four million people losing their homes. We'll be back here in 6 months, saying that what we said here today didn't even begin to address the issue out there, because it's a crisis. It's a crisis, and it's going to get much, much worse. And I don't think—either people are not being—don't realize it, or they're not being honest out there.

On the ground you see it. There is a solution out there. The solution is not a taxpayer bailout. It's not even some of the things we heard about today. It's about restructuring loans. The lenders created the problem. The brokers also created the problem, but the problem is, you can't find them. They are like roaches; once you step on one, there are about five more. But the lenders are out there, and they created the problem, so they need to fix it.

So what's the answer? Take what people can afford. Take their net income, their required liabilities they have to pay every month, their required expenses, determine what they can afford, and say to the lenders, restructure the loans.

But look what's happening on the ground out there. Look what the lenders are doing. They're saying to people, yes, you've made your payments out there. Yes, we understand you could afford a 6 or 7 percent interest rate. But now we're saying you have to—we won't let you out because of the prepayment penalty. And by the way, you're going to have to pay 10 or 11 or 12 percent. And who can afford it? Massive numbers of people are losing their homes.

I know it might be a little bit controversial to say, and it might get people a little angry, but I'm not sure what else to call that except economic terrorism. Because that's what's going on in this country. Hardworking people—because, remember, we have a reasonably strong economy—are losing their jobs—or not losing their jobs, but they're losing their homes. And these lenders and

servicers and the largest one in the country, Countrywide, well, they're engaged, as are others, in economic terrorism.

And then we hear from Fannie Mae and Freddie Mac, and they want to increase their limits. But they are now the 600 pound gorilla out there. They can determine this market. They can have a tremendous impact on what goes on. So before their limits are increased, they should say we will not buy mortgages from people who are engaged in unfair, deceptive, and maybe economic terrorist tactics until they reform their overall policies, not just for the loans that they buy.

So it's crucial on the ground—you know, the last thing I want to say is, I hear too much about how we're blaming the victims. The analogy is, if a car maker makes a vehicle that goes into overdrive and kills lots and lots of people, what do we do? We say to them, you have to correct your defective product. We don't say to the drivers, you're responsible. You're to blame, and we're going to take everything from you. Well, that's what's going on. The lenders created it, the lenders profited from it, and the lenders have to fix it.

Let me go on and talk a little bit—

The CHAIRMAN. You have another 30 seconds.

Mr. MARKS. I have another 30 seconds? There is a good way—there is a way to do it. NACA provides prime loans to subprime borrowers. We have $10 billion of a mortgage that is no downpayment, no closing costs, no fees, lending to subprime borrowers. The interest rate today is 5.375 percent for a 30-year fixed loan. One product. The performance of our loans is better than anything out there. So this argument that you have to compensate for risk for subprime borrowers by providing them with a mortgage that is unaffordable, it's a self-fulfilling prophecy. If you provide prime loans to subprime borrowers that are affordable, they become prime borrowers.

So we have committed a billion dollars out of that money to refinance people out of their predatory loans. But a billion dollars is a drop in the bucket out there. So what has to happen—and we have over 50,000 people who have responded. We have to do much more. The lenders have to restructure these loans.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Marks can be found on page 173 of the appendix.]

The CHAIRMAN. Next, Mr. Alex Pollock, who is a resident fellow at the American Enterprise Institute.

Mr. Pollock.

STATEMENT OF ALEX J. POLLOCK, RESIDENT FELLOW, AMERICAN ENTERPRISE INSTITUTE

Mr. POLLOCK. Thank you. Mr. Chairman, and members of the committee, what we're dealing with is the deflation of a classic credit-inflated asset bubble. Financial markets and governments have been here many times before. In response, it's sensible to have temporary programs to bridge and partially offset the impact of the bust and to reduce the changes of a housing sector debt deflation.

We can also take long-term steps to fundamentally improve the functioning of the mortgage market. And here, as some of you

know, I have a very simple but I believe very powerful idea, which is to tell borrowers what they really need to know about the mortgage in a clear and straightforward way. I appreciate the supporting comments of Congresswoman Maloney and Ranking Member Bachus and Secretary Paulson for this idea earlier today.

Needless to say, the unsustainable expansion of the subprime mortgage credit activity, but more importantly, the great American house price inflation of the 21st Century are over. Typical estimates of credit losses to lenders and investors are about $100 billion. All these elements of boom and bust display the classic patterns of recurring credit overexpansions and their aftermath, as colorfully discussed by such students of financial cycles as Charles Kindleberger, Walter Bagehot, and Hyman Minsky.

It's important to remember that the boom gets going because people experience financial success. This time we had the greatest house price inflation ever, according to Professor Robert Shiller, who carefully studies these matters. If the price of an asset is always rising, the risk of the loans comes to seem less and less, even as the risk is in fact increasing, and more leverage always seems better.

Now house prices are falling on a national basis, and with excess supply and falling demand, it's not difficult to arrive at a forecast of further significant drops in house prices as well as continued increases in mortgage delinquencies and defaults.

So, what to do? There are two categories of possible responses, as I said. Temporary programs to bridge the bust, and fundamental, long-term improvements. In the bridging-the-bust category, I think looking for an appropriate means of refinancing adjustable rate subprime mortgages is a project definitely worth pursuing.

President Bush, H.R. 1852, numerous Members of Congress and the FHA itself, as Secretary Jackson was saying this morning, have suggested using the FHA as a means to create a refinancing capability for these subprime mortgages, and I think this makes sense, because the FHA is and always has been since its creation in 1934 a subprime lending institution.

While we're pursuing this, though, we also have to consider that the mortgage servicers, who are the ones who actually deal with the borrower, are agents for the bondholders of securitization trusts in most of the cases. Their duty as agents is to maximize the returns of the bondholders of the trust. But I believe that a special program in which the FHA could refinance 97 percent of the current value of the house and the investors would accept a loss on any difference between that and the principal owed, would in fact be an alternative preferable to foreclosure for the investors, as well as obviously so for the borrowers. Chairman Bernanke also expressed this view a few minutes ago.

Regarding Fannie Mae and Freddie Mac, I do not favor an increase in the conforming loan limit and thereby expanding implicit government subsidies to the jumbo market. But perhaps, odd as it may seem coming from someone at AEI, I do favor granting Fannie and Freddie a special authorization for an increased mortgage portfolio.

However, I believe this should be strictly limited to a segregated portfolio devoted solely to refinancing subprime ARMs. In my view,

such a special authorization might be for $100 billion each and include the ability to purchase FHA-insured subprime ARM refinancings. That would give FHA loans both a Ginnie Mae and a Fannie/Freddie outlet for funding, but it needs to be strictly limited to this purpose.

Finally, a market economy based on voluntary exchange requires that the parties understand the contracts they're entering into, and in particular, a good mortgage finance system requires the borrowers understand how the loan will work and how much of their income it will demand. It's utterly clear that the current American mortgage system does not achieve this. A recent striking study by the FTC confirmed this with consumer research. This is a fundamental failure of the American mortgage system.

So what we need to get is informed borrowers so they can better protect themselves. That means information, as others have said. It has to be simply stated and clear in regular-size type, and presented from the perspective of what commitments the borrower is making. That is, the disclosure should focus on the financial impact on the borrower—and this can be done on one page. Mr. Chairman, here it is. I call it Basic Facts About Your Mortgage Loan. I believe a borrower should get this well before closing signed by the lender.

I really appreciate the fact that Ranking Member Bachus and cosponsors have included this proposal in H.R. 3012, that Congressmen Green and McHenry are working on a bill along these lines, and that Senator Schumer announced his intent to introduce a Senate bill with this proposal yesterday. I think this is a completely bipartisan idea, and with whatever else we do, we ought to do that. Thanks again for the opportunity to be here.

[The prepared statement of Mr. Pollock can be found on page 195 of the appendix.]

The CHAIRMAN. The questioning will begin with the gentleman from Massachusetts, Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman. Thank you for holding this hearing. I want to thank the ranking member as well, and I'd like to thank the panelists here for their help in informing the committee and helping us with our work.

I know that most of you on this panel were here for most if not all of the testimony of the previous panel, Mr. Paulson and Mr. Bernanke especially, but I personally got the sense by their remarks—and this was true of the previous hearing, that they are of the opinion that this crisis was either well in hand or actually behind us.

And I think that is in stark contrast to some of the comments I've heard here today. Ms. Liben and Mr. Marks, I think, you've been emphatic in the scale and the scope of this problem. I also think Mr. Bernanke, especially in his remarks, evidenced by his statement that he thought the GSEs in their offer of help, the help ought to be temporary and they ought to do it quick because pretty soon the market is going to take care of this thing and there will be no crisis.

I am not of that opinion. I've read through all of your testimony. Mr. Mudd, I noticed had a very good synopsis of the scale of the problem, and you note correctly that there is about $600 billion in subprime mortgages that will not reset until 2008.

And that will be another impact as well, not only in the subprime market but also in the wider markets. We don't have a compartmentalized economy here, and I think as you've indicated there will be a wider impact.

My feeling is that as far as the GSE's role, they need to get in the game in a bigger way. We set them up in the charters here to do exactly what they need to do right now and provide liquidity.

I have in my hand, you wouldn't know it from the previous testimony, but there is a list of 80 lenders that have closed shop or been acquired or stopped making loans. I have a list of about 120 hedge funds and private equity funds that are in dire straits because of their investments in subprime paper.

I would like to ask you, Mr. Mudd specifically, given that the consent decree which capped your portfolio was built around several requirements and actions you needed to take in order to fix the accounting and control problems that were discovered, can you update this committee as to where you stand on your financial reporting and other remediation efforts and where are we in that process?

I know the chairman called at the beginning of this hearing for the Senate to take up the GSE bill, and I am in full support of that, but I'd like to just get a snapshot of where we are in this process. And Mr. Syron, if you could, elaborate on your side as well.

Mr. MUDD. Sure, absolutely, Congressman. We're registered with the SEC. We completed our restatement, which was redoing the financials from 2001 through 2004. We have subsequently issued our financials for 2005 and 2006. We would expect to have the quarters, the quarterly report 10–Qs out for 2007 and to file the year as with other companies, completing the current year on time this year.

Those are kind of the items that have been checked off. The other way to think about those is it's not just going through the paces. But there is an enormous amount of underlying work that starts with a review of all your accounting policies, rebuilding the systems that support those, rebuilding the team, not only in the accounting department but at various levels of management, changing board procedures, and creating independent reporting.

Indeed, the chairman of our audit committee is the former head of the FASB, to take one example. So there has been really an overhaul from top to bottom that has produced that amount of progress. So I guess my argument would be that while we're anticipating being a current filer, and having all those items solved, we're not there yet, and I understand that's for us to do.

But certainly in this time we've made more than 10 percent improvement in the way that we operate that would justify a 10 percent increase in the cap.

Mr. LYNCH. Okay. Absolutely.

Dr. Syron.

Mr. SYRON. Thank you, Congressman Lynch. Don't call me "doctor" because I don't do colds.

Our situation, I think, is quite similar in a lot of ways to what Dan talked about. I mean we have totally rebuilt our organization in terms of the management of the organization, order of the orga-

nization, our accounting systems, our control systems. This takes a while.

We have made, I think, enormous progress. We have a little ways to go. But we filed this year—no, last year right after the turn of the year, we filed quarters for this year. We'll file another quarter before Thanksgiving. We will file our 2007 10–K on a timely basis.

Shortly after that we will be filing with the SEC, and again I like the construct that Dan used. If you wanted to say there wasn't any cap on these institutions—and I've been open in previous history in saying that I think in some parts we grew too fast, but gee, to have a complete ceiling now, right, while these organizations have made substantial progress and say, well, you have to wait until you get to the total end—I mean these organizations are creatures of the body politic, and they should do what the body politic wants.

The body politic set a capital ratio for the organization. We agreed because of our problems to have a 30 percent cap over that. It's a cap even on top of that.

Mr. LYNCH. Okay. Mr. Chairman, could I have 30 seconds?

The CHAIRMAN. Very quickly.

Mr. LYNCH. All right. I just want to thank—Mr. Mudd, I know you've done some great work with the Mass Housing Finance Agency in my district, as well as Ms. Liben and Mr. Marks, you've done great work in my district putting people, hardworking people, maybe some low-income people but hardworking people into housing that they could afford, and that is much appreciated.

I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman from Texas.

Mr. HENSARLING. Thank you, Mr. Chairman, and again, thank you for holding this hearing on a very important and somewhat vexing challenge that our Nation faces.

I ask myself several questions every time we have a hearing on the subject of the subprime market. Number one, how big is the problem? If we take a snapshot of it today relative to 2002, perhaps it isn't that bad. I'm not sure we have a crisis.

Certainly individuals who lose their jobs and lose their homes have a personal crisis, but my concern is where is it headed, particularly with all the resets scheduled for next year. So we ask ourselves the question, what is it that we do now if we fear larger economic implications for our Nation, and number two, how do we prevent it from happening in the future, and will whatever cure we concoct be better than the illness?

Second, let me ask the gentleman from the GSEs, you're clearly advocating an increase in your loan limits, but I'm still a little unclear on how this is going to help the subprime market.

I'm also under the impression, correct me if I'm wrong, that nothing prevents you from securitizing the subprime loans as we speak. Tell me, why wouldn't we instead be wiser to decrease your loan limits and force a greater focus on the subprime market, Mr. Mudd?

Mr. MUDD. Thank you, Congressman.

Two points. One is with respect to the limits. When Congress first established those limits the idea was—I think at least accepted that prices weren't the same everywhere so there was a higher

limit in Alaska and Hawaii, as it turned out. But if you look now at the prices of homes, the average price of a home in Alabama or Mississippi is in the vicinity of $100,000; in California it's in the vicinity of $800,000.

For a lot of areas in this country, a fairly expensive home actually often turns out to be a starter home. So if that's an issue that Congress wants to pursue, I said we'd be happy to act there.

With respect to the size of the portfolio cap as a general matter—

Mr. HENSARLING. Excuse me. I was just speaking of your loan limits, not your portfolio cap.

Mr. MUDD. That's the principal focus on—and I think the second part of your question was how does that affect the other part of the market.

I guess the only illustration that I would give you is that there seems to be a notion that each of these markets operates as its own contained bucket of liquidity. So there's subprime and Alt-A and prime and jumbo, and it turns out that actually it's a broad pool. There are distinctions between those various products, but an increase in liquidity overall in the market is generally helpful to everybody.

It's true that so far the conventional conforming piece, our piece that we focus on, has held up pretty well. The neighboring sectors of the market have not held up well, and there are those there that would tell you this is worse than—

Mr. HENSARLING. If I could, don't the jumbo tend to be the more profitable for your company?

Mr. MUDD. Well, we don't do jumbos. We don't do jumbos right now, and I would say as—

Mr. HENSARLING. Would they prove to be the most profitable?

Mr. MUDD. And I would say the profitability would generally be comparable to the broad scale of loans that we invest in.

Mr. HENSARLING. Dr. Syron, nothing personal, but in the interest of time, I'm going to move on.

Mr. Pollock, I can't tell you just how much enthusiasm I have for your one-page disclosure form. It is only exceeded by my enthusiasm at Congresswoman Maloney's response, since she is in a far better position to do something about it.

I have always feared that as Congress mandates more disclosure, that eventually too much disclosure becomes no disclosure, so I applaud you for that.

But in the remaining time that I have, I looked at part of your testimony where you speak about how Federal intervention should be temporary, inhibit as little as possible personal choice and long-run innovation and we in Congress should not—careless lenders, investors, speculative borrowers.

Could you speak a little bit about moral hazard as far as what incentives Congress would provide should we choose to bail out the players in the market?

Mr. POLLOCK. First of all, Congressman, thanks very much for your comments on the one-page form.

I think the moral hazard issue is exactly what I was trying to get at in the paragraph which you quote there from my testimony. In the bust where there is a danger of a debt deflation where declining asset prices lead to greater defaults, lead to further declin-

ing asset prices you can do temporary things I think sensibly, and I mentioned a couple of the things I think you might.

But in doing that you don't want to do all the other things I mentioned. You don't want to bail out careless investors, careless lenders, speculators, liars, and you do, above all, want to do things which are temporary.

I have done a study of the history of government-sponsored enterprises.

The CHAIRMAN. We don't have time for the history. If we can get contemporary—

Mr. POLLOCK. Can I summarize the history, Mr. Chairman, in 10 seconds?

The CHAIRMAN. No, if you could answer in the policy term, we are over time.

Mr. POLLOCK. It is this, that government-sponsored enterprises are a deal between the government and an enterprise, which the government should look at again every once in a while. And the notion of a program which focuses Fannie and Freddie more on refinancing a specific asset, subprime adjustable rate troubled loans would in my mind come in the realm of such a temporary deal.

Thank you, Mr. Chairman.

Mr. HENSARLING. My time is up. Thank you.

The CHAIRMAN. The gentleman from North Carolina. We'll do that, then we're going to go through some votes. I would ask the panel to stay.

I certainly plan to come back. I think these may be the final votes of the day. I apologize, but it is—a lot of the staff will be here and members will be here and I do plan to come back and I would hope to ask my questions.

The gentleman from North Carolina.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman.

Mr. Pollock, I'm sure that Mr. Hensarling would be even more surprised that I also agree that the current disclosures are apparently intentionally incomprehensible. They come at closing when it's too late to do anything about it, and usually the borrower signs 10 or 15 pages in 2 or 3 minutes. And so not surprisingly a lot of people don't know what they've signed and what's in their loan.

Where I think we part company is your apparent belief that better disclosure is enough, and is a solution in and of itself.

Mr. Pollock, if someone who has been hurt in a car wreck hires a lawyer and the insurance company tells the lawyer, we'll pay $40,000, but if your client takes $20,000, we'll pay you $10,000, if that's disclosed, if the client signs a piece of paper and says they agree to that, is that okay or is there something wrong with that is not fixed by disclosure?

Mr. POLLOCK. Congressman, thanks for that question. My point was not that disclosure addresses the current situation but that it addresses a really important element of a long-run, very much needed fix in the way our entire mortgage finance system works.

Mr. MILLER OF NORTH CAROLINA. Do you agree with me that the facts that I posed is a betrayal of faith, it is fraudulent, it is morally reprehensible?

Do you agree with me that that is not okay, even if it's—even if the client signs a form and says I agree to this?

Mr. POLLOCK. The point is not to get you out of the commitment or to put you into a bad commitment because you signed the form.

The point is to make sure that you understand what you're doing, and if you choose to take risks, and I think Americans should be able to take risks if they choose to, but they ought to know what risks they're taking.

Mr. MILLER OF NORTH CAROLINA. Fair enough.

A couple of years ago, I think, Mr. Dinham's predecessor testified here and I showed him a rate form, a rate sheet from a mortgage lender that went to brokers. And down one side of the form was a grid. Down one side of the form it showed credit scores and then across the top it showed loan to value or vice versa, and then it showed the interest rate that the borrower qualified for.

But there was a footnote, and at the bottom it said that for every point higher interest that the borrower agreed to pay the broker would get an additional half-point payment from the lender. It's called a yield spread premium.

I asked him about it. He first said that, well, I don't do business with that lender. And I said, well, you do business in this area; does that happen, is that a common practice? And then I got a fairly long non-answer that I took to mean yes, that happens, it's a fairly common practice.

I said if you have a consumer who could have gotten a 7 percent loan on the very same terms but instead gets a 9 percent loan where the broker gets a one percent additional yield spread premium in addition to whatever up-front commission they would have, does that strike you as something the law should allow?

And he said that is part of the agreement between you as a customer and me, that's part of my total compensation, that has been disclosed to you, it would be okay. But if this is a bonus that is outside the plan, if it is not disclosed on a good faith estimate or anything else and I said, so if a consumer signs a piece of paper—at that point the subcommittee chairman Bob Ney, Mr. Ney, interrupted me and told me my time had expired. Do you believe the law should allow that?

Mr. POLLOCK. I believe the law should encourage competitive markets. If you go to one store you can buy tomatoes for $1 and they might be $1.50 someplace else, and it would be the same tomatoes. But if it says on the label $1.50, that's the price you ought to pay, we ought to have markets that make it as efficient as possible for people to understand what they're really getting into and what they're really paying.

The disclosure I recommend focuses less on what the broker gets, although I know that's an issue in many people's minds, than exactly what commitments the borrower is making. I think the most important thing is, borrower, do you understand what commitments you're making and how much of your income it's going to take.

Mr. MILLER OF NORTH CAROLINA. Mr. Pollock, do you think on your one-page form instead of showing what the interest rate is and may become it should also show what you qualified for based upon how well you've paid your bills over your lifetime? Do you think that's something that's not on your form that should be?

Mr. POLLOCK. That would be something we could talk about, Congressman. I'd have to think about that.

The CHAIRMAN. The gentleman's time has again expired and we do have to go on.

I will, Mr. Pollock, when I come back, ask you to expand on the analogy.

Mr. MARKS. Can I respond to one point on the yield spread premiums?

The CHAIRMAN. Very quickly.

Mr. MARKS. You hit on an absolutely crucial point. The fact is, because the yield spread premium should be prevented, it should be outlawed, because the fact is what they're doing is brokers are incentivized to lie to the customer, to lie to the borrower to say they know what the par rate is. But in order for them to get paid they have to convince the borrower that they can only afford a much higher interest rate.

You're setting brokers up to steal and to lie to borrowers because that's the only way that they get the significant compensation out there.

The CHAIRMAN. All right. We will now have to break for votes. It may be as long as 45 minutes, but I hope that people will stay.

I do want to come back, and particularly I want to hear more about the analogy between buying a house through a broker and buying tomatoes because it did not appear to me to be immediately obvious.

Mr. POLLOCK. A used car might be better, Mr. Chairman.

Mr. ROBBINS. Can I provide also another point with that argument when you return?

The CHAIRMAN. We'll go back to your tomatoes—yes, when we come back you may.

Mr. ROBBINS. Thank you.

[Recess]

The CHAIRMAN. We had a pleasant surprise when we finished earlier. I did not want to have you waiting in case it went as long as it usually does. I think a motion that would have taken half-an-hour was ruled out of order.

Not everybody is back, but I think in the interest of time, we will begin. Mr. Campbell indicates he is ready to go. The gentleman from California is recognized for 5 minutes.

Mr. CAMPBELL. Thank you, Mr. Chairman. My first two questions are for Mr. Mudd and Dr. Syron.

My biggest concern in this whole thing is not about what I can see, it is about what I cannot see. Do you have recourse? These questions are for either of you. Recourse with any originators?

Mr. MUDD. Yes. We will on occasion have a recourse arrangement with a lender.

Mr. CAMPBELL. Dr. Syron?

Mr. SYRON. We often have recourse arrangements.

Mr. CAMPBELL. Does that recourse exist with any originators that are no longer around?

Mr. SYRON. No. In the sense that we had an originator who is no longer around and we had to go in and be sure that we got files and all those kinds of things, we came out of it fine, but your point is valid, that we have to monitor not just them but all

counterparties and be sure we are in a secure position, particularly in this period, obviously.

Mr. MUDD. Same answer, no. We have used recourse in very limited circumstances when the value of the recourse would be higher than the value of another credit guarantee product that would be available out there. That means that it is subject to a very high rating. As you know, none of those folks are off the radar screen.

Mr. CAMPBELL. In your delinquencies, I know what your overall delinquencies are, what about your delinquencies amongst loans made recently, in the last 12 months, this year, anything like that. Is that higher than your overall portfolio delinquencies?

Mr. MUDD. We have said this publicly and continue to believe it to be true. The general level of delinquencies on the book are going up, given what we do and given that we are an insurer and a guarantor for mortgages, our insurance would not be much if the cost did not go up when our customers were having difficulties.

Whereas they have been in the range of one to two basis points, one to two one hundredths of a point, we expect them to go up to about 4 to 6 basis points, which is about in line with historical levels, but not as high as the 12 to 13 basis point level that you would see associated with like the oil patch, that type of thing.

Mr. SYRON. Long term, we have priced for a 4 basis point problem. As Dan said, we were down to well below one basis point for a while. I have seen it move up. It is still in the four range down to the two to three range, but we expect it will come up in the neighborhood we are talking about.

Mr. CAMPBELL. What percentage of the portfolios that you guarantee, have, hold, mortgage based securities, whatever, are ARMs? Are adjustable? Are going to have resets?

Mr. MUDD. Our range of ARMs tends to run in the 20-ish percent range, mid to high 20 percent range. The question, it seems to me, goes to what condition are those loans in when they reset, and the broad majority of those loans are prime, conventional, well underwritten with some home price appreciation behind them.

The ones that worry us the most really was those loans that were originated for the market in general in 2006, and a microcosm of that would also apply to us, parallel to the answer I gave you a moment ago.

Those resets, Congressman, will peak kind of between March and September of next year, but remain at a fairly high level throughout.

Mr. SYRON. We have about the same thing. We have about 18 percent in adjustable rates. We do not guarantee any 2/28s or 3/27s. We have the same expectation as everyone's expectation as you look across the curve on resets.

We are not out of the woods by a very long shot.

Mr. CAMPBELL. My final question, different area, but for both of you, and anybody can comment if they want.

You mentioned earlier, Mr. Mudd, I think you were the one that mentioned the average home price in Mississippi was $100,000, and the average home price in California. I am in Orange County, California, one of those areas where the average home price in my district is near a million. In the county, 3.4 million people, it is close to $800,000 now.

How do we change the jumbo rates so that you are not financing the most expensive house in Mississippi while still basically in my area of California, you cannot do a conforming loan, you cannot do an 80 percent loan to value conforming loan on the average house?

Mr. MUDD. As I understand it, one of the solutions that has been proposed is to identify the high-cost States and make the loan limit in those States a multiplier off of the otherwise national conventional conforming limit.

As I suggested earlier, that was done by statute in the beginning with Alaska, Hawaii, and Guam. I was not around. I do not know why. It is clear where some of those high-cost States are not. That formula could be provided.

The one caveat or proviso I would make is that our HUD housing goals are denominator based, and a change in that base would move the denominator and change the math on the housing goals significantly.

I would just remind Congress that would need to be addressed in the process as well, Congressman.

Mr. SYRON. Dan has raised a very important point. If we were to make—in California, the average house price, I think, is 8 times the per capita income nationally, it is about 3½ times, so it is clearly a very different situation.

Just because you make more loans in the denominator, does not mean that you are making any less effort in the numerator. The percentage would change. We really ought to be concerned about the number of folks that you are helping in the numerator, put into these houses.

I think it is an incorrect notion to think that if you raise in high cost areas the jumbo loan limit, that it takes you away from your mission.

The CHAIRMAN. Will the gentleman yield? My understanding of our bill is we do this by metropolitan area, not just by the whole State. We do a cost analysis based on the MSA, which we think is the rational way to do it, so the loan limit varies with the median house price.

Fortunately, the Census Bureau already does that. Nobody has to do anything new. We already have median house prices by metropolitan area.

Mr. CAMPBELL. Particularly in California where there are several distinct markets that have very different averages.

Thank you.

The CHAIRMAN. The gentleman from Georgia.

Mr. SCOTT. Thank you very much, Mr. Chairman.

I would like to go on a little different track here, and to pick a favorite phrase from the President. Perhaps we need to focus on how we can do some creative preemptive strikes. If we do not do some things to detect this before it happens, it repeats itself, and we learn nothing from this.

If we know that at the heart of this problem is how to detect abusive lending practices for loans that are made to people with weak and bad credit, that is essentially it, which falls into subprime lending.

In each of the testimonies this morning from Treasury Secretary Paulson, Housing Secretary Jackson, and Fed Chairman Bernanke,

they each referenced—I think one said a lack of information. Another said not aware. Another said a lack of knowledge.

Somewhere along the line, each one hit the same chord that what we have here, to paraphrase another great saying, is a failure to communicate with our most basic group, those people who are targeted are targeted in the low-priced homes and the low-income communities, where their sophistication, education is not as it ought to be.

We know that. Where are we going to get the energy and the urgency to put together some very creative financial literacy and financial education packages, and in addition to that, a way to preempt some of the predatory lending practices that is causing this?

My idea is, and I throw this out, and what I am trying to do is get your reaction to this, I have been sort of preaching it for a while, it is not just going to be financial literacy programs, but to establish an 1–800 number here, set up a machinery, really out of the Treasury Department, with human beings on the other end.

Then not only as a conduit for information on a two way street, but we get marketing programs out, get them to NAACP, get them to ACORN, get them to the senior citizen groups, the preachers and the churches, the people who relate to these people, with the universal message, before you sign on the dotted line, call this number. Even more importantly, why not go a step further and require by law a background check?

We have the technology. We are very sophisticated. Most assuredly, if we can do background checks and instant background checks at that on the purchase of firearms, to make sure the people are not mentally incompetent or they are the proper age or have a criminal background, why cannot we begin to look at that this way and say for those subprime loans, particularly those where the individual has bad credit, we can come up with a formula. We can come up with something.

Before that can go through, it has to have that instant check, that background check. Some way we can be preemptive and look at this.

What it will do more than anything else is it will send a message out to those who practice these predatory lending practices to say I better not do this because these kinds of loans with these kinds of communities, they are going to be doing a background check, or there is a way for them.

Have the communications pointed out, obviously, before they sign on a dotted line, before they do anything, that they call, but also have it where we have the system in place that we can do some sort of checks on that, in addition to all the other financial literacy points.

I would love to get your response to this, do you think it is a great idea. Is it something we can—

The CHAIRMAN. Very quickly, the gentleman is almost out of time.

Mr. SYRON. Just very quickly, I think you need to do two things. I think you have to enhance financial literacy for a whole lot of reasons beyond housing, but that alone, I am afraid I disagree with some people that just the price of tomatoes thing does not necessarily work.

Mr. SCOTT. I do not mean alone.

Mr. SYRON. Disclosure alone will not do it. The plain fact of the matter that we have found is if you originate it, someone will buy it. I think what the mortgage brokers have talked about, about registering people and getting some mechanism to assure, even if people have been educated, they do not get into a bad loan, that is essential.

The CHAIRMAN. We will take one other response, if there is one, but then we have to move on.

Mr. Robbins?

Mr. ROBBINS. This is what the licensing is all about, background checks. We propose that if you have been convicted of a felony, that you cannot get a license to originate mortgages, and that a national registry be kept so that you can track the bad players in the industry from State to State and city to city, company to company.

You would have your background check. They would be fingerprinted. It would require the passage of tests, educational responsibility, and that subsequently, if they were convicted of a crime related to this, they would lose their license.

Mr. SCOTT. Thank you.

The CHAIRMAN. The gentlewoman from West Virginia, who is now the ranking member of the Housing Subcommittee.

Ms. CAPITO. Thank you, Mr. Chairman. I look forward to serving in that new capacity. I am excited to work with Chairwoman Waters and with the chairman of the full committee.

I wanted to just say to my colleague that there is an 1–800 number. I found it in my notes. It's a national hotline, 1–888–005–HOPE, which is run by the Home Ownership Preservation Foundation, in partnership with Neighbor Works, along the lines of what the gentleman was referring to.

I guess getting the word out is the important thing there.

I have been sitting here listening pretty much all day. I was thinking about what Secretary Paulson said about telling borrowers when they feel they are in trouble that they should get with their lender, do not pull away but try to get with the lender to find out if they can have some help.

I know that is a push nationally, communication. That was actually said the other day on the radio in a local talk radio scenario. I started thinking to myself about that person who is drowning in debt probably, it is not just the home they own that they are having trouble making payments, it is their credit card, it is their insurance, it is their water bill.

If you have to prioritize what you are going to pay first, you are probably going to pay your home first, hopefully after you pay your taxes maybe.

It is very, very difficult for people. It almost goes against the grain because you are getting dunned by all these other credit organizations to say the best way you can help yourself is to call your lender and find out where you can get help.

I think we really need to get that message out. I am not sure how we can do it. The other question I have is, in this day and age, who really is your lender? It used to be you walked down the street, you knew your neighborhood banker, because you owned the local grocery store or whatever, and you knew who they were. Now,

I am not. It is an 1–800 number in a lot of cases you have to call. There is no personalization.

That, I think, makes it more difficult when you begin to drown in debt, for you to be able to pick up the phone and call an unknown person to say I need help, help me.

I think we have to be really creative with the way that we promote this right now. I would like to know if anybody knows of any national scenarios where lenders really are going out to the people that are starting to fail, and instead of dunning them or aggressively trying to recover, trying to lend a hand to them.

Mr. ROBBINS. Yes. Let me respond to that. Being chairman of the Mortgage Bankers Association, I have had the opportunity to talk to the major servicers within our organization, which probably cover the vast majority of loans serviced in this country.

I would tell you that all of them have put programs into place, including early intervention, where, if their security allows, they will contact borrowers up to 90/120 days ahead of time, before their loan recasts, and start to talk to them about whether the borrower expects to have a problem, whether the loan reset going to be a problem.

Not all securities permit that early intervention, but we just recently got a ruling from the SEC that reinforces that we can do that.

The industry is utilizing that technique, remembering that the vast majority of borrowers do not respond. We have a very hard time getting borrowers to respond to our inquiries.

We have gone and hired and are using counseling services, consumer organizations, to intervene in our behalf and help us do that ahead of time.

As you well know, the industry loses $40,000 to $50,000 for every mortgage that goes into foreclosure, money that just walks about the door. We are highly motivated to try to help that borrower be successful over a long period of time.

Mr. MARKS. Can I please respond?

Ms. CAPITO. Yes.

Mr. MARKS. Now let's talk about the reality. That is nice in theory. That is not what is going on. Let's take two examples.

To a certain extent, they are restructuring, and it is really crucial that we understand what it is. That means the lenders have to restructure the loan, reduce the interest rate or reduce the outstanding principal. There are few that are doing that. HSBC is doing that on a limited scale.

On the other hand, you have Countrywide who says that they have assisted 35,000 people. Now they say of that, half of those people they have assisted by deed in lieu of foreclosure or short sale. They pushed them out of their homes.

Now what Mozilo has said yesterday was his answer is to hire more people in India to foreclose on American homeowners.

Those are nice theories but the reality is it is not getting done and it is clear why people do not call the lender, because the lender, all they want is more money on a loan that is unaffordable.

The CHAIRMAN. Mr. Robbins, did you want to respond?

Mr. ROBBINS. Yes. Thank you. They are a great deal more than theory. No bank or organization, including Countrywide, that

wants to own a home, take it back in a foreclosure, try to refurbish it, put it back on the market and re-sell it.

Mr. MARKS. Well—

The CHAIRMAN. Mr. Marks, please.

Mr. MARKS. Sorry.

Mr. ROBBINS. To the best of their ability, if they are able to do it within the terms of the structured security in which the loan is embedded, they will use early intervention programs. They will use all of the techniques that are at their disposal. Short sales are certainly one of those techniques. A deed in lieu is certainly one, but so is forbearance, which is being used to a major extent in the loans today. So are loan modifications where the loan is recast either in term or in interest rate or a combination of both.

There are a number of tools that mortgage bankers, mortgage servicers, are motivated to use. The last thing in the world that we want is for that loan to go into foreclosure.

The CHAIRMAN. The gentleman from Texas.

Mr. GREEN. Thank you, Mr. Chairman. I think that I can say that America thanks you for this hearing because all of America is concerned about what is happening in the subprime market and in the housing market in general.

I would like to also thank Mr. Perlmutter for staying so I am not last.

[Laughter]

Mr. GREEN. To my friends who represent the GSEs, one of the problems that we have, of course, is qualifying for a teaser rate and not qualifying for the adjusted rate.

Do you have in your portfolio these types of instruments?

Mr. SYRON. Earlier this year in February, we said that either in portfolio or in loans that we buy in securities that we might hold, that we would not have loans that were not done at the fully amortized rate.

I think we have some legacy loans that have been done in that, and that became effective given the market a chance to adapt by September 13th.

Mr. GREEN. As of September 13th, you are no longer doing it?

Mr. SYRON. That is right.

Mr. MUDD. Same answer, Congressman. We are fully in compliance with all the interagency regulatory guidance, both on subprime and non-traditional that speaks to this.

Even before that, we had a set of policies that we adhered to internally when the market had none with respect to prepayment, credit life insurance, origination processes and so forth. We adhered to those.

Also, we did our best with the voice that we had to sound the concerns that when all of the chickens came home to roost on the various features in these loans, the consumer would be facing a vastly different deal than they thought they had.

Mr. GREEN. In trying to find a cure, if you will, for this, having a teaser rate and an adjusted rate that you do not qualify for, how does one do this? How can you possibly qualify the person for the adjusted rate when you do not really know what it is at the time the teaser rate is accorded to the borrower?

Mr. MUDD. Typically, what is done is the underwriting is done to the first adjustment level or to an average adjustment level over a period of time and not just to the teaser rate itself. It happens at origination.

I think with this interagency guidance that came through, there seems to be a high degree of compliance with that, Congressman.

Mr. GREEN. Mr. Marks, quickly, can you tell me, please, the source of the billion dollars that you have at 5.375, no down payment, no fees?

Mr. MARKS. Yes. Actually, it is $10 billion. It is with Citigroup and Bank of America. We have one product and we counsel people to that one product, and our buyers and the people that we refinance would be considered subprime borrowers.

Mr. GREEN. Thank you. The renters, I am concerned about them. I was at one time fortunate enough to be the judge of a court that had exclusive jurisdiction over forcible detainers, forcible entry and detainers, and we commonly called them eviction lawsuits.

Tell me what is your proposal such that we can embrace this on a national scale as opposed on a State-by-State basis? I am aware that in Texas, we have some notice requirements once there is a foreclosure. I also am aware that this varies from State to State.

How would you have us embrace it? Do you have some language that perhaps you may not be able to share now, but you can share with me later, or if you can generally tell me, I would be most appreciative.

Ms. LIBEN. I can share some broad ideas, if that would be helpful. First of all, you are right. Foreclosure and eviction of residents on foreclosed property is a matter of State law. It changes from State to State. There are a few States that do a terrific job on this, and in fact, do not allow eviction post foreclosure unless there is another grounds for the eviction.

Lawyers and housing advocates and homeless advocates have started on their State level first. When they get their head above helping the individuals, they look to their State legislatures and they say could we not have more protective laws.

Some States are starting to do this. In our own State, we are making progress on a law that says foreclosure does not automatically terminate a tenancy, but even those are somewhat modest steps.

No one has taken a hard look yet at what could be done on the Federal level, but we have a few ideas.

First of all, just on the issue of Section 8 tenants, that we should involve HUD and people who know what is going on and saying let's take a look at this and see what we can do to assist Section 8 tenants and make sure our Section 8 money is not going to landlords who are now applying that money toward their building and toward their mortgages.

That is some work with HUD.

I think the second thing is within the jurisdiction of this committee or other agencies, to take some appropriate steps to discourage or to penalize lenders from evicting tenants per se, just as a result of the foreclosure, or at least penalize for evicting them very quickly and certainly in violation of State law. The process needs to slow down.

Third, if there was a way to think about creating incentives for lenders to maintain or redevelop their rental properties, especially as affordable housing, as always in these moments, you may have an opportunity.

Mr. GREEN. I am going to have to thank you. My time is up. Thank you, Mr. Chairman.

The CHAIRMAN. We have been talking with staff. In fact, this came to my attention when we did a hearing in Minneapolis for Mr. Ellison, and we learned of it and we have been talking about it since.

We intend, as I said to Secretary Jackson, to follow up. There is no one direct thing we can do at the Federal level, but we are going to be sending a letter to the State banking regulators and HUD and the banking regulators and the largest services and the ABA, and everybody we can think of, to call their attention to this.

I know the gentleman is interested in this. We will put together a taskforce and do whatever we can. To the extent there is something we can do legislatively to go forward, we will. It will be a high priority for us.

The gentleman from Colorado.

Mr. PERLMUTTER. Thank you, Mr. Chairman. Mr. Green, I wish you were last and not me.

The CHAIRMAN. I am last.

Mr. PERLMUTTER. Good.

[Laughter]

Mr. PERLMUTTER. Just a couple of comments and then some questions. To our friends from the GSEs, there is an irony here that about this time last year or even in the Spring, you were being villainized and now you are knights in shining armor. I hope the confidence that folks have expressed in terms of expanding kind of your portfolio and your limits, that we continue to move forward with that.

I am definitely in that camp. I just see that your ability to help this housing crunch and this credit crunch is one that my opinion is essential.

There was a comment, Ms. Liben, about all of a sudden, the renters are out, and they really had no notice. It struck me, too, that with respect to Mr. Robbins, the members of his organization, there are thousands of guys who were in the mortgage business that were given a pink slip on Monday and told that, "You are out of here on Friday."

There is, Mr. Marks, a consequence to all this money that came into the market, and people trying to find market share and put out loans without documentation, one percent interest rates or no percent interest rates, to take market share.

This is sort of where I want to go with these questions. I think there are two big macro-economic trends going on here. One is there was a ton of money coming in from overseas, from somewhere, from China, from Saudi Arabia, repatriating a lot of money that we have had.

Brokers were trying to put that money out without any underwriting. Now we are back to a more normal situation.

Those investors, China, whomever it might have been, they lost a lot of money in this deal. The investors lost a lot of money.

In the last 3 months, according to a recent story in the Denver Post, they really shut down providing credit to this country.

In Colorado, we were sort of the first into the foreclosure crisis. We were hoping we would be one of the first out. We were starting to climb out and then August hit, and it was like we went off a cliff again—no new home sales and very few re-sells.

This gets to Mr. Pollock and the fact that there is some kind of a cycle going on here where we are in a deflationary period. Everybody was betting on housing prices going up. When they stopped going up, all of a sudden your teaser rates, your one percent, your no documents, you are in trouble.

I do not know precisely what any of you think the cause is of all of a sudden there is deflation or a stagnant housing market, but that is the question I would like to ask, and just for fun, I will throw in one other point.

Maybe all these anti-immigration laws that we are passing have a real effect and all of a sudden we have taken two or three million people out of the marketplace and the housing market collapses.

Mr. MARKS. Can I respond? You are absolutely right on. Look how this was created. When you have lenders, investors and bankers saying we want to package a product, and what is the safest investment in the world, up until a year ago? It was American real estate. That was the best product out there, even more secure and safe than oil.

How do we get investors to a product that is based on American real estate. Let's have mortgage products that are going to get higher rates of return than you can get in the conventional market.

They went out and they marketed it. They got a huge demand, greater than they could ever imagine, so the product of these mortgages became more and more riskier because they had to meet the demand out there from investors around the world.

Finally, the product became so risky, it was the no verification documents, and those went bad immediately.

It was all premised on, based on the safest supposed investment and product in the world, American real estate. Now, they know better.

The last thing I would add to that is I have been at a lot of interviews with the foreign press. They are panicked out there. One of the things that they are really concerned about is they do not trust the rating agencies any more.

In a sense, the subprime market is shut down and it will not come back for many, many years, because investors do not trust what American rating agencies and what American investors and players in the market believe.

That is going to impact a lot of things in this country for years to come.

Mr. MUDD. I think your analysis is astute, that as home prices grow, they did grow at an unsustainable level, that led to growth in the market. That led to a lot of people chasing market share. You can only do that with either credit or price. Credit went down. Then this trouble manifested itself in the form of a liquidity crisis, which you have seen play out over the course of the past 2 or 3 months.

That was the last problem. Therefore, the first solution needs to go back to this liquidity problem. I would just mention there has been discussion about why do the agencies not just guarantee and securitize all this business.

I would remind the committee that all that process does is it creates a security. That security remains on the balance sheet of the institution that originated it. It has to be sold somewhere to make room for new loans. That is where the liquidity is needed. We are one of the folks that can actually provide that liquidity as a first step of moving through this trouble.

Mr. PERLMUTTER. Thank you.

Mr. POLLOCK. Congressman, you are very right on the cycle. I would add that financial panics are always unexpected, because if they were expected, they would have happened already.

The CHAIRMAN. Mr. Mudd, I am going to begin with where you left off. I was puzzled by Mr. Bernanke and Treasury saying well, yes, we want Fannie and Freddie to do more, but they can securitize it, it does not have to go in the portfolio. My answer was particularly with some of the stuff we want them to buy, the secondary market is not the market for tomatoes right now, even ripe ones.

Their answer was to some extent they could guarantee it, but then my question is is there any conceivable difference in terms of safety and soundness risk to something that you have guaranteed, to something that is in your portfolio? Is there any difference?

Mr. MUDD. Actually, those loans that we guarantee have a lower level of capital against them than the loans that we hold—

The CHAIRMAN. From a safety and soundness standpoint, they would be more shaky if there was any shakiness?

Mr. MUDD. One could make that argument and then the further argument down the line that those loans that are on our books give us the flexibility to implement some of the processes—

The CHAIRMAN. If you have guaranteed it, I do not understand how—

Mr. MUDD. Again, Mr. Chairman, the guarantee process only creates—

The CHAIRMAN. I understand that. You made that point already. I am on a different one now, which is they were arguing that you do not need an increase in the portfolio because you can securitize it as long as you guarantee, and I am saying from the safety and soundness argument, that does not make sense.

Secondly, on the jumbo's, and it does seem to me, I and others would like you to get more into subprime and do some riskier stuff. If the charter is a problem, we will change it. We do not want to do it in a way that makes it negative.

Let me put it this way. It is true for the FHA. When the FHA insures for higher loans, it makes money for the Federal Government. We are using that frankly to offset the higher loan loss rate we will get in subprime.

One of the differences in our bill and the Administration's is we both say let's guarantee the mortgages for people in subprime. They say but we will charge those people more, even if they are making their payments, because they are in a higher risk class. We say no. The woman who is making $43,000 and making her pay-

ments should not pay more. She should not subsidize the other person. We will take the money they get in the jumbo's and do it. In fact, this can help us if we do it right.

Similarly, for you. In terms of your safety and soundness, etc., if you start doing loans at $500,000 and $600,000 or $450,000, is that going to make you less safe?

Mr. MUDD. No. I think we would continue to adhere to all the risk disciplines we have put in place. We would continue to follow all the underwriting that we have followed.

The CHAIRMAN. Does that in any way—

Mr. MUDD. It helps us, Congressman, because you are managing a portfolio with a diversification—

The CHAIRMAN. Credit diversity. I absolutely agree.

It seems to me inconsistent to say no, we do not want them to do the more risky sub's because of safety and soundness, and then refuse also to let you do the more profitable stuff.

In fact, what we ought to do is a balance and leave to you how to work it out. That is our goal.

Just to be clear, if anything, if we do this right, the increase in the jumbo would enhance your ability to help at the lower end rather than cut it off. I know that is true of the FHA. CBO told me so.

Mr. SYRON. Just to add to the point, what you say is absolutely true. You have heard a lot from our regulators and from the Administration about a risk of the GSEs being not diversified enough.

To say you should only do subprime loans is the ultimate in lack of diversity.

The CHAIRMAN. I think it enhances it. I would also add, they say there is an implicit guarantee. I was around for the S&L crisis. We paid off depositors. When we talk about a Federal guarantee, it is of depositors.

Do either of you have depositors that I do not know about?

Mr. SYRON. No. We do not have depositors but I think an awful lot of people, and I think that is where there is some lack of consistency here, would have extreme doubts about if the two or three largest banks in the United States were to fail—

The CHAIRMAN. That may be, but the fact is in the previous crisis, we did not on the whole bail out stockholders or bond holders.

Mr. Marks, I was reading what you said about Countrywide. You mentioned Bank of America. Bank of America didn't buy it. They did buy a big chunk of it and provided them some money. I know you have had a very constructive relationship with the Bank of America.

I remember when they bought Fleet, you certified the good work they had done.

Have you approached them? They are a big owner of Countrywide. Given your objections to Countrywide, have you asked the Bank of America to try to be an influence here or did you object when they put the money in?

Mr. MARKS. We found out when you found out that they had put all that money in.

The CHAIRMAN. I found out Sunday night. Maybe you found out Monday morning.

Mr. MARKS. You found out before I did.

The CHAIRMAN. Have you urged them because you have this good relationship with them, to be a constructive force in trying to get some of these things done that you want?

Mr. MARKS. We have requested a meeting with Ken Lewis, the CEO of Bank of America.

The CHAIRMAN. This was a couple of months ago. Have you met with him?

Mr. MARKS. No, we have not heard back from them. We certainly believe you are absolutely right, Bank of America, and while they have not disclosed who are the other investors in Countrywide in the last $12 billion that has been provided to them, we think all the investors in Countrywide have a responsibility.

The CHAIRMAN. You said you have a good relationship with Bank of America. You have been very helpful to them. You have had a mutually beneficial relationship, not to your individual benefit, but for the people you help. That has been very constructive.

It does seem to me you are in a good position to talk to them about it.

Mr. MARKS. Absolutely. We have requested that. We do believe—

The CHAIRMAN. On the evening when I was notified that Bank of America was buying part of Countryside, I said I know you are very proud of your record, BOA, it seems to me incumbent upon you, now that you are a major owner of Countrywide, to have a similar role.

Mr. MARKS. Bank of America is the only major financial institution in the country that does not have a subprime lending entity.

The CHAIRMAN. Mr. Marks, they now have 20 percent of one. It is called Countrywide. I do not think that cuts it, and frankly, for your relationship with them.

Mr. MARKS. Ken Lewis, we have met with him when they had divested Nation's Credit.

The CHAIRMAN. As harsh as you are about Countrywide, you have a friend and you have somebody you do not like. I think it is incumbent upon you to be helpful. I do think Countrywide did take some exception to what you said. They will be making a submission for the record. You are free to add further to the record.

[Countrywide's submission for the record can be found on page 202 of the appendix.]

The CHAIRMAN. I just want to close by saying I think the elements are here. I think one clear message is we need the lenders to understand that foreclosure is bad for everybody, it is bad for the whole society, and they need to be willing to allow people to restructure.

We will be working, and I am glad to see what Senator Dodd has said, I hope within a month or 6 weeks, we will have an FHA that is fully able to insure the mortgages of people who are subprime. We will have Fannie Mae and Freddie Mac able to buy more of those refinanced mortgages.

It is certainly the case with financial institutions, we cannot order anybody to abrogate a contract, but we can say institutions that will be from time to time coming before this committee and asking us to do things that are in their interest will have more chance of a yes if they have done this.

We cannot legally compel them to do things. On the other hand, they cannot legally compel us to do other things that they would like.

I would just urge them to remember the absolutely most important principle of legislating—"The ankle bone is connected to the shoulder bone."

The hearing is adjourned.

[Whereupon, at 3:09 p.m., the hearing was adjourned.]

A P P E N D I X

September 20, 2007

FOR IMMEDIATE RELEASE:
September 20, 2007

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Prepared Remarks of Congresswoman Maloney

Full Financial Services Committee Hearing:

The Legislative and Regulatory Options for Minimizing and Mitigating Mortgage Foreclosures

Thank you Mr. Chairman.

I would like to welcome the witnesses and thank them for their testimony.

We are at a critical juncture with respect to the subprime mortgage crisis. Yesterday, RealtyTrac released the latest bad news that foreclosures reported in August increased 36 percent since July and 115 percent since this time last year. Expectations are that the next 18 months will be even worse, as many subprime loans reset to higher rates.

Anxiety over the state of the economy remains high, as concerns mount that the subprime mortgage meltdown will infect the rest of the economy. The Fed's action to lower its key short-term interest rate is an effort to prevent the economy from derailing and ease credit pressures, but it is no silver bullet.

This Committee is working hard to help borrowers stay in their homes. This week, the House passed legislation to enable the FHA to serve more subprime borrowers at affordable rates and terms, and offer refinancing to homeowners struggling to meet their mortgage payments. To make servicers more able to engage in workouts with strapped borrowers, we pushed FASB to clarify that its Standard 140 allows for modification of a loan when default is reasonably foreseeable, not just after default.

But there is much more that we can and should do to help borrowers now.

Fannie Mae and Freddie Mac are providing much needed liquidity in the prime market right now. We should also raise the cap on these entities' portfolio limits, at least temporarily, and direct all of those funds to help borrowers who are stuck in risky adjustable rate mortgages refinance into safer mortgages.

We should eliminate the cruel anomaly under Chapter 13 of the Bankruptcy Code which allows judges to modify mortgages on a borrower's vacation home or investment property, but not the home they actually live in. This allows families to stay in their home while new loan terms are worked out.

I think we should also eliminate the tax on debt forgiveness, sparing families the double-whammy of paying taxes on the lost value of their homes.

Reforms to contain this crisis and for the future are also critical.

Our regulatory system is in serious need of renovation to catch up to the financial innovation that has surpassed our ability to protect consumers and hold institutions accountable.

Even though the federal banking regulators have put out interagency guidance on subprime loans to improve standards, some three-quarters of the subprime market do not have a federal regulator. We need to extend the

guidance to create a uniform national standard to fight predatory lending and a single consumer protection standard for the entire mortgage market.

We should create, along the lines of advocated by Harvard Law Professor Elizabeth Warren, a Financial Product Safety Commission, patterned after the Consumer Product Safety Commission, to deter unscrupulous lending practices.

Mortgage contracts are virtually incomprehensible. A simple one-page form could provide the basic facts about mortgage loans to borrowers.

These are some steps and I hope our witnesses will have other specific proposals and recommendations. I look forward to the testimony.

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Congressman Ron Paul
Statement for the Record
Financial Services Committee
Full Committee Hearing
20 September 2007

Mr. Chairman, the situation facing us now in the mortgage industry has its roots in the Federal Reserve's inflationary monetary policy. Without addressing the roots of the current crisis, any measures undertaken to improve the situation will be doomed to fail.

As with asset bubbles and investment manias in past history, the fuel for the current housing bubble had its origins in monetary manipulation. The housing boom was caused by the Federal Reserve's policy resulting in artificially low interest rates. Consumers, misled by low interest rates, were looking to consume, while homebuilders saw the low interest rates as a signal to build, and build they did.

One of the primary means the Federal Reserve uses to stimulate the economy is manipulation of the federal funds rate and the discount rates, which are used as benchmark rates throughout the economy. The interest rate is the price of time, as the value of a dollar today and the value of a dollar one year from now are not the same. Just like any price in the market, interest rates have an important informational signaling purpose. Government price fixing of the interest rate has the same deleterious effects as price controls in other areas.

Reduction in the interest rate has two major effects: it encourages consumption over saving; and it makes long-term, capital-intensive projects cheaper to undertake. Under Chairman Greenspan's tenure, the federal funds rate was so low that the real interest rate (that is the nominal interest rate minus inflation) was negative. With a negative real interest rate, someone who saves money will literally lose the value of that money.

The Federal Reserve continued and still continues to increase the money supply. After ceasing the publication of M3 last February, private economists have calculated that M3 has risen at an annual rate of almost 12%, which is faster than we have seen since the 1970's.

Millions of Americans now find themselves stuck in a financial quandary that is not their fault. The result of manipulation of the interest rate, money supply, and mortgage markets are the recently popped housing bubble.

Further regulation of the banking sector, of mortgage brokers, mortgage lenders, or credit rating agencies will fail to improve the current situation, and will do nothing to prevent future real estate bubbles. Any proposed solutions which fail to take into account the economic intervention that laid the ground for the bubble are merely window dressing, and will not ease the suffering of millions of American homeowners. I urge my colleagues to strike at the root of the problem and address the Federal Reserve's inflationary monetary policy.

COMMITTEE ON SMALL BUSINESS
CHAIRWOMAN

COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

Congress of the United States
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Statement of Rep. Nydia M. Velázquez
Financial Services Committee
Hearing on:
"Legislative and Regulatory Options for Minimizing and Mitigating Mortgage Foreclosures."
September 20, 2007

Thank you Mr. Chairman. I appreciate you holding this hearing today and continuing to pursue the important question of how to best minimize and mitigate mortgage foreclosures across our nation.

As we all know, increasing homeownership is one of the most laudable goals a community and, indeed, a nation, can pursue. It opens up the doors of opportunity to families in all of our neighborhoods and ensures that generations have the security they need to build successful lives.

Foreclosure is a threat to this pursuit, forcing families into a corner because of their inability to pay their mortgage, oftentimes breaking them apart and crushing their dreams for economic stability and success. Moreover, if large numbers of families are only achieving homeownership for short periods of time, before going into foreclosure, our policies are misguided. We must work to ensure that families have the ability to not only enter the ranks of the homeowners, but to remain there.

We have seen an increasing number of subprime mortgages enter serious delinquency status. This has raised questions about the subprime market's underwriting standards and its ability to thrive under a stricter environment. However, acquiring a home through the use of subprime loans offers many families a great opportunity -- one that they may not otherwise have because of inconsistent credit histories or lack of capital. So we must find ways to balance our goal as a nation with ensuring affordable access to credit for all.

Homeownership is a vital part of the American dream, but it, too often these days, disrupts a family's life. That is, when first time homebuyers who were not made aware of all of the terms of their mortgage, find out, frequently too late, that they can not meet the monthly payments. This begins a swift trickle down effect which in many cases ends in foreclosure. But, these foreclosures could have been avoided if the homebuyer had been educated in all of the terms of the loan, and made aware of the full costs they would have to bear.

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I have argued for years that the financial sector and the government should work together to ensure that potential homebuyers have access to straightforward housing counseling. Proper counseling could have reduced the severity of the current housing crunch. In states like New York where housing costs are so high, the consequences of an unmanageable mortgage can be simply devastating. It is our duty to finally learn our lesson and better safeguard this system to protect homebuyers.

Addressing the rise in foreclosures is critical to the steady growth of homeownership in our nation. All of us here must continue to work together to find viable solutions to this issue, keeping in mind that our decisions affect millions of families across the country. This hearing will, without doubt, lead us in the direction of making meaningful and steadfast change to address and prevent mortgage foreclosures. Thank you.

For release on delivery
10:00 a.m. EDT
September 20, 2007

Statement of

Ben S. Bernanke

Chairman

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

September 20, 2007

Chairman Frank, Ranking Member Bachus, and members of the Committee, I am pleased to appear before you to discuss the origins of the problems in the subprime-mortgage market and the response of the Federal Reserve to these developments. I will also discuss some possible legislative options for addressing these concerns.

Recent Developments in the Subprime-Mortgage Sector

Let me begin with some background on the subprime-mortgage sector. Subprime mortgages are loans intended for borrowers who are perceived to have high credit risk. Although these mortgages emerged on the financial landscape more than two decades ago, they did not begin to expand significantly until the mid-1990s. The expansion was fueled by innovations--including the development of credit scoring--that made it easier for lenders to assess and price risks. In addition, regulatory changes and the ongoing growth of the secondary mortgage market increased the ability of lenders, who once typically held mortgages on their books until the loans were repaid, to sell many mortgages to various intermediaries, or "securitizers." The securitizers in turn pooled large numbers of mortgages and sold the rights to the resulting cash flows to investors, often as components of structured securities. This "originate-to-distribute" model gave lenders (and, thus, mortgage borrowers) greater access to capital markets, lowered transaction costs, and allowed risk to be shared more widely. The resulting increase in the supply of mortgage credit likely contributed to the rise in the homeownership rate from 64 percent in 1994 to about 68 percent now--with minority households and households from lower-income census tracts recording some of the largest gains in percentage terms.

However, for all its considerable benefits, the broadening of access to mortgage credit that has occurred during the past decade also had important negative aspects. Not surprisingly, given their weaker credit histories and financial conditions, subprime borrowers default on their

loans more frequently than prime borrowers. The consequences of default may be severe for homeowners, who face the possibility of foreclosure, the loss of accumulated home equity, and reduced access to credit. In addition, clusters of foreclosures can lead to declines in the values of nearby properties and do great damage to neighborhoods.

During the past two years, serious delinquencies among subprime adjustable-rate mortgages (ARMs) have increased dramatically. (Subprime mortgages with fixed rates, on the other hand, have had a more stable performance.) The fraction of subprime ARMs past due ninety days or more or in foreclosure reached nearly 15 percent in July, roughly triple the low seen in mid-2005.[1] For so-called near-prime loans in alt-A securitized pools (those made to borrowers who typically have higher credit scores than subprime borrowers but still pose more risk than prime borrowers), the serious delinquency rate has also risen, to 3 percent from 1 percent only a year ago. These patterns contrast sharply with those in the prime-mortgage sector, in which less than 1 percent of loans are seriously delinquent. Higher delinquencies have begun to show through to foreclosures. About 320,000 foreclosures were initiated in each of the first two quarters of this year (just more than half of them on subprime mortgages), up from an average of about 225,000 during the past six years. Foreclosure starts tend to be high in states with stressed economic conditions and to rise where house prices have decelerated or fallen.

Adjustable-rate subprime mortgages originated in late 2005 and in 2006 have performed the worst, with some of them defaulting after only one or two payments (or even no payment at all). Relative to earlier vintages, more of these loans carried greater risks beyond weak borrower credit histories--including very high initial cumulative loan-to-value ratios and less documentation of borrower income. In addition, the sharp deceleration in home prices since 2005, including outright declines in some markets, left many of these more-recent borrowers

[1] Estimates of delinquencies are based on data from First American LoanPerformance.

with little or no home equity. In this situation, some borrowers (particularly owner-investors) may have found that simply walking away from their properties was their best option. Moreover, low home equity has made refinancing--the typical way for many subprime borrowers to avoid large scheduled interest rate resets--difficult or impossible for many. Thus, with house prices still soft and many borrowers of recent-vintage subprime ARMs still facing their first interest rate resets, delinquencies and foreclosure initiations in this class of mortgages are likely to rise further. It is difficult to be precise about the number of foreclosure initiations expected in coming quarters, as it will depend on (among other factors) the evolution of house prices, which will vary widely across localities. Historically, about half of homeowners who get a foreclosure notice are ultimately displaced from their homes, but that ratio may turn out to be higher in coming quarters because the proportion of subprime borrowers, who have weaker financial conditions than prime borrowers, is higher. The rise could be tempered somewhat by loan workouts.

The originate-to-distribute model seems to have contributed to the loosening of underwriting standards in 2005 and 2006. When an originator sells a mortgage and its servicing rights, depending on the terms of the sale, much or all of the risks are passed on to the loan purchaser. Thus, originators who sell loans may have less incentive to undertake careful underwriting than if they kept the loans. Moreover, for some originators, fees tied to loan volume made loan sales a higher priority than loan quality. This misalignment of incentives, together with strong investor demand for securities with high yields, contributed to the weakening of underwriting standards.

The fragmented market structure of mortgage originators in the subprime-lending industry may also have contributed. Data collected under the Home Mortgage Disclosure Act

show that independent mortgage companies--those that are not depository institutions or their subsidiaries or holding company affiliates--made nearly half of higher-priced first-lien mortgages in 2006 but only one-fourth of loans that were not higher-priced. In addition, some sources report that the majority of mortgages are obtained through a broker, often an independent entity, who takes loan applications on behalf of a depository institution or other lender. The various lending institutions and brokers operate under different regulatory and supervisory regimes with varying intensities of enforcement effort. That fragmentation makes monitoring brokers and lenders difficult for regulators and investors alike.

Markets do tend to self-correct. In response to the serious financial losses incurred by investors, the market for subprime mortgages has adjusted sharply. Investors are demanding that originators employ tighter underwriting standards, and some large lenders are pulling back from the use of brokers. The reassessment and resulting increase in the attention to loan quality should help prevent a recurrence of the recent subprime problems. Nevertheless, many homeowners who took out mortgages in recent years are in financial distress. To help those borrowers, the Federal Reserve, together with the other federal supervisory agencies, has issued two statements--in April, to mortgage lenders; and earlier this month, to mortgage servicers--to encourage the financial industry to work with borrowers to arrange prudent loan modifications to avoid unnecessary foreclosures. The Conference of State Bank Supervisors (CSBS) joined the federal agencies in the second statement. Often, loan workouts are in the interest of all parties. We have also encouraged lenders and servicers to identify and contact borrowers who, with counseling and possible loan modifications, may be able to avoid entering delinquency or foreclosure. The simple step of reaching out to borrowers before they get into trouble can be very productive. In addition, a member of the Federal Reserve Board serves as a director of

NeighborWorks America, which encourages borrowers facing payment difficulties to seek help by contacting their lenders, services, or trusted counselors. Recently, NeighborWorks America launched a nationwide advertising campaign to increase awareness of available support from their 24-hour hotline, and they are now responding to 2,000 calls a day, almost double the number in June.

Additionally, the Federal Reserve is working closely with community and industry groups around the country to reduce homeowners' risks of foreclosure. The community affairs offices in each of the Reserve Banks provide significant leadership and technical assistance. For instance, a public-private collaboration initiated by the Federal Reserve Bank of Chicago with Neighborhood Housing Services of Chicago and the City of Chicago produced the Home Ownership Preservation Initiative (HOPI), which began in 2003. In the ensuing three years, the HOPI program counseled more than 4,000 people, prevented 1,300 foreclosures, and reclaimed 300 buildings.[2] HOPI has also been a model for foreclosure prevention programs now operating around the country, including in Baltimore and Atlanta and in Ohio. As another example, the community affairs office of the Federal Reserve Bank of San Francisco recently convened a series of workshops to develop community-based solutions to mortgage delinquencies in six cities. More than 700 lenders, housing counselors, community group representatives, and government officials attended.

Regulatory Responses

The Federal Reserve takes responsible lending and consumer protection very seriously. Along with other federal and state agencies, we are responding to the subprime problems on a

[2] "The Home Ownership Preservation Initiative in Chicago (HOPI): Reducing Foreclosures Through Strategic Partnerships," presentation by Bruce Gottschall, executive director, Neighborhood Housing Services of Chicago, June 25, 2007, http://nw.org/network/neighborworksprogs/foreclosuresolutions/documents/hopi_000.ppt.

number of fronts. We are committed to preventing problems from recurring, while still preserving responsible subprime lending.

Last year, in coordination with other federal supervisory agencies, we issued principles-based guidance describing safety-and-soundness and consumer-protection standards for nontraditional mortgages, such as interest-only and negative-amortization mortgages. We subsequently issued illustrations to help institutions clearly communicate information to consumers. In June of this year the agencies issued supervisory guidance on subprime ARMs. The guidance describes standards that banks should follow to ensure that borrowers obtain loans that they can afford to repay and that give them the opportunity to refinance without prepayment penalty for a reasonable period before the interest rate resets. We have requested public comment on illustrations to help lenders implement this guidance.

The Board also is committed to providing more-effective disclosures to help consumers defend against improper lending. As I discussed in my testimony to this Committee in July, we recently issued proposed rules under Regulation Z, which implements the Truth in Lending Act (TILA), to improve disclosures related to credit cards and other revolving credit accounts. We are now engaged in a similarly rigorous review of TILA rules for mortgage loans and will be conducting extensive consumer testing of mortgage disclosures for this purpose. In my view, better disclosure of the schedule of mortgage payments over the life of the loan can help borrowers understand the terms of their mortgages and judge their ability to make future payments. Consumers may also benefit from better information about costs, including brokers' fees, when choosing among competing mortgage products. In addition, we are developing two sets of proposed changes to TILA rules--one to address concerns about incomplete or misleading mortgage loan advertisements and solicitations and a second to require lenders to provide

mortgage disclosures more quickly so that consumers can get the information they need when it is most useful to them.

Improved and more timely disclosures may not be sufficient in some cases. As I discussed in July, we will use our rulemaking authority under the Home Ownership and Equity Protection Act to propose additional consumer protections later this year. We are looking closely at some mortgage lending practices, including prepayment penalties, escrow accounts for taxes and insurance, stated-income and low-documentation lending, and the evaluation of a borrower's ability to repay. The information that we gathered at a public hearing in June and from the subsequent comment letters has been extremely helpful.

The recent problems in subprime lending have underscored the need not only for better disclosure and new rules but also for more-uniform enforcement in the fragmented market structure of brokers and lenders. In that regard, the CSBS has partnered with the American Association of Residential Mortgage Regulators (AARMR) to develop a nationwide licensing system and database for mortgage professionals, and they have made considerable progress. The system is expected to start up in January 2008 with seven states, and another thirty states have committed and will be added gradually. Such a nationwide system would help limit the ability of originators who run afoul of their state regulators to continue operating simply by moving to another state.

Raising the quality of underwriting practices by all lenders to a uniformly high standard is an important objective. To that end, the Board and the other federal agencies worked with the CSBS to apply the two guidance documents I mentioned--on nontraditional mortgages and subprime ARMs--to state-supervised institutions. The CSBS published nearly identical guidance

documents and has urged the states to implement them. Many states have done so, or are moving to do so.

To achieve strong and uniform enforcement, interagency cooperation among a variety of federal and state agencies is essential. As I noted in my testimony in July, the Board has launched a pilot program with the CSBS, AARMR, the Office of Thrift Supervision, and the Federal Trade Commission. The goal of this program is to expand and improve consumer protection by strengthening compliance reviews at selected nondepository lenders with significant subprime-mortgage operations. The Board will review nonbank subsidiaries of bank holding companies, and the other agencies will conduct similar reviews of nondepository institutions of thrift holding companies, independent mortgage lending companies, and mortgage brokers doing business with these entities. The reviews will include an evaluation of the companies' underwriting standards and senior-management oversight of the practices used for ensuring compliance with consumer protection regulations and laws. The agencies have been working closely together and are scheduled to begin the on-site reviews in the fourth quarter. The partner agencies will share information about the reviews and make joint assessments of lessons learned. This project should also lay the groundwork for various additional forms of future cooperation to ensure more effective and consistent supervision and consumer protection.

Legislative Responses

Beyond the actions underway at the regulatory agencies, I am aware that the Congress is considering statutory changes to help alleviate the problem of foreclosures. Modernizing the programs administered by the Federal Housing Administration (FHA) is one promising direction. The FHA has considerable experience in providing home financing for low- and moderate-income borrowers. It insures mortgages made to borrowers who meet certain underwriting

criteria and who pay premiums into a reserve fund that is designated to cover the costs in the event of default. This insurance makes the loans less risky for lenders and investors, and it makes the loans eligible for securitization through the Government National Mortgage Association (Ginnie Mae).

Historically, the FHA has played an important role in the mortgage market, particularly for first-time home buyers. However, the FHA's share of first-lien home purchase loans declined substantially, from about 16 percent in 2000 to about 5 percent in 2006, as borrowers who might have sought FHA backing instead were attracted to nontraditional products with more-flexible and quicker underwriting and processing. In addition, maximum loan values that the FHA will insure have failed to keep pace with rising home values in many areas of the country.

In modernizing FHA programs, Congress might wish to be guided by design principles that allow flexibility and risk-based pricing. To alleviate foreclosures, the FHA could be encouraged to collaborate with the private sector to expedite the refinancing of creditworthy subprime borrowers facing large resets. Other changes could allow the agency more flexibility to design new products that improve affordability through features such as variable maturities or shared appreciation. In addition, creating risk-based FHA insurance premiums that match insurance premiums with borrowers' credit profiles would give more households access to refinancing options.

The risk of moral hazard must be considered in designing government-backed programs; such programs should not bail out failed investors, as doing so would only encourage excessive risk-taking. One must also consider adverse selection; programs that provide credit to only the weakest eligible borrowers are likely to be more costly than those that serve a broader risk

spectrum. Risk-based insurance premiums or tighter screening and monitoring by lenders can mitigate adverse selection. But ultimately such mechanisms have their limits, and no government program will be able to provide meaningful help to the highest-risk borrowers without a public subsidy. Whether such subsidies should be employed is a decision for the Congress.

The government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac are, to a limited extent, assisting in subprime refinancings and should be encouraged to provide products for subprime borrowers to the extent permitted by their charters. However, the GSE charters are likely to limit the ability of the GSEs to serve any but the most creditworthy subprime borrowers. Indeed, if GSE programs remove the strongest borrowers from the pool, the risks faced by other programs--such as a modernized FHA program--could be increased.

Some have suggested that the GSEs could help restore functioning in the secondary markets for non-conforming mortgages (specifically jumbo mortgages, those with principal value greater than $417,000) if the conforming-loan limits were raised. However, in my view, the reason that GSE securitizations are well-accepted in the secondary market is because they come with GSE-provided guarantees of financial performance, which market participants appear to treat as backed by the full faith and credit of the U.S. government, even though this federal guarantee does not exist. Evidently, market participants believe that, in the event of the failure of a GSE, the government would have no alternative but to come to the rescue. The perception, however inaccurate, that the GSEs are fully government-backed implies that investors have few incentives in their role as counterparties or creditors to act to constrain GSE risk-taking. Raising the conforming-loan limit would expand this implied guarantee to another portion of the mortgage market, reducing market discipline further. If, despite these considerations, the

Congress were inclined to move in this direction, it should assess whether such action could be taken in a way that is both explicitly temporary and able to be implemented sufficiently promptly to serve its intended purpose. Any benefits that might conceivably accrue to this action would likely be lost if implementation were significantly delayed, as private securitization activity would likely be inhibited in the interim.

Implications for Financial Markets and Monetary Policy

Most recently, as I am sure Committee members are well aware, subprime mortgage losses that triggered uncertainty about structured products more generally have reverberated in broader financial markets, raising concern about the consequences for economic activity. As I noted in a speech last month at the economic symposium hosted by the Federal Reserve Bank of Kansas City, the turbulence originated in concerns about subprime mortgages, but the resulting global financial losses have far exceeded even the most pessimistic estimates of the credit losses on these loans. These wider losses reflect, in part, a significant increase in investor uncertainty centered on the difficulty of evaluating the risks for a wide range of structured securities products, which can be opaque or have complex payoffs. Investors also may have become less willing to assume risk. Some increase in premiums that investors require to take risk is probably a healthy development on the whole, as these premiums have been exceptionally low for some time. However, in this episode, the shift in risk attitudes combined with greater credit risk and uncertainty about how to value those risks has created significant market stress. On the positive side of the ledger, past efforts to strengthen capital positions and financial market infrastructure places the global financial system in a relatively strong position to work through this process.

In response to these developments, the Federal Reserve moved in early August to provide reserves to address unusual strains in money markets. On August 17, the Federal Reserve Board

announced a cut in the discount rate of 50 basis points and adjustments to the Reserve Banks' usual discount window practices to facilitate the provision of term financing for as long as thirty days, renewable by the borrower. The purpose of the discount window actions was to assure depositories of the ready availability of a backstop source of liquidity. The Federal Reserve also took a number of supplemental actions, such as cutting the fee charged for lending Treasury securities.

Earlier this week, Federal Open Market Committee lowered its target for the federal funds rate by 50 basis points. The action was intended to help forestall some of the adverse effects on the broader economy that might arise from the disruptions in financial markets and to promote moderate growth over time. Recent developments in financial markets have increased the uncertainty surrounding the economic outlook. The Committee will continue to assess the effects of these and other developments on economic prospects and will act as needed to foster price stability and sustainable economic growth.

Prepared Testimony of

Harry Dinham, CMC, Past President

National Association of Mortgage Brokers

on

"Legislative and Regulatory Options for

Minimizing and Mitigating Mortgage Foreclosures"

Before the

House Financial Services Committee

United States Congress

Thursday, September 20, 2007

Good morning Chairman Frank, Ranking Member Bachus, and Members of the Committee, I am Harry Dinham of the National Association of Mortgage Brokers ("NAMB"). Thank you for inviting NAMB to testify today on "Legislative and Regulatory Options for Minimizing and Mitigating Mortgage Foreclosures." We appreciate this opportunity to address recent events in the mortgage market, particularly the rise in defaults and foreclosures, and their effect on the housing industry, U.S. consumers, and the global economy.

NAMB is the only national trade association exclusively devoted to representing the mortgage brokerage industry, and as the voice of the mortgage brokers, NAMB speaks on behalf of more than 25,000 members in all 50 states and the District of Columbia. NAMB members are typically small business men and women, who adhere to a strict code of ethics and best lending practices when presenting consumers with an array of mortgage financing options to choose from. Mortgage brokers typically maintain business relationships with various lenders so they can offer a variety of loan products to their customers. Our members play a critical role in helping the American economy and in making the dream of homeownership a reality for American families.

I. Introduction

Today's mortgage market is under significant stress. For the first time, problems in the American mortgage market have had far-reaching global ramifications and a number of consumers have been impacted. Foreclosure filings reported in the U.S. more than doubled last month, versus August 2006, and jumped 36 percent from July.[1] The effects of loose underwriting standards, historically low interest rates, originators trying to compete in a booming housing market, and Wall Street's eagerness to purchase mortgage loans and repackage them as securities, are now being fully felt by consumers.

The reality is that a multitude of factors likely contributed to the steadily rising number of foreclosures. Recognizing this fact, the Chairman and Ranking Member of this Committee requested the U.S. Government Accountability Office ("GAO") to undertake a comprehensive study of the causes of the recent surge in foreclosures. To date, the GAO has yet to release any findings. Because we believe it is important that any legislative or regulatory effort be undertaken in a thorough and deliberate manner, we urge the GAO to conclude their study and publish the results as soon as possible; giving legislators and regulators the tools they need to take the necessary and appropriate action to minimize foreclosures now and into the future.

When profits began to decline and the word "risk" returned to vogue, everyone started to zero-in on who is responsible for the current crisis. Investors began looking to the hedge funds and the secondary market; the secondary market looked to the banks responsible for creating and underwriting the loans; and the banks turned toward those who sold these products to consumers. Also intertwined is the role of the rating agencies, which were responsible for evaluating and rating the risks of pools of loans being sold onto the secondary market; and the regulators responsible for overseeing and evolving oversight mechanisms to keep pace with a growing mortgage industry. In the end, everyone played a role in creating or compounding the market and foreclosure problems we are faced with today.

The Mortgage Market's Reaction to Increased Foreclosures

The market is and has been adjusting to the increase in defaults and late payments on subprime loans. The guidance[2] issued by the Federal Banking Agencies[3] is working and the mortgage industry is adopting and implementing the necessary changes. NAMB supports these efforts, as well as the parallel guidance issued by the Conference of State Bank Supervisors ("CSBS"), the American Association of Residential Mortgage Regulators ("AARMR"), and the National Association of Consumer Credit Administrators ("NACCA"), which is applicable to state-chartered mortgage lenders and mortgage brokers.

Investment banks that securitize subprime mortgage products have tightened their wholesale lending requirements and have started enforcing buyback agreements against lenders; while mortgage lenders continue to require strong buyback commitments for nonperforming loans in their contracts with mortgage brokers. Fair Isaac is making changes to its FICO scoring system to improve its "predictive

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[1] "U.S. Home Foreclosures Soar in August," Veiga, Alex, Sept. 18, 2007.

[2] Interagency Guidance on Nontraditional Mortgage Products, 71 Fed. Reg. 58609 (Nov. 4, 2006); Interagency Statement on Subprime Mortgage Lending, 72 Fed. Reg. 37569 (July 10, 2007).

[3] The Federal Financial Institutions Examination Council includes the Federal Reserve Board ("FRB"), the Federal Deposit Insurance Corporation ("FDIC"), the Office of Thrift Supervision ("OTS"), the Office of the Comptroller of the Currency ("OCC"), and the National Credit Union Administration ("NCUA") (together, the "Federal Banking Agencies").

strength by 5 to 15 percent."[4] Some believe this is an effort to account for the practice of piggy-backing (where companies like Instant Credit Builders (http://instantcreditbuilders.com/) promise to increase a person's credit score by allowing a person with bad credit to add his/her name as an authorized user of the credit score of the individual with good credit (for a fee of course)).[5] Moreover, many leading subprime lenders have been forced to declare bankruptcy, eliminate certain lines of credit, or close their doors altogether – largely due to margin calls and credit tightening by Wall Street. As these lenders continue to downsize and shut-down mortgage operations, countless loan officers are being terminated, and these individuals are now receiving job offers from federally-chartered institutions that are marketing themselves by saying how easy it is for their loan officers to make loans and avoid state licensing requirements designed to protect consumers.[6] We fear this dynamic will continue and even accelerate should Congress take action that artificially favors one distribution channel over another.[7]

All of this recent activity has laid the foundation for stabilization of the mortgage market. However, these measures are also making it increasingly difficult for many honest, hard working Americans to obtain the credit they need to build wealth through the purchase of a home or refinance their existing adjustable-rate mortgage ("ARM") before it resets to a higher rate.

Today, small mortgage lenders and brokers face the prospect of losing their businesses because investors, hedge funds, pension funds, foreign banks, and others are no longer funding mortgage transactions. Additionally, wholesale lenders and banks are discontinuing their warehouse credit facilities to small mortgage companies. As a result, consumers are suffering the consequences of fewer product choices and mortgage providers in the marketplace. Current homeowners are finding it extremely difficult to refinance their loans and many who want to purchase a home are also struggling to secure financing. The turmoil that was once confined to the subprime market has now spread into the non-conforming and prime markets and is beginning to impact corollary financial services industries as well (*i.e.*, personal loans, auto loans, credit cards). As minimum credit scores increase and underwriting standards tighten, consumers unable to secure home equity lines of credit or other personal loans are now turning to their credit cards and facing steadily increasing interest rates.[8] In short, we are experiencing a very serious credit contraction that has left consumers reeling.

Underwriting standards, once too loose, have now become unnecessarily restrictive. The pricing of risk on the secondary market has gone from unrealistically low to unreasonably high. The re-pricing of risk has almost become irrational. Liquidity is drying-up and credit is becoming unavailable to consumers who have few assets and anything less than perfect credit. Earlier this month, in an informal survey of NAMB members, over half of those responding indicated that they have seen an increase of twenty or more points in the required credit score for conforming loans within the past month. As interest rates continue to rise, even on prime loans, and more loan products become unavailable everyday, borrowers who just a few weeks or months ago might have been able to easily purchase or refinance their home are today being turned away by lenders who are still more focused on earning a profit than working with homeowners to maintain some stability within their communities.

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[4] "Fair Isaac Combats Credit Manipulation," Elphinstone, J.W., Associated Press, June 5, 2007; and Fair Isaac Press Release, May 17, 2007.
[5] "Piggyback Credit Worries Loan Industry," Elphinstone, J.W., *The Cincinnati Post*, June 4, 2007, p. B7.
[6] *See*, Appendices A and B.
[7] For example, IndyMac Bancorp, Inc. is on a hiring spree of loan officers in an effort to build up their retail divisions that are facing a significant increase in business. "Mortgage Lender Hires 600," Wei, Lingling, *The Wall Street* Journal, Aug. 29, 2007, A3.
[8] "Credit Crunch Moves Beyond Mortgages," Kim, Jane J., *The Wall Street Journal*, Aug. 22, 2007, p. D1.

A Return to Normalcy in the Mortgage Market

Sadly, conditions are likely to get worse before they get better for anyone who hopes to refinance their adjustable-rate mortgage ("ARM") in the coming months. Large national banks and lenders who flooded the market when the industry was booming are now shutting-down their mortgage operations or closing-up shop altogether, leaving borrowers with few places to turn for home financing options.

Over the past several months, we have heard from NAMB members from across the country whose customers discovered, sometimes at the closing table, that their mortgage loan would not be funded because a lender was bankrupt, going out of business, or eliminating a particular line of credit. Thankfully, our members were able to work with these customers to ensure that they found and secured funding from an alternative source. However, this is further evidence that today, more than ever, the small mortgage companies and local banks that remain invested in their communities have a vital role to play in preserving the integrity of neighborhoods and helping consumers stay in their homes.

Congress has an opportunity to restore confidence and stability in the mortgage market and help countless homeowners facing the prospect of losing their home to foreclosure. We believe that this rising tide of foreclosures may be stemmed by swift and appropriate legislative action, but we urge Congress to remain cautious, thoughtful, and deliberate when contemplating changes that will have an effect on consumers' ability to obtain affordable credit and remain in their homes for years to come.

Today, we urge Congress to take the necessary steps to enable Fannie Mae, Freddie Mac, and the Federal Housing Administration ("FHA") to further their respective missions and provide much-needed assistance to homeowners facing eminent default or foreclosure. Temporarily lifting Fannie Mae and Freddie Mac's (together "the GSEs") portfolio caps will inject necessary liquidity into a distressed market and help make financing more available and affordable for countless homeowners, especially those living in high-cost areas. Moreover, increasing the limits for GSE conforming loans and FHA loans in high-cost areas, coupled with elimination of the FHA down payment requirement, will greatly expand the opportunities for these entities to reach the first-time, minority, and low to moderate-income borrowers their respective programs are intended to serve.

While there are a number of concrete steps that Congress can take to help struggling consumers today, there is an even greater opportunity for lawmakers to lay a strong foundation of consumer protection that will help safeguard generations of future borrowers. We outline in greater detail below our recommendations and proposals for minimizing and mitigating mortgage foreclosures both today and in the future.

II. Recommendations for Reducing the Number of Foreclosures Today

A. Lift the GSEs' Portfolio Caps & Increase Their Conforming Loan Limits

Recent events in the mortgage and credit markets have placed many homeowners in the untenable position of facing resets on their ARMs with little or no hope of being able to refinance or afford the higher monthly payments. However, in times of market stress, the GSEs have proven to be a reliable source of strength to the housing market. While others may have exited or severely curtailed their participation in the residential mortgage market, we believe the GSEs have the potential to step up, promote stabilization, and infuse much-needed liquidity into the market, thus providing borrowers looking to buy or refinance a home with greater options.

Those who reside in certain high-cost areas of the country should not be penalized simply because of where they choose to live. Homebuyers living in these areas should be able to avail themselves of the

same assistance and benefits that the GSEs offer to other borrowers throughout the country. For this reason, NAMB supports setting regional conforming loan limits at levels designed to better serve those families living in high-cost areas where the median price of a home often exceeds the current conforming loan limits. Increasing the conforming loan limits in high-cost areas was an essential component to the Federal Housing Finance Reform Act of 2007 ("H.R. 1427"), which was passed by the House earlier this year. We applaud this committee for its work on H.R. 1427, and we strongly urge the Senate to pass companion legislation as quickly as possible.

Moreover, NAMB supports injecting liquidity and stability into the mortgage market by lifting the caps currently placed on the GSEs' mortgage portfolios. Temporarily lifting the caps would enable the GSEs to purchase additional mortgages thereby easing, in part, the current credit crunch and giving consumers who are in loans about to reset an opportunity to refinance and avoid possible default and foreclosure. We urge the Office of Federal Housing Enterprise Oversight ("OFHEO") to restore confidence in our mortgage markets for both current and future homeowners, by lifting the portfolio caps and injecting much-needed liquidity into the mortgage market.

B. Create a Stronger and More Viable FHA Loan Program

1. H.R. 1852: The Expanding American Homeownership Act of 2007

In this environment of rising interest rates and shrinking liquidity, many first-time, minority, and low to moderate-income homebuyers need the safer and less-expensive financing options that the FHA program can provide. This is especially true for those consumers living in high-cost areas. For example, in California, twenty-nine of the fifty-eight counties are currently at the FHA ceiling of $362,790, with another six counties approaching that ceiling. Approximately eighty-five percent of California's population resides in these twenty-nine counties, and many of these Californians are struggling to become or remain homeowners in areas where the median home price is $534,470.

California is not alone. High-cost areas exist in many states, including New York, Massachusetts, Pennsylvania, Connecticut, New Jersey, and Maryland. In Maryland, twenty-four counties are currently at the $362,790 ceiling for FHA, while another seven counties are within $1,885 of that limit. As in California, these counties represent the great majority of Maryland's population. Therefore, FHA has been driven from those parts of the country where consumers are most in need of affordable financing, forcing millions of borrowers to turn to high-cost financing and other non-traditional loan products.

A stated objective of the Federal Housing Administration ("FHA") loan program is to increase origination of FHA loan products and expand homeownership opportunities for first-time, minority and low to moderate-income families. NAMB believes that the benefits of the FHA program should be available to all taxpayers; including those residing in high-cost areas, where borrowers are most often in need of affordable mortgage financing options.

We applaud the amendment to the FHA reform bill, offered by Chairman Frank (D-MA) and Reps. Gary Miller (R-CA) and Dennis Cardoza (D-CA) and approved by the House earlier this week, which increases FHA loan limits on single-family homes from $417,000 to $500,000, to better accommodate more borrowers living in high-cost areas of the country.

We urge the Senate to act to revitalize this valuable program and ensure that FHA remains capable of fulfilling its stated objectives and helping more Americans purchase and remain in their homes. A recent survey conducted by The Mellman Group of Washington, D.C. revealed that eight out of ten Americans favor FHA modernization that would make it easier for FHA to offer mortgage loans to first-time and

moderate-income homeowners.[9] In passing H.R. 1852 earlier this week, the House has responded swiftly to the current market crisis, and paved the way for a stronger more vital FHA that is capable of meeting the needs of qualified borrowers.

We applaud the House for passing H.R. 1852 and helping to once again make FHA loans a real choice for borrowers.

2. The FHASecure Initiative

FHASecure is a temporary program (loan applications must be signed no later than December 31, 2008) designed to provide refinancing opportunities to homeowners whose payments on conventional ARMs are expected to increase. Under FHASecure, homeowners who are delinquent under their existing mortgage following the reset of the interest rate, but have demonstrated their ability to repay, are eligible to refinance into a prime-rate FHA-insured mortgage.[10]

While NAMB supports the FHASecure initiative, its reach is limited. We are also concerned that lenders have been slow to adopt this new refinancing alternative, preventing this program from having its desired effect in the marketplace. To respond to the needs of thousands of subprime borrowers facing resets and trying to keep their homes, Congress must pass FHA reform legislation that allows for greater, long-term access to FHA loan products for all qualifying consumers.

C. Provide Temporary Federal Income Tax Relief for Cancelled or Forgiven Mortgage Debt

Industry participants are beginning to do what they can to assist borrowers struggling to avoid defaulting on their mortgages and stave off foreclosure. However, legislative and/or regulatory options for minimizing foreclosures and defaults are needed in some areas. For example, the current tax law counts any forgiven or otherwise cancelled mortgage debt on primary residences as "unearned income." This means that it is taxable income. So, if a homeowner's mortgage is refinanced, modified or they are able to arrange a work-out with a lender, the homeowner is penalized at tax time for the amount of the forgiven or cancelled mortgage debt. President Bush has encouraged instituting temporary tax relief for forgiven or cancelled mortgage debt on primary residences, and bipartisan bills have been introduced in both the House and Senate that address these changes. NAMB supports these initiatives so that more borrowers can work with their lenders in an effort to preserve their homes.

D. Revise the Bankruptcy Code to Allow Homeowners to Restructure their Mortgage Debt and Stave Off Foreclosure

Borrowers whose financial situation has forced them to turn to bankruptcy are facing an even greater obstacle to staying in their homes. Today, bankruptcy courts are unable to extend any relief on mortgage debt after bankruptcy proceedings have been initiated. This is due to a 1978 amendment to the Bankruptcy Code[11] that prohibits the restructuring of primary mortgages for borrowers who have filed for bankruptcy. To complicate matters further, under the 2005 Bankruptcy Code Amendments,[12] a Chapter 7 filing (where a lender can agree to let a borrower keep his house during a bankruptcy proceeding) was made much more difficult, forcing many borrowers to file Chapter 13, where the debtor must receive counseling and establish a repayment plan, and the court is prohibited from modifying any mortgage debt.

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[9] PR Newswire, June 14, 2007.
[10] Mortgagee Letter 2007-11, U.S. Department of Housing and Urban Development, September 4, 2007.
[11] PL 95-598, 1978 HR 8200
[12] PL 109-8, 2005 S 256

There have been a number of proposals to eliminate or otherwise limit (either permanently or temporarily) the provisions that exclude home loans from bankruptcy relief and place home mortgage debt on par with other secured and unsecured debt (*i.e.*, allow a bankruptcy court to extend relief on mortgage debt). NAMB supports lifting the prohibition on restructuring a primary mortgage and allowing borrowers facing imminent foreclosure to skip the counseling requirement. We believe amending the bankruptcy code could help thousands of subprime borrowers facing unaffordable resets potentially avoid foreclosure and keep their home, despite declaring bankruptcy.

III. Steps Necessary to Protect Future Borrowers and Ensure Market Stability

We reiterate our longstanding view that abusive lending practices relate directly back to how individual loan officers present different loan programs to consumers and how consumers understand the features of the loan product they ultimately choose. Loan products and the pricing of risk are not inherently abusive. Each consumer is unique; each consumer chooses a loan originator and loan product for their own personal reasons and determines what is appropriate for them. For this reason, we support the implementation and enforcement of minimum standards for all loan officers; the creation of a national registry to track and remove bad actors from the industry; improved enforcement of prohibitions against deceptive and misleading advertising of mortgage products; reformed mortgage disclosures; and efforts to improve consumer financial literacy.

A. Require All Originators to be Knowledgeable When Working With Consumers

Since 2002, NAMB has consistently advocated for more stringent standards for all loan originators to protect consumers and curb abusive lending practices in the mortgage industry. Today, we again urge Congress to adopt uniform national standards for education, testing, and criminal background checks for *all* mortgage originators, and we support the creation of a national registry, governed by a federal agency, which would include every individual mortgage loan officer, including those working at banks, lenders, and brokerages. We remain steadfast in our belief that the value of an all originator approach lies in the uniformity of treatment between competing channels of distribution. Consumers deserve the same level of protection no matter where they choose to obtain a mortgage loan.

One primary example of why *all* mortgage originators should be subject to uniform minimum standards was articulated by South Carolina Attorney General, Henry McMaster, in a March 2007 mortgage fraud report.[13] Attorney General McMaster stated that South Carolina has "directly and disproportionately been targeted for this type [mortgage] of fraud." While both the mortgage broker and mortgage broker's company are required to be licensed in the state of South Carolina, "mortgage lenders [mortgage bankers] and their originators [loan officers] are basically unregulated. There is no oversight by the State."[14] Not coincidentally, the FBI has identified South Carolina as one of the top ten "hot spots" for mortgage fraud in the United States.[15]

Moreover, recent events in the mortgage market offer clear examples of why *all* mortgage originators should be subject to uniform minimum standards. The mortgage market of the 21st century has evolved in conjunction with the burgeoning growth of the secondary market for mortgages, but the laws, regulations and oversight of this market have lagged behind to the severe detriment of consumers. Today, any legislative, regulatory, or other governmental effort should account for the fact that the mortgage market is vastly different from the one that existed 20 years ago.

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[13] *See,* Appendix C, "Mortgage Fraud Report," South Carolina Department of Consumer Affairs, March 2007, p.1.
[14] Ibid, p.4.
[15] Ibid, p.1.

The traditional, "bank-centered," model of mortgage credit involved institutions originating, funding and holding the risk of credit in a mortgage portfolio, which was overseen by in-house risk management and monitoring procedures. Credit and market innovations have separated these functions, allowing for greater efficiencies, diversification, spreading of risk, and increased liquidity. This, in turn, opened the doors of the market for mortgage credit to first-time, low-to-moderate income, and minority borrowers that had previously been shut-out of the home market. Accompanying this credit evolution were, of course, corporate structure and operational changes that influenced how customers obtained their loans, as well as how these loans were funded, managed and serviced. Today, the vast majority of loans are "brokered loans" regardless of whether they are obtained through a bank, mortgage lender, correspondent lender or mortgage broker.[16]

We do not deny that differences exist between depository and non-depository institutions, both in terms of their business models and how they are regulated, primarily because some of these entities are involved in businesses other than mortgage lending, namely banking. However, when it comes to the origination of mortgage loans, these entities are virtually indistinguishable, particularly in the eyes of consumers.

Against this backdrop, we address one particular proposal that has been put forward regarding oversight and regulation of market participants. It has been suggested that a minimum net worth and capital requirement should be imposed on all mortgage market participants, regardless of business activities or size, as a measure of stability and accountability in the market. However, we have witnessed first-hand that capital requirements do little to protect either the market or the consumer. Many (large) lending companies that were once viewed as financially solid are bankrupt and gone, proving capital and net worth requirements are ineffective indicators of a mortgage originator's ability to service or make the consumer whole.

Net worth is illusory. A financial statement provides no assurance at all that an originator will *maintain* their net worth requirement; it simply provides a snapshot and can easily disappear. Imposing capital and net worth requirements does not enhance lending standards, but rather merely promotes market shares among competing channels. Capital and net worth requirements succeed in erecting barriers to small businesses entering the market, place an unfair and undue burden on them, and inhibit competition, leaving consumers with fewer choices and increased costs, while failing to offer any real protection to consumers now or in the future.

In short, size and wealth do not automatically equate to honesty and competence. This fact must guide any future legislative or regulatory action, and it is inherent in the current proposal to establish uniform national standards for education, testing and criminal background checks, as well as a national registry, for *all* mortgage originators. The assertion that there is no need to oversee and regulate to some minimum standard the individual loan officers of institutions has proven to be faulty. Stories of "baseball bats," "boiler rooms," and other push-marketing sales tactics paint a clear picture that oversight and regulation of the entity alone is simply not enough.[17]

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[16] *See,* Appendix D, "A Breakdown of the Mortgage Industry and How It Operates," NAMB, June 2007.

[17] "Pressure at Mortgage Firm Led to Mass Approval of Bad Loans," Cho, David, *The Washington Post*, May 7, 2007, A01; "Workers Say Lenders Ran 'Boiler Rooms'," Hudson, Mike and Reckard, Scott E., *Los Angeles Times*, Feb. 4, 2005; "Inside the Countrywide Lending Spree," Morgenson, Gretchen, *The New York Times*, Aug. 26, 2007.

1. Increase Professional Standards: Require Minimum Education, Testing, and Criminal Background Checks for All Mortgage Originators

Unfortunately, the growth that has occurred in the mortgage finance industry has led to a corresponding rise in the number of uneducated and unlicensed mortgage originators. We must be careful however, not to allow ourselves to be blinded by the notion that these unlicensed and uneducated bad actors have found a home exclusively in one segment of the industry. There are unprofessional and unscrupulous originators working throughout the mortgage industry, including at banks, credit unions, brokerages, and loan companies. If we really want to safeguard homebuyers from abusive and predatory lending practices and provide them with more than the illusion of protection, professional standards must be established for *all* mortgage originators and enforced across *every* distribution channel.

When consumers are sitting across the table from a mortgage originator, they generally cannot distinguish one distribution channel from another. From the perspective of the consumer, there is essentially no difference between banks, lenders, and brokers when it comes to originating mortgage loans. Moreover, there is no reason to distinguish one distribution channel from another when each is engaged in essentially the same activity. It is not in the consumers' best interest to draw artificial lines between entities based upon their size, structure, or place in the federal-state regulatory dichotomy. There is absolutely no relationship between the size or structure of a mortgage company and the quality of its loan officers. Regulating only small segments of a larger industry leaves cracks for bad actors to continually slip through, as evidenced by the ease of un-checked movement of loan officers from one employer to another in today's market. As we mentioned above, we are now seeing many of the loan officers that have been terminated by lenders being offered positions at federally-chartered institutions that are marketing the ease with which their loan officers can avoid state licensing requirements and originate loans in all 50 states.

More can and should be done to increase professional standards for all mortgage originators. NAMB believes that part of the solution to successfully combating abusive and predatory lending practices is requiring a minimum level of education and mandatory testing for all loan officers, regardless of where they are employed. Education and testing of each and every mortgage originator helps to ensure that consumers will receive accurate and consistent product information that will allow them to make an informed decision about different loan financing options available in the market. To ensure all mortgage originators remain knowledgeable and competent to address customer concerns, NAMB also supports mandatory continuing education and professional ethics training. NAMB also believes that all mortgage originators should be subject to a federal criminal background check to prevent bad actors from entering or remaining in the industry.

The application of these minimum professional standards to *all* originators will create a mortgage market where consumers are free to shop and compare mortgage products and pricing across distribution channels without fear or confusion. We believe a federal effort must be undertaken to establish and implement minimum national standards that would function as a floor for all state and federal regulation, as well as internal corporate policies and procedures.

It has been suggested by some that requiring minimum standards for all loan originators is unnecessary, but we strongly disagree. The creation and implementation of a national minimum standard for every mortgage originator, which functions as a baseline for all regulation and corporate policy, is neither burdensome nor duplicative. Such a standard, when implemented across every distribution channel, will raise the bar for anyone currently failing to meet it, and impose no greater restrictions on any state or entity whose requirements already surpass it.

2. Create a National Registry, Governed by a Federal Agency

NAMB supports the creation of a national registry, provided: (1) it is governed by a federal agency such as the FTC, the Federal Reserve Board, or HUD; (2) the federal government requires every individual mortgage originator, including loan officers working for federal and state-chartered banks and lenders, credit unions, and mortgage brokers to register; (3) every individual pays a fee to be in the registry; and (4) the fee is used to cover operational costs for the registry, create funds earmarked for additional enforcement of mortgage laws, and assist ongoing consumer financial literacy programs.

We believe individuals who choose to work in the mortgage industry should be held accountable for their actions. If any mortgage originator is found guilty of improper conduct, he or she should be kicked out of the industry permanently. This national registry will stop bad actors from remaining in the mortgage industry, but only if it includes every individual mortgage originator at every state and federally-regulated entity. Without universal inclusion in the registry, bad actors will remain free to move, unchecked, from one entity to another and one community to another without any interference.

In a recent *Business Week* article,[18] it was reported that a homebuilder offered to provide a mortgage to a couple seeking to purchase a new home, rather than to send them to a lender or a bank to obtain financing. When it appeared that the couple may not qualify for the loan, the homebuilder inflated the couple's earnings reported in loan application documents by incorrectly stating that they were collecting rental income from the house they would be vacating. This couple now has a very large debt on two dwellings that they are unable to pay and they are nearing foreclosure. This example is just one of many that illustrate why a national registry should include all mortgage originators. A registry that includes only mortgage brokers would not capture this homebuilder's in-house lender.

Ranking Member Spencer Bachus (R-AL) along with several leading members of this Committee have introduced H.R. 3012, the "Fair Mortgage Practices Act of 2007," which mandates all mortgage originators be included in a national registry so that consumers, like the couple in the example above, can track their loan originator. This legislation also requires mandatory licensing, education, testing, and criminal background checks for mortgage originators. We believe this is common-sense legislation that protects consumers regardless of which distribution channel they choose, and we strongly urge the committee to adopt this legislation.

B. Improve Lending Practices: Require Mandatory Escrow Accounts for Taxes and Insurance on All Subprime Loans

There continues to be significant discussion surrounding mandating escrow accounts for taxes and insurance for certain segments of the mortgage market. NAMB supports requiring escrow accounts for taxes and insurance on all subprime, first lien mortgages, regardless of the borrower's loan-to-value ratio.

C. Strengthen Enforcement of Prohibitions Against Deceptive Marketing and Advertising of Mortgage Products

Just last week, the Federal Trade Commission ("FTC") warned mortgage lenders, brokers, and media outlets that some ads appearing in print and online may violate federal law. In letters to more than 200 mortgage advertisers and others, the FTC noted that "many mortgage advertisers are making potentially deceptive claims about incredibly low rates and payments, without telling consumers the whole story – for example, that these low rates and payments apply for a short period only and can go up substantially

[18] "Bonfire of the Builders: By Rushing Into the Mortgage Business Big-time, Homebuilders Helped Fuel the Housing Crisis," Der Hovanesian, *Business Week*, August 13, 2007.

after the loan's introductory period. Homeownership is the American dream, but it can become a nightmare for consumers who don't have the information they need to understand the terms of their mortgage."[19]

NAMB supports the efforts being undertaken by the FTC and urges Congress to encourage all state and federal regulators to strengthen and increase enforcement actions against all parties involved in deceptively advertising or marketing mortgage loan products or services to consumers.

D. Clearly Disclose the Role of the Originator in Mortgage Transactions

Because of the proliferation of affiliated business arrangements and the blurring of once clear lines of delineation between distribution channels, consumers are finding it more difficult than ever to choose a mortgage originator and understand the role that the originator will play in their loan transaction. NAMB believes consumers would benefit from a clear, upfront, and uniform disclosure of the role of the mortgage originator in each transaction. To enhance consumers' ability to comparison shop, this uniform disclosure should be required to be given by each and every mortgage originator (whether state or federally-chartered or supervised) at the onset of the consumer's mortgage shopping experience. In 1998, NAMB urged the U.S. Department of Housing and Urban Development ("HUD") to adopt such a disclosure as part of the required disclosures under the Real Estate Settlement Procedures Act ("RESPA"). In 2002 and in 2005, NAMB again requested that HUD adopt this disclosure. To date, HUD has not responded. Some states have adopted this as a requirement, but it is not enough.

A disclosure of the role of the mortgage originator should outline the nature and extent of the relationship between the consumer and his/her mortgage originator, and clearly communicate one of the following:

- The mortgage originator does not owe any obligation or duty to the consumer or any other party to the transaction (*i.e.*, the bank, lending source, or other entity), and is acting as an intermediary only;

- The mortgage originator has a fiduciary obligation to the bank, lending source, or other entity and therefore cannot act exclusively in the consumer's best interests in this transaction;

- The mortgage originator is willing to enter into an agency relationship with the consumer through a binding contract that will make the originator the "agent" of the consumer.

We strongly believe that this simple, straight-forward disclosure of the mortgage originator's role in specific transactions would, if universally required, eliminate any confusion on the part of consumers and strengthen consumers' bargaining position when shopping for a mortgage.

A direct analogy may be drawn to the real estate brokerage industry, which is also largely state-regulated. Not unlike mortgage originators, real estate brokers and agents deal with different parties to a transaction (buyers and sellers) in a variety of different capacities. Real estate brokers and agents may enter into an agency relationship with either a buyer or a seller; or they may function in a limited agency capacity for both the buyer and the seller. Alternatively, they may elect not to enter into any agency relationship at all and act exclusively as an intermediary. We believe that mortgage originators should operate under a similar model, where they may choose, along with their customers, to enter into an agency relationship with either the lender or the borrower; serve as the limited agent for both the lender and the borrower; or, act as an intermediary only in the mortgage transaction.

[19] "*FTC Warns Mortgage Advertisers and Media That Ads May Be Deceptive,*" FTC Press Release, September 11, 2007, quoting Lydia Parnes, Director, FTC Bureau of Protection.

Because of the complex and sometimes uncertain nature of the relationship between originators and borrowers, we believe consumers would benefit from a clear, concise, and mandatory disclosure of that relationship early in the mortgage shopping stage. Some states, like Florida, require real estate brokers to provide consumers with a specific Brokerage Relationship Disclosure that outlines the duties of real estate brokers serving in their different capacities (*i.e.*, as a single agent, limited dual agent, or intermediary). Florida requires this disclosure to be made in writing.

NAMB believes that the real estate brokerage model in Florida could serve as an appropriate template for a mandatory disclosure of the role of loan originators in the mortgage industry. We take this opportunity to once again urge HUD to use it rulemaking authority to adopt a uniform Role of the Originator Disclosure, and require it to be given to consumers early in the mortgage shopping process.

In addition to choosing the loan product and pricing options that they prefer, consumers should be given the opportunity to make an informed choice of whether to shop around or work with a mortgage originator who is willing and able to act as their agent in the transaction. Requiring all originators to clearly and accurately inform consumers of their role in the transaction will level the playing field and enhance consumers' ability and perhaps desire to comparison shop and find a loan product and originator they are comfortable with.

E. Create Simplified, Modernized, and Consumer-Tested Mortgage Disclosures

NAMB supports clear, consistent, and uniform communication with borrowers from the mortgage shopping stage, through consummation and afterwards, throughout the life of the loan. When designed and used appropriately, in conjunction with originator education and consumer financial literacy efforts, disclosures alert potential borrowers to the risks and benefits presented by particular loan products and promote meaningful comparison shopping. Although disclosures alone are not enough, proper disclosure of critical information can aid the consumer in making an informed choice of loan product.

As reported in a recent Federal Trade Commission ("FTC") Report on Improving Mortgage Disclosures, "choosing the wrong mortgage can cost consumers thousands of dollars in unnecessary up-front costs and larger monthly payments, result in unpleasant surprises and financial difficulties during the course of the loan, and, in some cases, even threaten a consumer's homeownership and financial solvency."[20] The report goes on to say that "consumers can better avoid these problems if they understand the costs and terms of their mortgages. By comparing loan offers from competing lenders, and by understanding the cost and terms of the loans, consumers can make accurate comparisons and identify the least expensive loan that fits their needs."[21]

Current disclosures have failed to keep pace with market innovations. Consumers are not being given the tools needed to effectively shop for a mortgage in a market with increasingly innovative and complex options. The FTC study reveals that both prime and subprime borrowers failed to understand key loan terms when viewing current disclosures, and both groups of borrowers benefited when given improved prototype disclosure forms. In addition to showing that current mortgage disclosures are ineffective at conveying key mortgage costs to consumers, the prototype disclosures developed by the FTC and used for this study illuminate the importance of consumer testing and demonstrate the fact that creating a better disclosure form is feasible.[22]

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[20] "Improving Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype Disclosure Forms," Federal Trade Commission, Bureau of Economics, June 2007, p. 1.
[21] Id.
[22] Id., Executive Summary.

NAMB believes it is necessary to create and implement a revised Good Faith Estimate ("GFE") and a new, loan-specific payment disclosure that will: (1) educate consumers about the specific loan product being considered and/or chosen, and (2) enable consumers to comparison shop and ultimately exercise an informed and independent choice regarding a particular loan product.

1. A Revised Good Faith Estimate ("GFE")

In 2005, NAMB proposed a one-page GFE in response to a series of roundtables conducted jointly by HUD and the Small Business Administration.[23] This one-page GFE mirrors the HUD-1 consumers receive at settlement, communicates the loan features and costs, and fully discloses the role of the loan originator in the mortgage transaction. Most important, the revised GFE provides specific information that is most valued by consumers – meaningful closing costs and monthly payment.

This one-page GFE can help curb abusive and predatory lending tactics, such as bait-and-switch schemes, and safeguard homebuyers by clearly and objectively informing them of the role of the loan originator in the transaction and granting them a private right of action against their loan originator.

2. A Loan-Specific Payment Disclosure

There is currently no loan-specific disclosure given to borrowers that effectively communicates the variability of the interest rate and monthly payments for specific loan products. As a result, some borrowers are choosing mortgages without really understanding how much or how often their interest rate and payments can fluctuate. This leaves consumers open to confusion, unable to meaningfully comparison shop, and susceptible to "payment shock."

NAMB recognizes that there is a critical need for a uniform loan-specific disclosure, and that such a disclosure must be required across *all* distribution channels if it is to be effective. The Proposed Illustrations of Consumer Information for Subprime Mortgage Lending ("Proposed Illustrations"), recently issued by the Federal Banking Agencies, is a good first step, but these illustrations do not go far enough. The Proposed Illustrations are not intended as model forms and will not be required by the Agencies. A model loan-specific disclosure form should clearly and concisely outline all of the material terms (*i.e.*, actual rate and payment adjustments under a "worst case scenario") of the specific products that a consumer is considering, and should be mandated across all distribution channels. We believe such a disclosure will minimize the risk of consumer surprise or "payment shock" when interest rates reset on ARM loans.

NAMB strongly encourages Congress to urge the Federal Banking Agencies to adopt a model loan-specific disclosure form and require *all* loan originators to provide this form to consumers, regardless of loan-product type. We believe such a mandate can and should be accomplished through regulation, in order to speed its implementation and ensure its application across all distribution channels. Specifically, we believe a loan-specific disclosure can be required early in the loan shopping stage through RESPA, Regulation X (*e.g.*, it can accompany the initial GFE); and an additional loan-specific disclosure can be required at closing through the TILA, Regulation Z. As with any disclosure, NAMB strongly believes that a loan-specific disclosure should be consumer-tested by an independent third-party or government agency prior to requiring that all mortgage originators provide this form to their customers.

[23] *See,* Appendix E, "NAMB Proposed GFE."

A uniform and straight-forward disclosure, such as the one proposed here, will aid in the comparison shopping process for consumers and will provide a simple and clear explanation of the "worst-case-scenario" for various loan products.

F. Encourage Consumer Financial Literacy

NAMB believes consumers should possess the necessary financial knowledge to carefully evaluate the risks and rewards of different loan products. Financial literacy is the tool that consumers need to make an informed decision as to whether a particular product meets their individual needs. Financial literacy can also be valuable in helping consumers avoid default and foreclosure. If a consumer understands the risks and rewards of the product they choose, they will be more likely to understand their obligations under that product and the ramifications of any failure to satisfy those obligations.

Regardless of how knowledgeable a mortgage originator is or becomes, an educated consumer is always in a better position to make an informed decision when selecting a loan product to match his or her financial needs and goals. Borrowers must possess a certain financial acumen to properly evaluate the risks and benefits of different mortgage products that have been highlighted and communicated by an educated mortgage originator. NAMB urges Congress to allocate funds for financial literacy programs at the middle school and high school levels so that consumers are educated about the financial decisions they make and retain their decision-making ability. NAMB also supports utilizing funds raised from the national mortgage originator registry, discussed above, to support ongoing financial literacy programs in the states.

NAMB has always been a staunch supporter and advocate for consumer financial literacy. Our firm belief that an educated borrower is significantly less likely to face default or foreclosure is demonstrated by our active involvement in various consumer education efforts. Recently, NAMB introduced a pamphlet entitled "What Happens When Your Credit Report is Requested – Stop the Calls; Stop the Junk Mail; Protect Your Credit; Protect Your Identity." This consumer-oriented piece offers tips to avoid identity theft and provides valuable information about what to watch out for in prescreened credit solicitations. NAMB is also preparing to finalize a new consumer brochure that offers some basic tips for first-time homebuyers and defines a number of key mortgage shopping terms.

NAMB commends President Bush for recently announcing his intentions to create a Presidential Council on Financial Literacy, and we look forward to working with other leaders in the financial services industry to raise awareness of the many important and complex issues facing consumers today. We urge Congress, state and federal regulatory agencies, and our partners in the industry to continue to explore avenues of outreach to borrowers and work to educate borrowers on financial literacy throughout their lives, rather than just at the time of application or at the closing table.

G. Maintain Consumers' Role and Responsibility as Decision-Maker

It is imperative, regardless of what measures are ultimately pursued, that we ensure the integrity of the consumer decision-making process remains intact. Consumers are and must remain the ultimate decision makers regarding the product, price, and services purchased in conjunction with mortgage financing. Selecting a mortgage is a very personal choice, and *only* the consumer can determine whether a particular loan product is "suitable" for his or her financial needs and goals, or if it might be in his or her "best" interest to continue shopping. No mortgage originator, company, bank, investor, or government agency should ever superimpose or be required to superimpose its own judgment for that of the consumer.

Consumers currently enjoy the freedom and responsibility to choose their own mortgage products, take advantage of the competitive marketplace, shop, compare, ask questions, and expect answers. No law or

regulation should ever take away consumers' freedom to decide for themselves what is or is not a valuable loan product. NAMB remains opposed to any contemplated law, regulation or other measure that attempts to impose a fiduciary duty upon mortgage originators and strip consumers of their ability to freely choose the product, pricing, and services that meet their individual financial needs and goals.

IV. Conclusion

The reality of today is that any regulatory, legislative, or other governmental effort to address the rising number of foreclosures and help consumers remain in their homes must be undertaken in a thorough and deliberate manner. It is important to bear in mind that the problems consumers are facing have likely been caused by a multitude of factors, and therefore require multifaceted solutions. We anxiously await the results of the GAO study on foreclosures and we look forward to working with Congress to address the needs of consumers today and to craft meaningful safeguards that will protect borrowers into the future.

Consumers want to get loans they can afford and keep. They want to know how much their monthly payment will be, if it will change and how much getting that loan will cost them at the closing table. Consumers deserve more than merely the illusion of protection. Consumers deserve the same level of protection no matter where or with whom they choose to do business.

Thank you for the opportunity to appear before this Committee and discuss this very timely and critical issue. I am happy to answer any questions that you may have.

APPENDIX A

----- Original Message -----
From: Jeff Gantt
To: undisclosed-recipients:
Sent: Tuesday, August 21, 2007 5:33 PM

Dear Valued Customer,

My name is Jeff Gantt and I am the former VP of National Sales & Marketing for PHM Financial Services. Unfortunately PHM decided to withdraw from wholesale operations due to volatile market conditions. My sales team and I have since moved on and have partnered with Horizon Banks, N.A. to create Horizon Banks Wholesale Lending.

Horizon Banks, N.A. is a federally chartered bank based out of Denver, CO. The wholesale lending division is a nationwide wholesaler of Alt-A, Jumbo, Agricultural, Option Arm and Conforming loan programs. We have an extensive product offering with many niche products and unique benefits. One of those unique benefits provides you with the ability to originate loans in **ALL** 50 states with **NO** additional licensing requirements.

Though the current lending market is experiencing radical changes and instability Horizon Banks Wholesale Lending has a wide array of Alt-A and Non Conforming products available.

Feel free to contact me directly or visit our website to obtain product highlights and information.

www.horizonbankswholesale.com

My sales team and I look forward to working with all of you again.

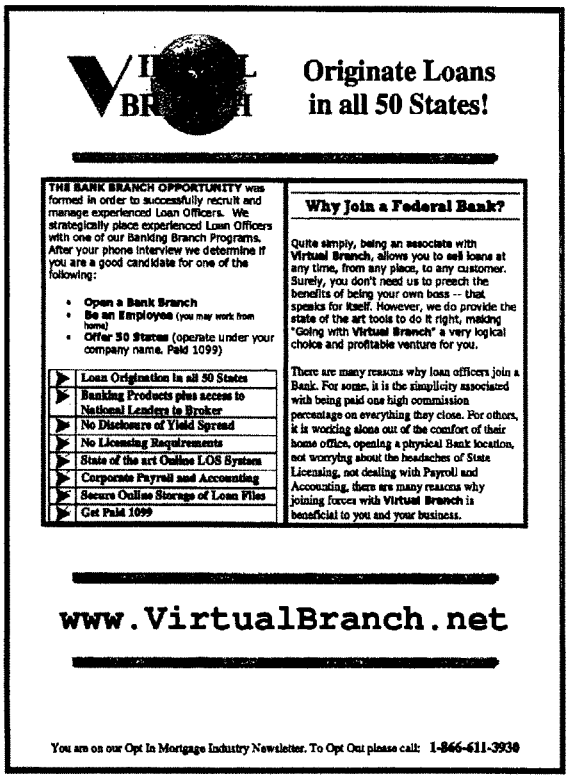
Sincerely,

Jeff Gantt
V.P., National Sales
Horizon Banks Wholesale
Direct: 303.962.0112
Fax: 303.962.0162
www.horizonbankswholesale.com

APPENDIX B

From:
Sent: Sunday, September 09, 2007 9:35 PM
To: governmentaffairs@namb.org
Subject: Another way to avoid state licensing

Am I a sucker to try to comply with state laws when it becomes this easy to avoid them? This is about the fourth offer I've received in recent days to avoid all state licensing requirements. There are probably many more companies with similar offers. I just have not looked for them.



Originate Loans in all 50 States!

THE BANK BRANCH OPPORTUNITY was formed in order to successfully recruit and manage experienced Loan Officers. We strategically place experienced Loan Officers with one of our Banking Branch Programs. After your phone interview we determine if you are a good candidate for one of the following:

- **Open a Bank Branch**
- **Be an Employee** (you may work from home)
- **Offer 50 States** (operate under your company name. Paid 1099)

- Loan Origination in all 50 States
- Banking Products plus access to National Leaders to Broker
- No Disclosure of Yield Spread
- No Licensing Requirements
- State of the art Online LOS System
- Corporate Payroll and Accounting
- Secure Online Storage of Loan Files
- Get Paid 1099

Why Join a Federal Bank?

Quite simply, being an associate with **Virtual Branch**, allows you to sell loans at any time, from any place, to any customer. Surely, you don't need us to preach the benefits of being your own boss -- that speaks for itself. However, we do provide the state of the art tools to do it right, making "Going with **Virtual Branch**" a very logical choice and profitable venture for you.

There are many reasons why loan officers join a Bank. For some, it is the simplicity associated with being paid one high commission percentage on everything they close. For others, it is working alone out of the comfort of their home office, opening a physical Bank location, not worrying about the headaches of State Licensing, not dealing with Payroll and Accounting, there are many reasons why joining forces with **Virtual Branch** is beneficial to you and your business.

www.VirtualBranch.net

You are on our Opt In Mortgage Industry Newsletter. To Opt Out please call: **1-866-611-3930**

APPENDIX C

SOUTH CAROLINA DEPARTMENT OF CONSUMER AFFAIRS: MORTGAGE FRAUD REPORT

March 2007

Written By: Charles M. Knight, Staff Attorney
Brandolyn Thomas Pinkston, Administrator

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Letters from the South Carolina Mortgage Fraud Taskforce:
South Carolina Attorney General
The US Attorney, South Carolina District
The FBI, Columbia Division
South Carolina Field Office, HUD
The Internal Revenue Service, South Carolina Office
South Carolina State Housing Finance and Development Authority

Stop Mortgage Fraud: A Call to Action Brochure

ACKNOWLEDGEMENTS

The South Carolina Commission on Consumer Affairs:

The Honorable Lonnie Randolph Jr., Chair, Columbia
The Honorable Mark Hammond, Secretary of State, Columbia
The Honorable Barbara B. League, Greenville
The Honorable Louis Mayrant Jr., Pineville
The Honorable Tony Macomson, Cowpens
The Honorable Wayne Keith Sims, Columbia
The Honorable Wayne Powell, Gaffney
The Honorable David Campbell, Columbia
The Honorable Carole C. Wells, Woodruff

The Department would like to give special thanks to the following SCDCA Staff

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The Department would also like to give special thanks to the following

Mortgage Fraud Taskforce members:

The Honorable Henry McMaster, South Carolina Attorney General
Gene McCaskill, South Carolina Attorney General's Office
The Honorable Reginald I. Lloyd, US Attorney, South Carolina District
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Lisa Bussey, South Carolina State Housing Finance and Development Authority

South Carolina General Assembly and their staff

Mortgage fraud is one of the fastest growing crimes in the United States. In their latest report, the Federal Bureau of Investigation (FBI) identified South Carolina as one of the top ten "hot spots" for mortgage fraud in the United States. **The South Carolina Attorney General further indicates that South Carolina has directly and disproportionately been targeted for this type of fraud.**

WHAT IS MORTGAGE FRAUD?

Mortgage fraud is a material misrepresentation, misstatement or omission that is relied upon by an underwriter or lender to fund, purchase, or insure a loan. Mortgage fraud is insidious, robbing homeowners and seniors of the equity in their homes and preventing first time home buyers from buying a home - the American Dream. Mortgage fraud also hurts the economy, since the housing industry has been its driving force in recent years. Therefore, we all lose. There are generally three motives for mortgage fraud: fraud for profit, fraud for housing and fraud to support or hide other criminal activity.

Fraud for profit is generally perpetrated by those inside the housing and mortgage industry. To be able to perpetrate the fraud requires the insiders to work together, resulting in a conspiracy. The list of those involved includes real estate agents and brokers, loan originators for mortgage brokers and lenders, homebuilders, appraisers, title insurance agents and closing attorneys, as well as others. **Cases in the last three years prosecuted by the United States Attorney's Office in South Carolina have resulted in convictions or plea agreements of over 80 individuals who were insiders as described above.** The fraudulent schemes include property flips, loans based on fictitious properties, misrepresenting investment property as owner-occupied property, misrepresenting or using the personal identity of others (identity theft), using false or forged documents very often through "straw buyers" to obtain a loan, and creating fictitious or nonexistent payees.

Fraud for housing is generally initiated either by a homebuyer or with their assistance so they can purchase or refinance a home. This type of fraud, although assisted by the homebuyer, generally results in huge profits for the insiders. Typically, the borrower will misstate income and/or expenses or forge documents to qualify for a mortgage or lower interest rates.

Fraud to support or hide other criminal activity, usually involves criminals using the mortgage industry to launder money or using the proceeds from a mortgage fraud scheme to fund other criminal activity. The fraudulent schemes include drug traffickers purchasing homes at inflated prices to launder money, terrorists buying safe houses and homes purchased for other criminal

activity, such as drug manufacture, prostitution, "chop shops" or counterfeiting. According to the FBI, criminals see the large sums of money in the mortgage industry as more profitable and less risky than other crimes.

WHAT IS CAUSING THE INCREASE IN MORTGAGE FRAUD?

The following information is excerpted from various reports on the mortgage industry and provides a historical perspective on the changes that are attributable to the increases in mortgage fraud experienced today.

The mortgage industry used to be a highly regulated business. Most mortgages were originated "in house" by banks and savings and loan companies. "In house" means bank employees originated the mortgages and the bank retained and serviced the mortgages. The banks and savings and loan companies were all highly regulated, primarily by federal regulators, however with the collapse of the savings and loan companies, new players entered the market. These new players included mortgage brokers and mortgage bankers. The mortgage brokers essentially took the place of the "in house," employee/originators, and the mortgage bankers provided the funding, wholesale lenders. Mortgage bankers either sell their mortgages in the secondary market or hold them. If they hold the mortgages they will either service them or sell the servicing rights to others. Other new players include joint ventures between banks and others in the housing industry, for example, real estate agents/brokers, homebuilders and others. The mortgage bankers, brokers and joint ventures, in most cases, are only regulated by the individual states. Until recently, most states did not regulate these industries, or if so, only minimally.

The mortgage industry has seen phenomenal growth, grossing approximately $400 billion in 1999 to between $2 and $4 trillion in 2006. Based on recent history, it appears this growth will continue. Additionally, the mortgage industry is very competitive; forcing those in the industry to cut their costs, reduce the time from origination to closing and to introduce new products. Cost cutting has seen a shift from quality control to production. Quality control is where you would expect questionable loans to be identified. Reducing the time to close has taken the human element, the experienced eyes that would detect fraud, out of the process. Additionally, the shift to automated underwriting, again takes quality control out of the equation. In some cases, the new products, such as low documentation and no documentation loans (low doc and no doc) being offered are more prone to fraud. Low doc and no doc loans require less or no verification of the applicant's income or assets.

With these conditions and the possibility of making extraordinary amounts of money, the industry attracts unsavory characters with little or no experience or regulatory oversight.

WHO PAYS FOR MORTGAGE FRAUD?

We all pay, directly or indirectly. Homeowners and homebuyers pay directly through increased costs for mortgages and higher property taxes as fictitious appraisals and property flips increase property values. Indirect costs include taxes and lender costs to fight and/or prevent such crimes. Lenders also pass on their increased costs to consumers.

WHAT IS THE EXTENT OF MORTGAGE FRAUD?

The short answer is we do not know. Primarily because there is not a single repository or clearing house for mortgage fraud information, the extent of mortgage fraud is unknown. This need has been recognized by the FBI, industry and state regulators as a shortfall.

The FBI obtains their information based on Suspicious Activity Reports (SARs), however, only federally regulated entities are required to file SARs. Regardless, there is an increase in the number of SARs filed nationally, from 62,388 in 1996 to 522,655 in 2005. The latest report from the FBI states 279,703 SARs were filed in the first six months of 2006, with the expectation that 2006 will break all records. Also in this report, the FBI indicated South Carolina is one of the "Top Ten Hot Spots" for mortgage fraud. Additionally, the report shows that the foremost occupations for the fraudsters as finance related, including mortgage brokers, lenders and their employees. The types of fraudulent mortgage loan activity reported included falsification of the loan application, identify theft/fraud, misrepresentation of loan purpose or misuse of loan proceeds, appraisal fraud, fraudulent flipping of property and fraud involving multiple loans.

The Mortgage Asset Research Institute (MARI) is another source of information on mortgage fraud. MARI receives information primarily from subscribers, primarily mortgage lenders, therefore the data is not complete, but it paints a bleak picture as well. MARI attributes some of the reported mortgage fraud on the following factors: high origination volumes have strained lenders quality control processes, companies concentrating on production demands, assigning new, less trained staff in production where seasoned employees might detect mortgage fraud and the introduction of non-traditional products with less

quality control. MARI ranks individual states based on a mortgage fraud index. From 2001 through 2004, MARI reported South Carolina in the top ten in the United States in mortgage fraud. However in their latest report South Carolina has moved to number nineteen. An improvement, but we should not be satisfied, last place is our goal. To achieve this goal, we need to move forward with additional measures to further reduce mortgage fraud.

The FBI and MARI both agree that mortgage fraud is on the increase. A concerted effort is necessary to combat mortgage fraud; otherwise it could cripple the industry and prevent every American's dream of home ownership.

WHAT HAVE WE DONE IN SOUTH CAROLINA?

On June 3, 2003, South Carolina's Governor signed the South Carolina High Cost and Consumer Home Loans Act (the Act), with an effective date of January 1, 2004. This historic legislation's purpose was to curb abusive residential mortgage lending practices in South Carolina. Added to the Consumer Protection Code, the Act gave the Department of Consumer Affairs (Department) the primary responsibility for its enforcement. The Act is very similar to the Predatory Lending Act (PLA) in North Carolina. However, North Carolina soon realized that the PLA was not enough. Additional legislation was required to set minimum standards for all elements of the industry - lenders and brokers alike; and to give the State the authority necessary for enforcement. The solution was the Mortgage Lending Act (MLA). The MLA was a collaborative effort of consumer advocates, industry leaders and lawmakers. Without this comprehensive licensing law, authorities were unable to find those in violation of the PLA. In South Carolina, we find ourselves facing the same problem.

On January 13, 2005 Act Number 7, amendment to Title 40 Chapter 58, Licensing Requirements Act of Certain Brokers of Mortgages on Residential Real Property became law. The amendment required the licensing of originators for Mortgage Brokers and established minimum standards to be licensed. These standards provided a threshold for a segment of the industry and the Department enforcement authority. Prior to passage of this legislation no minimum standards, in experience or education, or a mechanism to check even state criminal records for originators employed by mortgage brokers existed. However, this was only the first step necessary for regulation and enforcement in the mortgage industry. **Mortgage lenders and their originators are basically unregulated. There is no oversight by the State. Additionally, first mortgages and junior liens less than 12% have little or no protections for consumers under the Consumer Protection Code. Most mortgages in today's market are funded and in some cases originated by non-depository mortgage bankers,**

who in most cases are only regulated by the individual states. In South Carolina, that regulation is missing.

The South Carolina Department of Consumer Affairs, in coordination with the North Carolina Commissioner of Banks, the Georgia Department of Banking and Finance, the Florida Office of Financial Regulation and the Department of Housing and Urban Development (HUD) (Southeastern Region) sponsored a mortgage fraud conference in Savannah, Georgia on June 22, 2006. The conference, Stop Mortgage Fraud, Spot it! Stop it!, was attended by state and federal regulators and law enforcement, including the sponsors, the FBI, the US Attorney for SC and NC, other law enforcement and regulators, and industry professionals. The conference resulted in increased cooperation and information sharing between all participants to combat mortgage fraud. As an example, the Department has referred several cases to the FBI, IRS and the Secret Service in recent months and routinely shares information with other state regulators.
(SEE ATTACHMENT)

In addition, the Department has sponsored and conducted numerous classes on detecting and preventing mortgage fraud. These classes were given to mortgage professionals in South Carolina. Also the Department participates in other educational events such as the Palmetto Affordable Housing Forum. Lewis Burns, Chair of the Department's Mortgage Broker Advisory Board said, "We still have a lot of work to do and I look forward to working with the Department in making South Carolina a state free of mortgage fraud."

HOW DO WE COMBAT MORTGAGE FRAUD?

We combat mortgage fraud by using a two-pronged approach: First, identify and prohibit known perpetrators from engaging in business, then investigate and prosecute the perpetrators.

To identify and prohibit known perpetrators (fraudsters), requires a licensing process that includes national records checks, including FBI and state criminal records and adjudicated enforcement actions by licensing authorities in other states. Fraudsters are known to be mobile, moving from one state to another, and migrating from one industry to another. For example, an investment adviser in South Carolina lost his securities license as a result of converting an investors funds to his own. This person then changed to the mortgage industry and was recently prosecuted for mortgage fraud. The licensing must include loan originators whether employed by mortgage brokers or lenders, first and second mortgage lenders and mortgage servicing companies. **(See Comparison of SC and NC licensing laws at Attachment)** The mortgage industry has become for the most part, national and even international in scope but regulation and enforcement should remain with the state where the actual

damage is felt. We looked at other states' laws, including North Carolina, and believe that there can be a balance between necessary regulation and any burden to the industry. **(See Attachment that show states that regulate mortgage brokers, lenders and services)**

We have also been working with our national associations, American Association of Residential Mortgage Regulators (AARMR) and the Conference of State Bank Supervisors (CSBS) to develop a National Licensing System. It is intended to be a web-based licensing application system that would be used by all states and make available licensing and adjudicated actions against a licensee to all states in which a license is sought. This will help curb fraudsters and bad actors from moving from one state to another as they do now.

The member states are also working to increase uniformity for licensing and regulation of the mortgage industry. We believe that this initiative will help lessen the burden on the industry as well. HSBC's Presentation to the National Conference of State Legislatures reinforces this concept. Furthermore, another area of concern is mortgage servicing. The Department receives a significant number of consumer complaints related to mortgage servicing, another part of the mortgage industry that is essentially unregulated, but affects our largest investment, our home.

To effectively prosecute requires a clearinghouse for all suspected mortgage fraud and a coordinated effort to investigate and prosecute the perpetrators, including local, state and national authorities. The Department is already working with state and national authorities, including the Attorney General of South Carolina, the FBI, the Secret Service, the IRS, the US Attorney's Office and HUD in this effort. We have formed a mortgage fraud task force and have started sharing information. More needs to be done; we need the assistance of local and state law enforcement and solicitors in the investigation and prosecution of perpetrators. In addition, state and local law enforcement need clear authority and guidance on the crime of mortgage fraud. And finally, the Department needs the law changes previously identified to assist in enforcement actions and identifying the fraudsters.

RECOMMENDATIONS

- Enact a Comprehensive Mortgage Lending Act
- Consider Participation in the National Licensing System
- Continue working with other states to develop uniformity in licensing and regulation of the Mortgage Industry
- Assist in establishing a National Clearinghouse for Reporting suspected mortgage fraud that includes a toll-free number.

TIPS TO PREVENT YOU FROM BECOMING A VICTIM OF MORTGAGE FRAUD

General Tips:
If it sounds too good to be true—it probably is!

Never sign a blank document or a document containing blanks. This leaves you vulnerable to fraud.

Don't sign anything you don't understand.

Mortgage Fraud Prevention Tips:
Get referrals for real estate and mortgage professionals. Check the licenses of the industry professionals with state, county, or city regulatory agencies.

Be suspicious of outrageous promises of extraordinary profit in a short period of time.

Be wary of strangers and unsolicited contacts, as well as high-pressure sales techniques.

Look at written information to include recent comparable sales in the area and other documents such as tax assessments to verify the value of the property.

Understand what you are signing and agreeing to. If you do not understand, re-read the documents or seek assistance from an attorney.

Make sure the name on your application matches the name on your identification.

Review the title history to determine if the property has been sold multiple times within a short period. It could mean that this property has been "flipped" and the value falsely inflated.

Know and understand the terms of your mortgage. Check your information against the information in the loan documents to ensure they are accurate and complete.

KEY TERMS OF FRAUD SCHEMES

Backward Applications: After identifying a property to purchase, a borrower customizes his/her income to meet the loan criteria.

Air Loans: These are non-existent property loans where there is usually no collateral. An example would be where a broker invents borrowers and properties, establishes accounts for payments and maintains custodial accounts for escrows. They may set up an office with a bank of telephones, each one used as the employer, appraiser, credit agency, etc., for verification purposes.

Silent Seconds: The buyer of a property borrows the down payment from the seller through the issuance of a non-disclosed second mortgage. The primary lender believes the borrower has invested his money in the down payment when, in fact, it is borrowed. The second mortgage may not be recorded to further conceal its status from the primary lender.

Nominee Loans: The identity of the borrower is concealed through the use of a nominee who allows the borrower to use the nominee's name and credit history to apply for a loan.

Property Flips: Property is purchased, falsely appraised at a higher value, and then quickly sold. What makes property flipping illegal is that the appraisal information is fraudulent. The schemes typically involve fraudulent appraisals, doctored loan documents, and inflation of the buyer's income.

Foreclosure schemes: The subject identifies homeowners who are at risk of defaulting on loans or whose houses are already in foreclosure. Subjects mislead the homeowners into believing that they can save their homes in exchange for a transfer of the deed and up-front fees. The subject profits from these schemes by re-mortgaging the property or pocketing the fees paid by the homeowner.

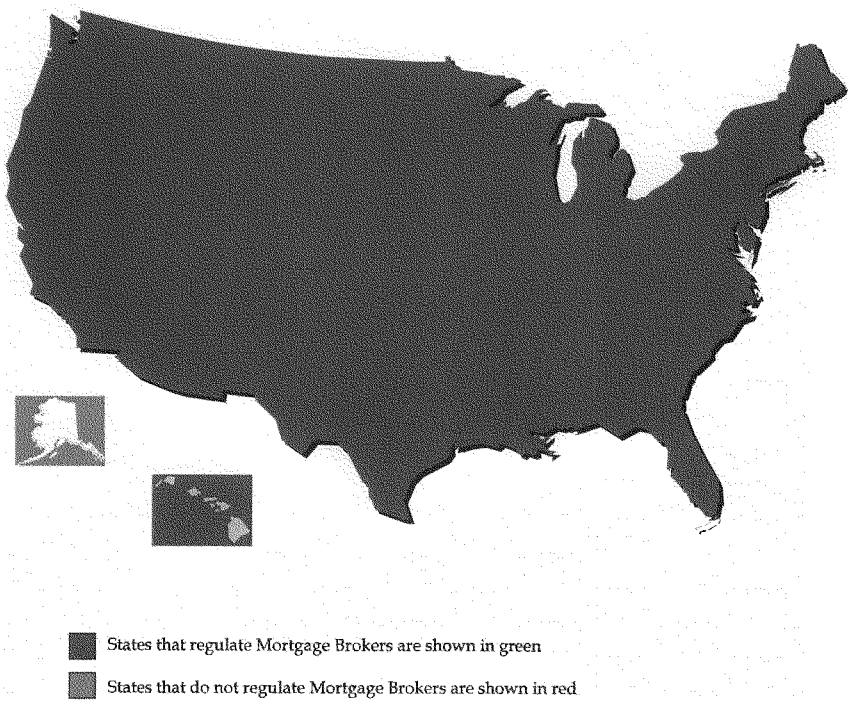
Equity Skimming: An investor may use a straw buyer, false income documents, and false credit reports to obtain a mortgage loan in the straw buyer's name. Subsequent to closing, the straw buyer signs the property over to the investor in a quit claim deed which relinquishes all rights to the property and provides no guaranty to title. The investor does not make any mortgage payments and rents the property until foreclosure takes place several months later.

COMPARISON OF SOUTH CAROLINA AND NORTH CAROLINA LAWS RELATED TO THE MORTGAGE INDUSTRY

Mortgage Brokers	South Carolina	North Carolina
Broker License	Yes	Yes
Originator License	Yes	Yes
Licensee Testing	**No**	Yes
Prelicensing Education	**No**	Yes
Continuing Education	Yes	Yes
Criminal records check	SC only, no fingerprints	NC and FBI, requires fingerprints
Surety bond	$10,000	$50,000
Registration for exemptions	**No**	Yes

Mortgage Bankers/Lenders	South Carolina	North Carolina
Lender License	Only for 2nd Mortgages greater than 12% (Supervised Lender)	Yes
Originator License	**No**	Yes
Licensee Testing	**No**	Yes
Prelicensing Education	**No**	Yes
Continuing Education	**No**	Yes
Criminal records check	**No**	NC and FBI, requires fingerprints
Surety bond	0	$150,000
Registration for exemptions	**No**	Yes

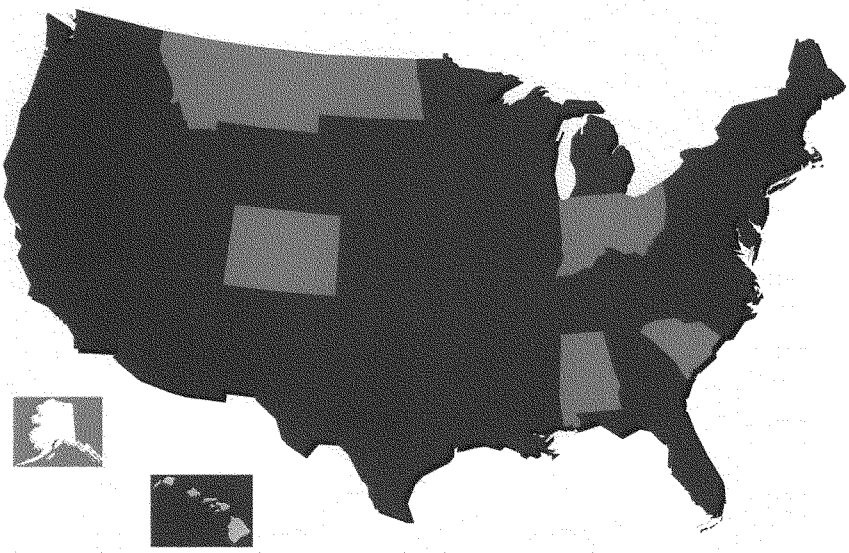
US MAP SHOWING STATES THAT REGULATE MORTGAGE BROKERS



States that regulate Mortgage Brokers are shown in green

States that do not regulate Mortgage Brokers are shown in red

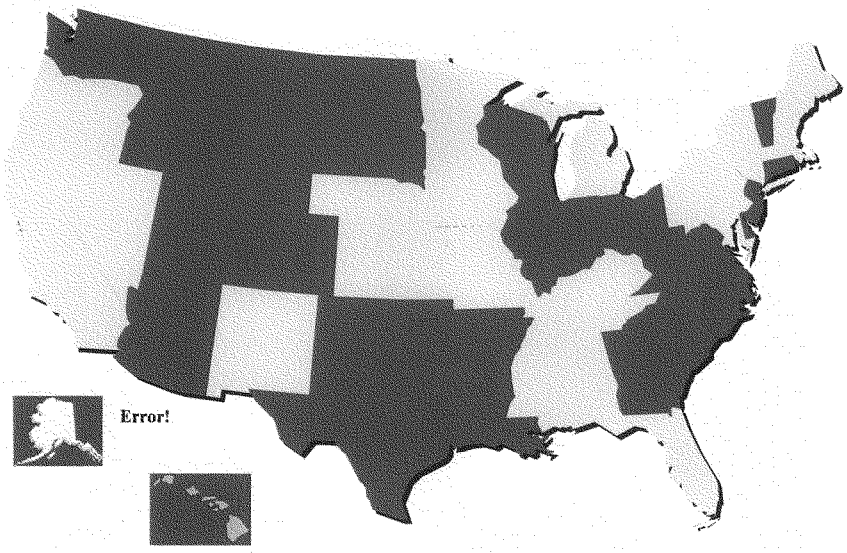
US MAP SHOWING STATES THAT REGULATE MORTGAGE BANKERS/LENDERS



States that regulate Mortgage Bankers/Lenders are shown in blue

States that do not regulate Mortgage Bankers/Lenders are shown in red

US MAP SHOWING STATES THAT REGULATE MORTGAGE SERVICERS



States that regulate Mortgage Servicers are shown in yellow

States that do not regulate Mortgage Servicers are shown in green

SOUTH CAROLINA
STATE HOUSING
FINANCE AND DEVELOPMENT AUTHORITY

Division: Special Projects

Subject: High Cost Home Loan Counseling Program

Calendar Year 2005 Update

The Legislation
On June 3, 2003, Governor Mark Sanford signed into law the South Carolina High Cost and Consumer Home Loans Act (Act No. 42) in an effort to protect consumers from predatory lending practices. Under the new law, borrowers seeking a "high cost home loan" must be advised by the lender that free counseling by an approved counselor is required before securing the loan. Along with definitions and procedures, the law also includes provisions for both enforcement and education. These are key provisions for the success of the law. Subsequently, the South Carolina Department of Consumer Affairs was tasked with enforcement of the law and the South Carolina State Housing Finance and Development Authority was tasked with educating consumers about the law, primarily in the form of consumer counseling.

The Loan
The law addresses loans that include home mortgages, such as first mortgages, mobile home and land, purchase money and home improvements and manufactured homes without land, auto title lenders and mortgage brokers. Aside from traditional loan closing procedures, those loans that are considered "high cost home loans" also have additional requirements specifically related to borrower counseling. That counseling is facilitated by the use of a checklist. The checklist is a list of items each counselor will cover with the borrower including questions regarding the borrower's individual circumstances, the terms of the loan, the fees of the loan and any other information deemed appropriate.

A High Cost Home Loan has the following components: having a principal amount that does not exceed the Fannie Mae conforming loan size limit for a single-family dwelling; is incurred for primarily personal, family, or household purposes; is secured either by a security interest in a manufactured home or a mortgage on real estate upon which there is or there is to be located a structure designed principally for occupancy for 1-4 families and which will be occupied primarily as a principal dwelling; and meets one of two thresholds. The thresholds are: Interest Threshold, first mortgage – 8% over US Treasury securities, second mortgage and manufactured housing – 10% over US Treasury securities; or, Points and Fees Threshold, loans greater than $20,000 – 5% of the loan, loans less than $20,000 – 8% of the loan, non-real estate manufactured homes – 3% of the loan.

The Borrower
The law was enacted to protect South Carolina's most vulnerable citizens. Typically, "high cost home loan" borrowers fall into one or more of the following categories: poor credit and/or insufficient collateral and either thinks or actually is incapable of being financed by a more traditional lender; good credit, but thinks he/she has bad credit; good credit, but trusts the high cost lender more or is hesitant to use a traditional lender; or, needs money quickly and feels a traditional lender would be too slow. It is because of these perceptions and 'feelings' that the role of the counselor becomes so critical. Some may be completely inaccurate and burden the borrower with unnecessary risk.

The Counselor
A High Cost Home Loan Counselor is primarily an educator. According to the law, the counselor is to counsel "...on the advisability of the loan transaction and the appropriate loan for the borrower." The South Carolina Department of Consumer Affairs has interpreted this to mean that "...the counselor's role should be that of an educator, facilitating the borrower's awareness of the loan's terms and costs."

The criteria for becoming a counselor is experience in housing counseling, credit or financial counseling, or a background in the mortgage lending industry – although a counselor must not have any current interest or affiliation with any lenders – attendance of a training session and signing of the Counselor's Assurance, which assures that the counselor will act in the best interest of the borrower, will neither collude with nor act on behalf of any lending institution and will conduct themselves professionally. With tools such as the Truth in Lending Disclosure, a good faith estimate of closing costs and a copy of the borrower's credit reports, the counselor educates the borrower on the terms of the loan, the importance of credit and other financial implications. It is the end-goal of the counselor, though, that is the most critical: to convey to the borrower the risks associated with high cost home loans.

The Program
The inception of the High Cost Home Loan Counseling Program was January 1, 2004 when the South Carolina High Cost and Consumer Home Loans Act became effective. For the first year, counselors were volunteers and were not compensated for their sessions conducted. In January 2005, The Board of Commissioners of the Authority decided to begin compensating counselors for their efforts. Compensation was set according to a determined schedule. Aside from these actions and the increase in recruitment with corresponding training, no major changes were instituted in the program in 2005.

Following is a review of the program since its inception.

Table 1. Measures of High Cost Home Loan Program Since Inception Presented by Calendar Year

Measure	2004	2005	2006	2007
Number of Sessions for	200	142		

Calendar Year				
Number of Sessions for First Quarter	37	38		
Number of Sessions for Second Quarter	63	35		
Number of Sessions for Third Quarter	54	42		
Number of Sessions for Fourth Quarter	46	27		
Number of Counselors	74	73		
Percent of Counselors Participating	51%	29%		
Number of Counties with Sessions	28	*		
Percent of Loans Less Than $20,000	69%	63%		
Percent of Loans Greater Than $50,000	8%	3%		
Percent of Loans for Debt Consolidation	43%	30%		
Percent of Loans for Home Improvement	29%	21%		
Percent of Loans for First Lien	85%	92%		
Percent of Loans for Refinance	32%	32%		
Average Amount Borrowed	$16,583.00	$18,741.00		
Highest Amount Borrowed	$180,000.00	$258,504.00		
Least Amount Borrowed	$2,300.00	$2,907.00		
Cost of Counseling Program**	$0.00	$7,590.00		

* Data is not available for the referenced year.

** Cost is based solely on invoices submitted to SCSHFDA by High Cost Home Loan Counselors. In 2004, counselors were volunteers.

Conclusion

The activity in the High Cost Home Loan Counseling Program seems to have dropped significantly, as has the participation of the counselors. Most of the other indicators for 2005 appear to be of an approximate level with 2004, varying more in the mix of the categories than in the categories themselves. The Authority staff will continue to develop more appropriate measures of the effectiveness of the program, including conducting open sessions for discussing issues that have arisen for counselors in the course of their provision of services, periodic updates to participating counselors and inclusion of information sessions during the Palmetto Affordable Housing Forum. Since the nature of the responsibility of the Authority in this legislation is to provide consumers with adequately trained counselors who can advise them on the appropriateness of the loan, no effort has been made to gather information on the effectiveness of the legislation; merely on the effectiveness of the educational program.

U.S. Department of Justice

United States Attorney

District of South Carolina

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Reply to: Columbia

October 2, 2006

Brandolyn Thomas Pinkston
Administrator
SC Department of Consumer Affairs
P.O. Box 5757
Columbia, SC 29250

Re: Mortgage Fraud Consumer Report

Dear Ms. Pinkston:

As you prepare your report on mortgage fraud to consumers in South Carolina, please consider for inclusion the following from the United States Attorney's Office, District of South Carolina:

The United States Attorney's Office, District of South Carolina, has actively prosecuted individuals involved in mortgage fraud, with approximately 80 convictions obtained over the last three years across the state. Federal law prohibits providing false information to a bank in connection with a mortgage loan, and authorizes sentences of up to 30 years in prison and a fine of $1,000,000.00. Federal agencies that investigate mortgage fraud include the FBI, Secret Service, IRS, the Postal Inspector, and the Department of Housing and Urban Development (HUD).

Those prosecuted in South Carolina for mortgage fraud include mortgage brokers, loan officers, developers, appraisers, real estate agents, closing attorneys, paralegals, and borrowers. In each case, the individual convicted played a role in misleading the mortgage lender as to the true nature of the transaction at issue, and usually a coordinated effort was undertaken by two or more individuals in the deception. For example, in Columbia last year a developer and appraiser conspired to fraudulently inflate the value of a residence, while in Anderson a mortgage broker and loan officer conspired to hide from the bank a borrower's debts on loan applications. In both cases, the respective lender was misled by the false

information, and those involved were held responsible.

Recent cases handled by the U.S. Attorney's Office included frauds involving: (1) false submissions to lenders concerning the creditworthiness of borrowers; (2) inflated appraisals; (3) illegal flip transactions, in which properties were bought at low prices, then immediately resold at falsely inflated prices; and (4) fraudulent refinancing transactions. In each case, false information was relied upon by the lender in making loans to otherwise unqualified borrowers to purchase or refinance over-valued houses. The illicit proceeds were often taken by the perpetrators as bogus repair or renovation costs, unearned commissions, or false creditor pay-offs. The borrowers victimized by these mortgage frauds found themselves owing more on their houses than they were worth, and saddled with monthly mortgage payments they couldn't afford. They ultimately defaulted on their mortgages and abandoned their homes, which adversely affected the values of neighboring homes.

Consumers considering a real estate transaction should be wary of unscrupulous individuals that purport to be working for the consumer, but who in fact are only interested in obtaining a share of the bank's loan proceeds for themselves. These individuals may attempt to convince potential mortgage loan borrowers that there is nothing wrong with omitting poor credit information on loan applications, or providing the lender with documents that misrepresent the condition and value of properties to be purchased. Consumers should realize that such activity is illegal, and can result in federal prosecution for a knowing participation in mortgage fraud. A key point for consumers to remember is that honest real estate professionals will never ask potential borrowers to lie about anything. Should such a request be made, borrowers are urged to contact law enforcement and the S.C. Department of Consumer Affairs immediately.

I hope this submission proves helpful. If you require anything further, please contact me.

Sincerely,

REGINALD I. LLOYD
UNITED STATES ATTORNEY

By _____

Kevin F. McDonald
Chief Assistant United States Attorney
General Crimes Section
1441 Main Street, Suite 500
Columbia, South Carolina 29201
(803) 929-3000

Mr. William Dudley Gregorie, Former Field Office Director, US Department of Housing and Urban Development (HUD) stated that "Mortgage fraud was one of the fastest growing crimes in America" with the number of pending cases nearly doubling in the past three years." One of the most common mortgage fraud schemes is to sell a home at a hugely inflated price, relying on phony appraisals.

A property is acquired at a low or modest price and little or no rehabilitation repairs are performed. The house is then placed on the market at a much higher price of up to several times the acquisition cost. The new price is supported by a bogus appraisal. This type of property flipping is a crime that takes the collusion of several parties to pull off," Gregorie states. "That's why when you see cases of flipping mortgage fraud, you'll usually find some combination of real estate brokers/agents, appraisers, and mortgage brokers involved.

New anti-flipping rules instituted by HUD for FHA mortgages have taken effect that restrict property flipping. Properties must be owned for ninety days before resale and the costs of repairs and improvements must be documented. These changes in policy have reduced mortgage fraud in property flipping resales." Mr. Gregorie also cited the work of HUD's approved Housing Counseling Agencies through their homebuyer education programs. "More knowledgeable purchasers have contributed to a reduction of Mortgage Fraud in South Carolina."

The U.S. Department of Housing and Urban Development, Atlanta Region and its partners including the South Carolina Department Consumer Affairs Office sponsored free symposium for Mortgage Professionals on "Stop Mortgage Fraud". Recent published and broadcast news reports highlight many cases of mortgage fraud. Georgia, Florida, North Carolina, South Carolina are among the top five states in the Nation where mortgage fraud was most prevalent. The Symposium and the news media increased awareness of fraud by identifying all types of fraud within the single family housing industry, fostered relationships with other industry partners, and raised consumer awareness.

IRS Nationwide Enforcement Actions Real Estate Fraud

Real Estate Fraud: Facts, Figures and Closed Cases

IRS Criminal Investigation (CI)
October 2006

Special agents with IRS Criminal Investigation are uniquely equipped to investigate mortgage fraud and illegal real estate crimes.

When times are booming, you can expect to see increases in frauds and schemes that victimize people and businesses, including struggling low-income families lured into home loans they cannot afford, legitimate lenders saddled with over-inflated mortgages and honest real estate investors fleeced out of their investment dollars.

IRS criminal investigators find common real estate schemes, which include:

- **Property Flipping** — A buyer pays a low price for property, and then resells it quickly for a much higher price. While this may be legal, when it involves false statements to the lender, it is not.
- **Two Sets of Settlement Statements** — One settlement statement is prepared and provided to the seller accurately reflecting the true selling price of the property. A second fraudulent statement is given to the lender showing a highly inflated purported selling price. The lender provides a loan in excess of the property value, and after the loans are settled, the proceeds are divided among the conspirators.
- **Fraudulent Qualifications** — Real estate agents assist buyers who would not otherwise qualify by fabricating their employment history or credit record.

In these real estate fraud cases, the income earned from these schemes is often laundered to hide the proceeds from the government. Money laundering is simply a process of trying to make money earned illegally to look like it was legitimately earned. Many criminal tax investigations focus on money laundering because it is often inseparable from tax evasion.

In addition, the IRS has thousands of returns under audit involving individuals and entities associated with the real-estate business.

As the following statistics indicate, IRS criminal investigations of real estate

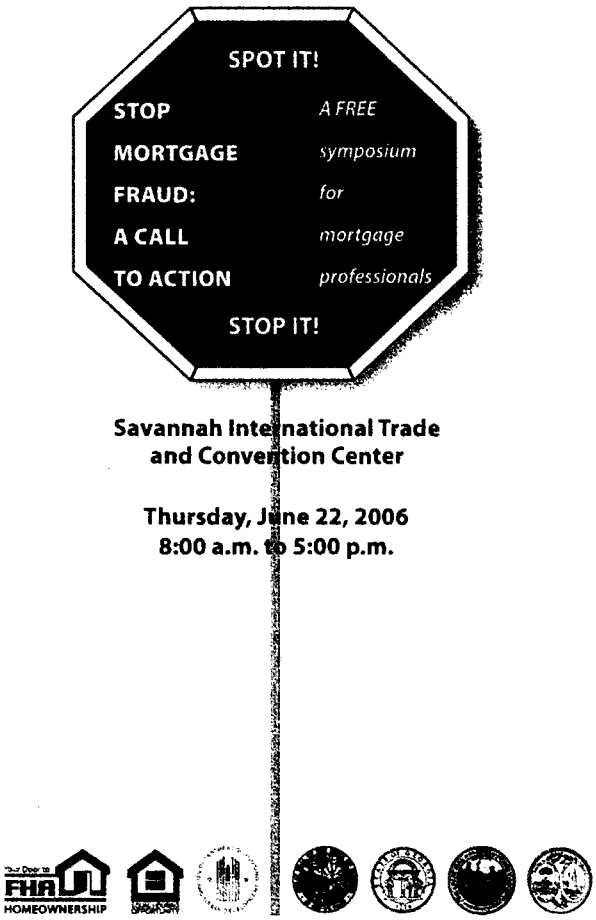
fraud continue to be an area of concern.

IRS Criminal Investigation
Real Estate Fraud Statistics

	FY 2004	FY2003	FY2002
Investigations Initiated	194	215	194
Prosecution Recommendations	148	117	148
Indictments/Informations	102	94	102
Convictions	89	81	89
Sentenced	78	65	78
Incarceration Rate*	92.3%	87.7%	92.3%
Avg. Months to Serve	41	46	41

*** How to Interpret Criminal Investigation Data**
Since actions on a specific investigation may cross fiscal years, the data shown in cases initiated may not always represent the same universe of cases shown in other actions within the same fiscal year. Therefore, in fiscal year 2004, the data should reflect an increase in convictions and sentenced due to the fiscal year 2003 increase in case initiations, prosecution recommendations and indictments.

***Incarceration may include prison time, home confinement, electronic monitoring, or a combination.**


SPOT IT!
STOP
MORTGAGE
FRAUD:
A CALL
TO ACTION
A FREE
symposium
for
mortgage
professionals
STOP IT!
Savannah International Trade
and Convention Center
Thursday, June 22, 2006
8:00 a.m. to 5:00 p.m.
FHA
HOMEOWNERSHIP

STOP MORTGAGE FRAUD: A CALL TO ACTION
Savannah, Georgia
June 22, 2006

8:00-9:00 **Registration & Exhibits Open**

9:00-9:40 **Opening Session**

Introduction of Mayor Pro-Tem
Pattie Wainwright
President, Mortgage Bankers Association of Georgia, Savannah Chapter

Welcome to Savannah
Edna Jackson
Mayor Pro-Tem, Savannah, Georgia

Welcome
"Everyone pays for mortgage fraud."
Bob Young
Regional Director, Region IV, Department of Housing and Urban Development

Why Are We Here
"You can't stop mortgage fraud if you don't know what it is."
Brandolyn Thomas Pinkston
Administrator, South Carolina Department of Consumer Affairs

9:50-12:10 **Where Fraud Begins**

Moderator
"Mortgage fraud has been rapidly increasing over the last several years, and in North Carolina, we believe that the government and industry must work together to address the problem."
Tami Hinton
Director of Consumer Affairs, NC Office of the Commissioner of Banks

Money Laundering - How to Spot It
"Don't let dirty money ruin your reputation, your business, or your profession."
John Atkinson
Assistant Vice President, Federal Reserve Bank of Atlanta

Mission Possible: Preventing Fraud from a Lender Perspective
"Fraud: The dirty side of our business. Don't be a victim or a participant."
Susan Billings
CTX Mortgage

Recent Interviews: Prevention of Fraud from the Real Estate Agents View
"Zero Tolerance"
Grant Simon
President, First Florida Home Loans

Tainted Transactions
"Because that's where the money is."
Seth Weissman
General Counsel, Georgia Association of REALTORS

Regulatory Compliance Investigation and Inflated Property Values
"The real estate and lending regulatory agencies are at war with an elusive enemy identified as fraud, and currently it is believed by many that fraud is winning."
Larry Disney
President, Association of Appraiser Regulatory Officials

10:50-11:10 **Break - Exhibits Open**

Prevention from the Victim's View

"Mortgage fraud is a crime that devastates neighborhoods and destroys naive 'investors'. It can only be stopped by the combined efforts of each segment of the industry using every available tool and resource."
Ann Fulmer
Vice President, Industry Relations, Interthinx

Results of Fraud- Who Is the Real Victim

"When interest rates rise, the potential for fraud also rises."
Debbie Kidd
Housing Director, Homeownership Resource Center, Family Services, Inc.

Over Reliance on Technology - What Lenders are Missing

"Because quality loans come from quality lenders."
Arthur Prieston
Chairman, The Prieston Group

ID and Income Fraud Detection

"Although technology intended to improve consumer services, it has also supported a new boldness by perpetrators of misrepresentation. There's a growing selection of powerful tools that lenders can use NOW to detect and protect against loss."
Robert Knuth
President, NCS/ National Credit-reporting System, Inc.

Questions and Answers

12:10 - 1:25 **Luncheon - Exhibits Open**

"I firmly believe that one of the best ways to prevent fraud is to have educated consumers. That's why we at FHA are trying very hard to get the word out about FHA products. FHA products are designed to protect the consumer and the more folks know to ask for an FHA loan, the better off they are."
Brian Montgomery
FHA Commissioner, Department of Housing and Urban Development

Mortgage Fraud 2005 Trends

"Mortgage Fraud - Where and What's Hot"
Merle Shanik
Manager, Business Development, Mortgage Asset Research Institute, Inc.

1:25-3:00 **How Fraud Gets To Closing - Everyone's Obligations**

Moderator

"Fighting mortgage fraud—government and secondary market expectations"
Alfred Pollard
General Counsel, Office of Federal Housing Enterprise Oversight

What Is Being Done To Resist Mortgage Fraud

"Preventing mortgage fraud takes commitment AND imagination."
William Brewster
Director, Anti-Fraud Initiatives, Fannie Mae

What Expectations are of Market Participants

"If it sounds too good to be true, it IS too good to be true."
Jenny Brawley
Lead Fraud Investigator, Freddie Mac

Top Ten List: What Brokers Can Do to Stop Mortgage Fraud, "The Buck Stops Here!"

"To combat mortgage fraud, each party to the transaction must adhere to the motto, 'The Buck Stops Here!'"
Loretta Salzano
President, Franzen and Salzano, P.C.

The Role of Closing Attorneys in Mortgage Fraud and Expectations of State Regulators

"In S.C. you cannot have meaningful mortgage fraud without the assistance, whether knowingly or unknowing, of an attorney".
Henry Richardson
Disciplinary Counsel, Office of Disciplinary Counsel, Supreme Court of South Carolina

Fraud Affects All Market Participants

"Mortgage fraud - not a victimless crime."
Paul Lee
Chief Investigator, Office of Disciplinary Counsel, Supreme Court of South Carolina

"Mortgage Fraud– Stealing the American Dream & Working Together to Stop It."

"Mortgage fraud is stealing the American Dream."
Charles Knight
Staff Attorney, South Carolina Department of Consumer Affairs

Questions and Answers

2:55-3:15 **Break**

3:15- 4:55 **Enforcement- After the Crime**

Moderator

"We owe it to the American public to constantly be alert for those who prey on the mortgage industry to illegally enrich themselves. Law enforcement and the industry must cooperate with one another and hold offenders accountable."
Michael Stephens
Deputy Inspector General, Department of Housing and Urban Development

"Stings by the FBI"

"One of the cornerstones of the American way of life is home ownership. Confronting and prosecuting those who strive to defraud and manipulate this aspect of American life is a priority for the FBI."
Brian Lamkin
Special Agent in Charge, Columbia Division, Federal Bureau of Invesigation

"Shell Companies - Moving Money Off The HUD 1"

"The Shell Saga, a/k/a "scheme du jour:" the current alternative to the Classic Flip where fraudulently inflated loan proceeds are disbursed to shells companies listed on the HUD 1."
Gale McKenzie
Assistant U.S. Attorney, Northern District of Georgia, U.S. Attorney's Office

"Professionals Making Money Through Fraud"

"We prosecute dishonest brokers, appraisers and lawyers who participate in mortgage fraud because such schemes cannot succeed for long without their help and complicity."
Michael Savage
Chief, Criminal Division, Western District of North Carolina, U.S. Attorney's Office

"Flipping Schemes"

"Joining Forces and Combining Resources Can Significantly Impact Flipping Fraud."
Ruth Valdes,
Assistant Special Agent in Charge, Office of Inspector General, Miami Office, Department of Housing and Urban Development

"Crooked Sellers and Builders"

"Sellers, particularly builders, are the newest culpable group to join the ranks of mortgage fraudsters - happily selling homes at grotesquely inflated values and then kicking money back to other fraudsters."
David McLaughlin
Assistant Attorney General, Office of the Attorney General of Georgia

"Role of State Regulatory Agencies in Preventing Fraud"

"Mortgage Fraud - It can be prevented with your help!"
Andy Grosmaire
Financial Administrator, Bureau of Finance Regulation, State of Florida

Quality Control

"Mortgage Fraud- is like an infectious disease, if left untreated it will continue to spread."
Verlon Shannon
Director, Quality Assurance Division, Atlanta Homeownership Center, Department of Housing and Urban Development

Questions and Answers

4:55- **Closing Remarks and Wrap Up**

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North Carolina Commissioner of Banks
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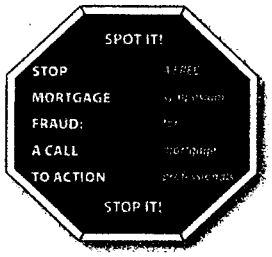

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Popular Mortgage Corporation
Putnam Mortgage and Finance, LLC
South Carolina Mortage Brokers Association

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Atlanta Homeownership Center
Fulton/Atlanta Community Action Authority
Georgia Association of Mortgage Brokers
GREFPAC (Georgia Real Estate Fraud Prevention and Awareness Coalition)
Federal Deposit Insurance Corporation
Interthinx
NAREB
NeighborWorks
Verification Bureau, Inc./Prevent Mortgage Fraud
Quality Mortgage Services
Rural Development (USDA)
Iron Stone Bank
Merchants Credit Bureau
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Charlotte Regional Realtor Association Housing Opportunity Foundation

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APPENDIX D

A Breakdown of the Mortgage Industry and How It Operates

Introduction and Background

NAMB reiterates our steadfast support for, and urges policymakers to move forward with, legislation that empowers consumers to make informed decisions; allows states to afford their citizens protection against predatory lending practices; uniformly fights mortgage fraud across the board; and enables industry to continue its efforts to increase fair and affordable financing to borrowers seeking to achieve homeownership.

The reality today is that any effort—legislative, regulatory or guidance—must take into account how the mortgage market has evolved in relation to the burgeoning growth of the secondary market for mortgages. Any effort must consider that the problems facing the mortgage market are not exclusively attributable to one distribution channel and rather are the result of a combination of factors. The following factors have contributed to the factors we are facing today: originating, underwriting, servicing, debt collection, secondary market investment, securitization, and the bond rating system.

Additionally, any effort must also bear in mind that, in the wake of Watters v. Wachovia, the mortgage industry landscape is now bifurcated. Two separate mortgage camps now exist: those that operate solely under federal regulation *versus* those mortgage participants in the "non-bank camp" that are subject to both federal and state oversight. The "non-bank camp" that is subject to this layered oversight includes mortgage bankers, mortgage lenders, mortgage brokers, in-house or affiliated lenders, state-chartered banks or savings institutions that are not FDIC-insured and state-chartered credit unions, and creditors. In essence, the Watters decision created an imbalance in the mortgage industry oversight scheme that oversees a mortgage market that is vastly different from what it was 20 years ago at the advent of the secondary market for mortgage financing.

Issue

You have asked us to further address and explain the issue with non-traditional mortgage bankers/originators that we discussed during our meeting on Wednesday, June 20, 2007. Specifically, you requested information on how non-traditional mortgage bankers/originators operate; how they could be confused as brokers; and why a consumer would be under the impression that they are representing the consumer and not the bank.

We address each of these questions below.

A. How do non-traditional mortgage bankers/originators operate?

Today, mortgage originator entities and individuals operate functionally in one of three ways:

- As lenders;
- As correspondent lenders; or

- As mortgage brokers.

All three of these "types" distribute their products in one of three principal ways. Some originators distribute products through a retail branch. Some companies distribute products through their correspondent lending division. Some participants distribute products through their broker division.

1. What is a correspondent lender?

It is important to note at the outset that States license people and businesses and that federal mortgage-related statutes generally define and regulate the mortgage transaction (under Real Estate Settlement Procedures Act of 1974 ("RESPA") and Truth in Lending Act ("TILA")). So, irrespective of how a business or individual is treated by the governing state or federal authority, the federal statutes will define the mortgage transaction by its nature. This treatment is what gives rise to lenders acting in various capacities, either in a true creditor capacity, in a table funding capacity,[1] or in a broker capacity (despite the fact that their business license may say "mortgage lender"). When a lender is engaging in any one of these types of transactions and is offering multiple product lines of other lenders they are acting as a correspondent lender.

A correspondent lender is a mortgage banker or mortgage lender that does not typically offer its own product line. Rather, a correspondent lender is a mortgage banker or mortgage lender that has entered into **multiple contracts** with various other banks or lenders to offer their product lines to the consumer. The multiple contracts enable the correspondent lender to offer an array of products and remain competitive in today's market.

Typically, a correspondent lender will close the loan in its own name and fund the loan through its warehouse line of credit. However, the correspondent lender knows in advance that they do NOT want to permanently fund, service or hold the loan and therefore, they act as an intermediary between the consumer and one of the bankers or lenders with whom they have contracted and to whom they will be selling the loan. The correspondent lender will, within five to ten business days after closing, sell the loan to the appropriate bank or lender and be compensated through a servicing release premium (SRP).

Because the correspondent lender has entered into multiple contracts, is offering the loan products of various lenders and banks, and selling the loan in exchange for a SRP, they are functionally acting as brokers. A difference between the correspondent lender and the broker is that the correspondent lender *temporarily* funds the loan at closing and then within 5 to 10 business days releases all interest in that loan and does **NOT** have to disclose all the compensation (*i.e.,* SRP) earned on the transaction. Thus, the interest that the correspondent lender represents is wholly dependent on whose loan product the consumer qualifies for and chooses (*i.e.,* the lender represents the interests of any one of the multiple banks or lenders with whom it has contracted). In a correspondent relationship, the consumer generally does not know until days or sometimes weeks afterward that they are receiving a loan from Banker A, Banker B or Banker C.

With respect to licensing and compensation, a mortgage banker can be licensed in a state so that it can act as ***both*** a mortgage banker and as a mortgage broker. This does not require the entity to obtain multiple licenses. As a mortgage broker, the yield spread premium (YSP) earned must be disclosed. However, the

[1] A correspondent lender can also engage in a table-funded transaction. Table funding is the origination of a loan by a correspondent lender with a simultaneous transfer or sale of the loan at the time of funding to a lender. In a table-funded transaction, the originating company is a creditor for purposes of TILA and therefore, state and federal agencies treat them as lenders. However, The Department of Housing and Urban Development has determined that table-funded transactions are mortgage broker transactions for purposes of the RESPA, subjecting these transactions to the YSP disclosure requirement. Therefore, the correspondent lender who table funds is essentially both a lender and a broker.

entity can choose to act as a correspondent lender under its mortgage banker license and would NOT have to disclose the SRP that is earned on the transaction. Because an entity can act as both a mortgage banker and a mortgage broker in a state, it can choose transaction by transaction whether it wants to originate the loan as a correspondent lender (requiring no disclosure of SRP) or a mortgage broker (requiring disclosure of YSP). Thus, the consumer is not able to discern easily whether the officer is working under the mortgage banker hat or the mortgage broker hat.

2. What is a Broker?

Mortgage brokers generally contract with several wholesale lenders to offer a variety of product options, which their customers may then choose from. Every mortgage provider – whether broker, banker or lender – offers a different set of product choices to borrowers. It is the borrower's responsibility to shop around to different mortgage brokers, as well as banks and mortgage lenders, until they find a loan product they are comfortable with. Although mortgage brokers typically offer a wider array of products to choose from, they do *not* act on behalf of their customers or shop around to find them the best loan product available.

Although they are more alike than different, there are a few differences between a broker and a correspondent lender. A broker does not close a loan in its name because they do not temporarily fund the loan. A broker must also disclose all compensation (*i.e.,* YSP) earned on the transaction. In contrast, the correspondent lender closes the loan in its name and is not required to disclose its YSP/SRP. As mentioned above, correspondent lenders typically sell the loan quickly to another larger lender or bank.

3. What is a Retail Branch?

Retail branches allow banks, non-banks, and broker entities to offer their products directly to the consumer through loan officers working in their brick-and-mortar retail shops. Retail is direct from the bank, non-bank or broker to the consumer. Retail origination can also occur on the phone or through the internet. In addition to retail branches, bank and non-bank entities can also offer products through their correspondent lending divisions or through their wholesale lending division (*i.e.,* broker division), the functions of which are discussed above.

It is important to note that the bank and non-bank entities themselves also can functionally engage in and do engage in correspondent lending with other banks and non-banks through their retail shops. These entities choose to act as correspondent lenders when they know that they do not want to own, service or hold the loan on their books. The bank or non-bank entity 'pre-sells' the loan to another lender and so they know prior to and at closing that they must meet this other lender's criteria.

For example, Bank A can close a loan product in its own name and at closing know that they are almost instantly selling the loan to Bank B. At the time of closing, the consumer has no idea that the loan officer owes their interest **not** to Bank A but to Bank B.

Another example is the non-bank national residential mortgage company licensed in multiple states ("Mortgage Co. X"). Mortgage Co. X has retail branches, a correspondent channel division, and a broker channel division. Through its retail channel, Mortgage Co. X can close a loan in the name of Mortgage Co. X **or in the name of another bank, such as Mortgage Co. Y**. In this fashion, Mortgage Co. X is acting as a mortgage broker for Mortgage Co. Y through Mortgage Co. X's retail branch.

Summary on how non-traditional mortgage bankers/originators operate.

In all three scenarios above, the entity has the ability to engage and does engage in the marketplace as an intermediary between the consumer and various other lending or bank parties through whom they can obtain a loan product for the consumer.

It is important to note that the employed loan officers are all under an employer-employee agency relationship with their respective entities, be it a bank, correspondent lender shop or broker shop. It is the institutions behind the loan officers that have varying interests because they have entered into various contracts with banks and lenders.

Below are a few examples of mortgage bankers or lenders that functionally operate as brokers because they enter into multiple contracts to offer a variety of loan products that are not their own, present the product choices to the consumer and almost immediately after funding the loan sell it to the lender or to the secondary market.

- An in-house mortgage company of a real estate firm.[2]
- An in-house mortgage company of a builder.
- A bank or non-bank retail branch acting as a correspondent lender.
- Private label mortgage companies.
- Small community banks that act as correspondent lenders.

B. How non-traditional mortgage bankers/originators could be confused as brokers and why a consumer would be under the impression that they are representing the consumer and not the bank.

Consumers do not know the difference between various channels of distribution for several reasons:

1. There is no official signage requirement;
2. The branch offices look exactly the same to the consumer, if there is a physical location at all (*i.e.*, internet);
3. In addition, the vast majority of mortgage bankers do not take deposits and their place of operation looks no different than that of a mortgage broker;
4. These entities generally have "mortgage company" in their names and do not have lender, banker or broker in their title;
5. In most states there is no written agreement or disclosure required to tell the consumer the nature of the relationship; and
6. As discussed above, regardless of the name of their company these entities can act in different ways in different transactions.

Therefore, it is not clear to the consumer whether they have walked into a mortgage banker shop and or a mortgage broker shop. This is especially true where so many mortgage bankers get state-licensed as a mortgage banker or lender so that they can do correspondent lending as well as act as a mortgage broker. As a result, many consumers work with someone who they *think* is a mortgage broker only to learn later that he or she is in fact a mortgage banker who is **NOT** required to disclose their back-end compensation; **NOT** required to be licensed; **NOT** subject to criminal background checks; and **NOT** held to any standard of knowledge or expertise.

[2] Commonplace in the industry today are mortgage companies affiliated with other service providers. It is quite common for a mortgage company to be a subsidiary or be affiliated with a real estate agency firm. This creates an ability of the real estate agency to represent the buyer or the seller, or both, in the real estate transaction while also profiting from the mortgage transaction. Similarly, builders of new homes routinely operate in-house mortgage providers and therefore, act also as a seller and a provider of financing. These companies routinely act as correspondent lenders.

Conclusion

As discussed above, today the mortgage banker or lender functionally acts as a broker because they (1) have entered into multiple contracts with various banks and lenders to offer an array of products, (2) know at the time of closing they will quickly sell the loan, and (3) generally know how much they will make off the loan when the sell it. Today, most lenders quickly sell their loans onto the secondary market, blurring the line that once divided lenders and brokers, and destroying the risk - reward equilibrium that mortgage lenders claim is so critical to maintain. As a result, mortgage bankers and lenders are exposed to virtually the same risk as mortgage brokers, and significantly less financial risk than they have been exposed to in the past.

Mortgage bankers and lenders that operate as correspondent lenders are simply 'fronting' the funds for another bank, lender or the secondary market, and then being compensated from the market, in addition to the consumer, for such temporary fronting of funds. Unfortunately, to the consumer none of this is apparent. Plus, the consumer has no idea that these entities are getting paid directly as well as indirectly because mortgage bankers do not need to disclose that they earn SRP when they sell the loan days after closing.[3]

Consumers want to get loans they can afford and keep. Consumers want to know how much their monthly payment will be, if it will change and how much getting that loan will cost them at the closing table. The mechanics of this industry are complex. The mortgage market has evolved, forcing the distribution channels to become hyper-competitive. As a result, the lines between the distribution channels have blurred. This is why we advocate for an all-originator standard.

Consumers deserve the same level of protection no matter who they choose to do business with.

[3] Brokers are still the ONLY mortgage origination distribution channel that can claim FULL transparency of ALL fees – both direct (on the Good Faith Estimate ("GFE") through points) and indirect (on the GFE as required by RESPA Regulation X).

APPENDIX E

US Department of Housing and Urban Development

Uniform Good Faith Estimate Statement

Name and Address of Borrower	Originating Company Name and Address: Loan #: _____
Property Address:	**Proposed Interest Rate:** % **Term of the loan:** Years
	Proposed Loan Amount: $
	Program Type: ☐ **Conventional;** ☐ **FHA;** ☐ **VA;** ☐ **Other:**
	☐ **Fixed Rate Mortgage Loan**, or ☐ **Adjustable Rate Mortgage Loan**
	Prepayment Penalty: ☐**May;** ☐**May Not** **Balloon Payment:** ☐ **Yes;** ☐ **No**

Settlement Charges:	
800: Items Payable in Connection With The Loan:	
801: Loan Origination Fee (%) to:	
802: Loan Discount Fee (%) to:	
803: Appraisal Fee to:	
804: Credit Report Fee to:	
805: Lender's Inspection Fee to:	
806: Application Fee to:	
807: Flood Certification Fee to:	
808: Mortgage Broker Fee (%)	
809: Tax Service Fee to:	
810: Processing Fee to:	
811: Underwriting/Admin Fee to:	
812: Wire Transfer Fee to:	
813:	
900: Items Required By Lender To Be Paid In Advance	
901: Interest for days at $ /day	
902: Mortgage Insurance Premium for mos. to	
903: Hazard Insurance Premium for mos. to	
904: Flood Insurance Premium for mos. to	
905: VA Funding Fee / Mortgage Insurance Premium	
1000: Reserves Deposited with Lender: Waived ☐**Yes** ☐**No**	
1001: Hazard Insurance: months @ $ per mo.	
1002: Mortgage Insurance: months @ $ per mo.	
1003: City Property Taxes: months @ $ per mo.	
1004: County Property Taxes: months @ $ per mo.	
1005: Annual Assessments: months @ $ per mo.	
1006: Flood Insurance: months @ $ per mo.	
1007: months @ $ per mo.	
1008:	
1100: Title Charges	
1101: Settlement or Closing/Escrow Fee to:	
1102: Abstract or Title Search to:	
1103: Title Examination to:	
1104: Title Insurance Binder to:	
1105: Documentation Preparation to:	
1106: Notary Fees to:	
1107: Attorney's Fee to: (Includes above item numbers:)	
1108: Title Insurance Fee to: (Includes above item numbers:)	
1109: Lender's Coverage $	
1110: Owner's Coverage $	
1111: Includes Commitment Fee to:	
1112: Endorsement Fee to:	
1113: Wire Fee to:	
1114: Electronic Doc Fee to:	
1115: Courier Fee to:	
1116:	
1117:	
1118:	
1200: Government Recording and Transfer Charges	
1201: Recording Fees: ☐Deed $ ☐Mortgage $ ☐Release(s)/Reconveyance(s) $	
1202: City/County Tax/Stamps: ☐Deed $ ☐Mortgage$	
1203: State Tax/Stamps: ☐Deed $ ☐ Mortgage $	
1204: Assignment Fee to:	
1205: Subordination Fee to:	
1300: Additional Settlement Charges	
1301: Survey to:	
1302: Pest Inspection Fee to:	
1303: General Inspection(s) to:	
1304: Home Warranty Fee to:	
1305: Elevation Certificate Fee to:	
A: Settlement Cost (Sections 800, 1100, 1200, 1300 above) **B: Prepaid Items (Sections 900 and 1000 above)**	
1400: Total Estimated Settlement/Closing Costs	

Summary of the Borrower's Transaction:	
Contract Purchase Price	
Existing Loan Amount to be Paid Off	
Personal Property	
Total Settlement/Closing Cost Charges to Borrower(s): **1400 A**	
Total Pre-Paids/Reserves Charged to Borrower(s): **1400 B**	
Gross Amount Due From Borrower(s):	
<Deposit of Earnest Money>	( )
<Principal Amount of new loan(s)>	( )
<Seller Paid Closing Cost Credit(s)>	( )
<Subordinate Loan Proceeds>	( )
<Other Credit(s)>	( )
Amounts Paid By or In Behalf of Borrower(s):	( )
Cash at Settlement Due From/To Borrower(s):	
Proposed Payment(s):	
1st Mortgage: ☐Principal & Interest pmt. ☐ Interest Only pmt	
2nd Mortgage: ☐Principal & Interest pmt ☐ Interest Only pmt	
Property Taxes	
Home Owners Insurance	
Private Mortgage Insurance	
Homeowners Association Dues	
Other	
Other	
Total Proposed Monthly Payment:	

Nature of Relationship: In connection with this residential mortgage loan, you the Borrower(s), has/have requested assistance from _____ (Company name) in arranging credit. We do not distribute all products in the marketplace and cannot guarantee the lowest rate.

Termination: This agreement will continue until one of the following events occur:

1. The Loan closes
2. The Request is denied.
3. The Borrower withdraws the request.
4. The Borrower decides to use another source for origination.
5. The Borrower is provided a revised Uniform Good Faith Estimate Statement.

Notice To Borrower(s): Signing this document does not obligate you to obtain a mortgage loan through this mortgage originator; nor is this a loan commitment or an approval; nor is your interest rate locked at this time unless otherwise disclosed on a separate Rate Lock Disclosure Form. Do not sign this document until you have read and understood the information in it. Fees received under this estimate are legal and permissible under the Real Estate Settlement and Procedures Act. You will receive a re-disclosure of any increase in interest rate or if the total sum of disclosed settlement/closing costs in **Section 1400A** increase by 10% or more of the original estimate. Should any such increase occur; mandatory re-disclosure must occur prior to the settlement or close of escrow.

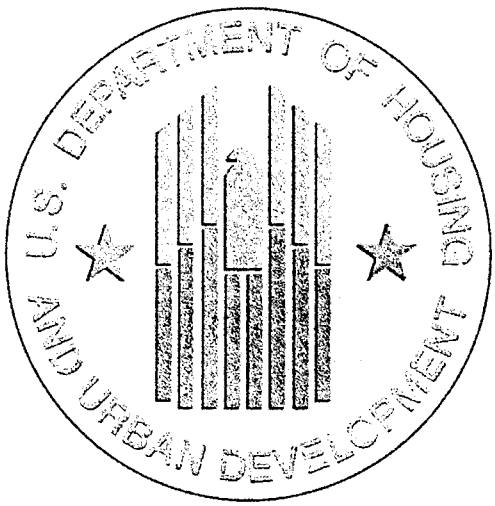
Applicant(s) hereby acknowledge(s) the receipt of a copy of this Good Faith Estimate and that you/they inquired into real estate mortgage financing with _____ (Company) on _____(date).

Borrower: _____ **Co-Borrower:** _____

_____ _____

STATEMENT OF ALPHONSO JACKSON
Secretary of Housing and Urban Development

Hearing before the Committee on Financial Services
United States House of Representatives



"Legislative and Regulatory Options for Minimizing and Mitigating Mortgage Foreclosures"

September 20, 2007

Chairman Frank, Ranking Member Bachus, distinguished members of the Committee, thank you for inviting me to testify this morning. I also want to recognize my colleagues Secretary Henry Paulson and Chairman Ben Bernanke for their valuable actions and partnership over the past few months. I am pleased to join them today.

Mr. Chairman, the significant effects of foreclosure on our national economy and on world markets brings us here today. Your hearing's title, that you are examining both legislative and regulatory options for minimizing foreclosures, hits the nail on the head. At HUD, I can report that we are working on both in our efforts to mitigate the adverse effects of this market correction on borrowers.

One of the strongest tools we have to protect both borrowers and markets is the Federal Housing Administration (FHA). As you know, FHA helps individuals secure credit by providing mortgage insurance through a private sector distribution network that makes owning a home more affordable and safe and, therefore, a reality for many borrowers that might otherwise go unserved.

I have firmly believed for some time that many of those who ultimately entered the subprime market would have been better off with an FHA-insured loan. Many may still be eligible to refinance today. Although we cannot go back in time to ensure each borrower made the best decision when obtaining a mortgage, we can provide refinancing options to many subprime borrowers and we can do more to help people make better decisions going forward through both innovative products and counseling support.

Mr. Chairman, as Federal Reserve Chairman Alan Greenspan once said, the subprime market "democratized credit." And this resulted in homeownership for millions of Americans. At the same time, Mr. Chairman, some borrowers used mortgage products that put them at risk due to interest rate resets. Foreclosures followed for tens of thousands of people. Our ongoing concern is that more Americans may face foreclosure with the new rounds of resets anticipated from now through the end of 2008.

Not all subprime loans will result in foreclosure. It is important that we know this. The lesson here is not to throw out or do away with subprime loans. Most people with subprime loans will be fine and their homeownership gives them equity, a financial stake in the community, and adds wealth to our economy. Estimates are that an overwhelming majority of the subprime loans made in 2005 and 2006 will not be problematic. But, if you are a family that's in one of these troubled situations, facing foreclosure, the problem is real and it certainly doesn't seem modest.

I've met with families in this situation and I understand their concerns. That's why I've made it a top priority to help as many families as possible stay in their homes. The Department of Housing and Urban Development has a role to play to help homeowners – but we must also remember that it's a limited one.

For example, the Administration does not support a federal bailout of lenders because that would only encourage these problems to happen again in the future. We also don't

think it's the government's job to bail out speculators, those with second homes, or those who made the decision to buy a home they knew they could never afford.

Nevertheless, there are many American homeowners who we can help get through this tough time. What we need is a little more flexibility from lenders, and a little more flexibility from the FHA.

Already, FHA has stepped forward within the full extent of its statutory and regulatory abilities. By the end of Fiscal Year 2007 we will have helped more than 100,000 borrowers refinance with an FHA loan this year. But in order to assist more Americans, the President has proposed a series of important initiatives to keep people in their homes. Some of them do not require Congressional action, while others do.

Late last month, the President announced a new FHA product called "FHA*Secure*." Under this proposal, borrowers who are otherwise creditworthy, but have recently become delinquent on their mortgages as their teaser rates reset, may now apply for an FHA-insured loan. Traditionally, FHA has not allowed delinquent borrowers to refinance through FHA. Under this new temporary program, eligible homeowners will be required to meet FHA's strict underwriting guidelines and pay the corresponding mortgage insurance premium. This offsets the risk to FHA and costs the taxpayers nothing. I want to repeat that: there is no cost to the taxpayers. We estimate that with FHA*Secure* we can help an additional 80,000 delinquent, yet otherwise creditworthy, borrowers refinance and save their homes.

This is in addition to the 160,000 other borrowers we already expect to help in Fiscal Year 2008. This will bring the total number of new borrowers assisted through FHA's existing refinance efforts to 240,000 next fiscal year.

Borrowers also need to be as informed as possible, which is one reason why we strongly urge them to use the nation's 2,300 HUD-approved housing counseling organizations. Information leads to wise borrowing, manageable loans, and more economic security.

It is also why, on August 31, the President asked Secretary Paulson and I to reach out to a wide variety of groups that offer foreclosure counseling and refinancing for American homeowners. Since then, FHA Commissioner Brian Montgomery and I have met with a number of people and organizations, including mortgage lenders and community organizations.

I have also directed FHA to prepare a new notice for risk-based pricing. This makes sense. Safer borrowers should pay less; riskier borrowers should pay a little more. I am hopeful that we will be able to implement this change in January so that we can reach an additional 20,000 borrowers.

This is what may be done through administrative action. But this country needs FHA Modernization, which the President has asked from the Congress once again this year. I'm grateful that the House again, earlier this week, passed legislation modeled on the

President's proposal. And just yesterday, a day after the House vote, the Senate Banking Committee approved its version of the legislation by a strong 20-1 vote.

We need FHA Modernization now. I know you appreciate the sense of urgency. We need a bill that raises loan limits so we can help low to moderate income and first-time homebuyers in more expensive housing markets. We need a bill that gives families more flexibility in down payment options, something we cannot do today. These legislative changes would help some 200,000 additional families, if not more, purchase or refinance into safe FHA-insured mortgages. It would allow the FHA to be more responsive to the housing market.

Mr. Chairman, I must add that we are working on ways to improve mortgage disclosure for homebuyers so that they do read and understand the fine print. The President and I want the process to be more transparent and understandable. We want to help homebuyers shop for the best mortgage loan and prevent them from getting into trouble before they sign on the dotted line. So, we are preparing new mortgage regulations under the Real Estate Settlement Procedures Act (RESPA) to provide borrowers with the tools they need. These changes would apply to all home purchase and refinance transactions. While it's still too early to detail the substance of a new RESPA rule, I can tell you our focus will be to improve the Good Faith Estimate (GFE) in ways that provide a clear summary of loan terms and total estimated settlement charges so that buyers do not experience sticker shock at the closing table. HUD will also work to modify the HUD-1 form to facilitate comparison of the estimated charges on the GFE and the final charges on the HUD-1, and provide a clearer disclosure of fees and charges. We expect to propose a new RESPA rule soon.

And we have worked with other federal and state authorities to prosecute predatory lenders. We will use the full force of the law to end predatory lending practices once and for all.

Mr. Chairman, every day places thousands of homeowners face the risk of foreclosure. Working together, the President and Congress can continue to make changes that will address the subprime crisis. Foreclosure isn't good for anyone: the homeowners, the community, the local tax base, the lender. Today we have the chance to make powerful and positive changes that will reflect statesmanship and good sense.

Again, I thank the Committee for the opportunity to appear today. We look forward to working with you as our various proposals move through the legislative and regulatory processes.

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HOMEOWNERS ARE NOT THE ONLY VICTIMS OF THE MORTGAGE FORECLOSURE CRISIS; TENANTS IN FORECLOSED RENTAL PROPERTIES ARE BEING DISPLACED NATIONWIDE

TESTIMONY OF JUDITH LIBEN,
HOUSING ATTORNEY AT THE MASSACHUSETTS LAW REFORM INSTITUTE
BEFORE THE HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

SEPTEMBER 20, 2007

I. Introduction.

Good morning, Mr. Chairman and Members of the Committee. My name is Judith Liben. I am a housing attorney at the Massachusetts Law Reform Institute in Boston. MLRI is a nonprofit statewide legal services support center. We advocate for low-income people, minorities, immigrants, elders, and people with disabilities in their struggles for basic human needs; defend against measures that harm people living in poverty; advocate for systemic reforms that achieve social justice; and provide support that will enable others to carry out these objectives.

Thank you for this opportunity to alert you to the plight of thousands of people who are innocent victims of the current mortgage foreclosure crisis and whose stories until recently have been largely ignored by the media and government officials.

I am referring to tenants living in foreclosed rental properties in cities and towns around the country. The buildings these renters resided in may have been owner-occupied, but more often they were owned by investors and speculators hoping to profit on the rents, who then defaulted on their mortgages, with the properties going into foreclosure. These foreclosed rental properties are typically smaller buildings, condominiums, and single-family rented homes. They are found in cities and surrounding suburbs, in lower-income and also more upscale neighborhoods—in short, almost everywhere.

In recent months, housing advocates in Massachusetts have been working to improve our state's landlord-tenant laws to give more protections to renters in foreclosed properties so they won't be quickly evicted from their homes with nowhere to go. The Massachusetts Senate has passed such legislation and the House of Representatives is now working on the same issue. In the course of that work, we have corresponded with legal services lawyers and housing advocates in other states and have collected newspaper articles (some attached here) all telling similar stories: When banks take possession after foreclosure, they either promptly evict the tenants or refuse to maintain their properties, leaving devastated families and scarred neighborhoods.[1] As more information comes to light, it is now clear that, nationwide, tenants who did nothing wrong except to rent from a defaulting owner are suffering harsh collateral damage from the mortgage fallout. We urge the Committee to look carefully at this pressing issue.

II. Renters in Foreclosed Properties Are Quickly Put Out of Their Homes.

In most states, foreclosure terminates a tenancy, and, if the foreclosing bank takes title, it evicts the renter households very quickly—usually with only three to thirty days' notice.[2] For example,

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[1] We recognize that it is not always the lender that takes title to the rental property after foreclosure. For example, investors might purchase at a foreclosure sale. But, for purposes of this testimony, I will refer to the post-foreclosure owner as "the bank."

[2] There are some notable exceptions to the general rule that most tenancies are terminated by foreclosure. For example, federal Section 8 leases should not be terminated by foreclosure (although foreclosing banks nonetheless often try to evict these tenants). And, in a few jurisdictions, such as **New Jersey, New Hampshire, and the District of Columbia**, tenancies do survive foreclosure, and post-foreclosure owners are prohibited from evicting tenants unless they have independent grounds.

in **Nevada**, a legal services lawyer reports: "The Housing Hotline in our office in Las Vegas receives dozens of calls each day from tenants who are being evicted after foreclosure. In Nevada, the new owner need only give 3 days' notice to tenants telling them to get out."

And in **Oregon,** a housing lawyer describes the plight of these families and individuals:

> We get calls from tenants who are given a two-week notice to quit after a bank forecloses on a home. This puts the tenants in a terrible position in that they have to locate, apply, receive approval, and move all in 14 days or risk an eviction on their record. I would say that, in 99% of these cases, the tenants become homeless, double-up in another family's home, or remain in place until they are evicted through court procedures and incur further costs as a result. We have never seen a bank give a family a longer period of time in which to leave or offer them a short-term lease in order to assist the family in moving.

The director of the Housing and Economic Rights Advocates in Alameda County, San Francisco County, and Contra Costa County, in Northern **California**, describes the situation there:

> We have heard from HUD-certified housing counseling agencies and consumer credit counseling agencies that they are receiving calls for assistance from tenants renting homes that have been foreclosed. The tenants' complaints include the foreclosing bank failing to provide utilities as required under state law and high-pressure tactics and outright threats by the foreclosing lender or its agent trying to force the tenant out of the property on an accelerated timeline.
>
> Many of these tenants are renting single-family homes in middle-class neighborhoods that were owned as investment properties by individuals. Notably, my office started getting calls in July of this year from homeowners who were going into foreclosure on their single-family *investment* properties with high-cost, subprime mortgages that they could not keep up with.

And in Riverside and San Bernardino counties in California, housing lawyers see two basic scenarios:

> First, a tenant in a home where the landlord loses title through foreclosure is served with a 30-day notice. Because there are no defenses that the tenant can raise, the tenant will have a judgment against him or her for possession and, usually, for money damages, which absolutely ruins their chances for obtaining other housing for up to seven years and will ruin what is usually already-precarious credit.

Further, some states are now providing longer notice periods for selected groups of tenants. For example, in August 2007, **North Carolina** enacted a law increasing to 30 days the court notice given to tenants in property containing 15 or more rental units. **Illinois** recently passed a law extending the notice period for tenants in foreclosed buildings to 120 days or the remainder of the lease, whichever is shorter. See August 31, 2007, article from the *Chicago Daily Southtown*, "New Law Gives Foreclosure Notice to Help Renters," attached here.

The second situation, which involves an "invalid" tenant, occurs during times when there are a lot of foreclosures. Scam artists study the Notices of Default published in newspapers and go to the addresses. If the house is vacant, they break in, change the locks, clean the place up just a bit and advertise them for rent. People then come, pay a heavy security deposit, and rent the house "as is." After paying rent to the fake landlord for three or four months, lo and behold, there's that pesky notice to quit posted on the house by whoever owns through foreclosure, an entity the rent-paying tenant has never heard of. The same procedure as in the preceding example then takes place.

Further aggravating the problem, displaced tenants are now competing with evicted foreclosed homeowners who are looking to rent. This means that, in some areas, rental markets are becoming tighter and more expensive. See August 30, 2007, article from Greensboro, North Carolina, "Mortgage Mess Hits Renters," attached here.

A recent article in the Summer 2007 issue of the housing journal *Shelterforce*, entitled "Losing Ground," describes what is happening in **New York City**.

> Not only are rampant foreclosures helping to accelerate change in the economic and racial make-up of these neighborhoods, but they are also exacerbating the lack of affordable housing in New York City. Foreclosures on two- to four-family and larger multifamily homes have led to wholesale evictions of lower-income tenants. Tenants in multifamily homes suffer as a result of foreclosures when landlords walk away from the home, stop making needed repairs, and fail to communicate with tenants about their housing status. As new owners take over the buildings, particularly in gentrifying neighborhoods, lower-income tenants are driven out to make way for higher rents.

Foreclosing banks claim, often with no support or data, that they must evict all tenants because empty buildings will sell more easily. The banks rarely consider that in many cases it would be more prudent and more profitable to keep the buildings occupied with rent-paying tenants while they search for a new owner. A typical situation is described by a legal services lawyer from Chester, **Pennsylvania**:

> I represented a Section 8 tenant. When the landlord lost the property through foreclosure, the bank bought at the sheriff's sale and promptly served the tenant with an action in ejectment. The Housing Authority was caught off-guard because the landlord had been giving assurance that the mortgage default was being settled. The Housing Authority immediately offered to assign the Section 8 contract and payments to the bank, but the bank refused and instead insisted on proceeding with the ejectment. My thought was that someone at the bank clearly wasn't thinking when they passed up the chance to get paid a few months' rent and opted instead to pay lawyers to start an ejectment action.

In **Massachusetts,** we have found that the banks often are unable to justify their insistence that all tenants must be put out of their homes; their lawyers and brokers merely repeat that the client wants the tenants out, no matter if they are good, rent-paying tenants who have lived in the property for years. As in other states, the banks in Massachusetts claim that they can't sell the buildings unless they are empty. But when a tenant's lawyer (in the rare case where the tenant

has obtained legal counsel) or a neighborhood housing advocate asks what price the bank is asking for the building and whether they could work out a deal in which a local nonprofit purchases the property, the answer from the bank is still "no." The banks' lawyers and brokers have their marching orders: get the tenants out. See August 13, 2007, story in *Banker and Tradesman*, "Tenants Displaced After Foreclosures," attached here.

To move the renters out fast, in most states the banks send out agents with "cash for keys" offers, which go something like: "If you leave in five days, we'll give you $500. Otherwise, we'll evict quickly and you'll get nothing." Many households, assuming the courts will evict them anyway, take these offers, although the money is hardly sufficient to find new housing. And, to make things worse, most tenants can't get the return of their security deposits or last month's rent that they gave to the original owner. See "Renter Affected by High Foreclosure Rate," August 15, 2007, from KVBC in Las Vegas, Nevada, attached here.

Even where post-foreclosure evictions are prohibited by state, local, or, in the case of Section 8 leases, federal law, housing advocates report that the banks often ignore the law and threaten tenants with eviction. For example, under the law in the District of Columbia, a foreclosing bank cannot evict a tenant unless it has good cause. Nevertheless, as a housing lawyer from DC explains:

> Banks typically send 30-day notices to vacate immediately upon foreclosing, despite the tenants' absolute right to stay and rent after the foreclosure. The majority of tenants are frightened into moving by these notices, even though the notices lack any legal basis. In recent weeks, we have seen a rise in the number of tenants seeking help in responding to these notices to vacate. When tenants do show up in court to fight the eviction, the banks dismiss their cases—but then begin pressuring tenants into "cash for keys" deals that barely offer enough for security deposit on a new place.

III. When Banks Own Rental Properties After Foreclosure, They Refuse to Maintain the Buildings and Often Stop Providing Utilities.

Let me describe how the process typically works in many states.

First, tenants often have no idea that their landlord has defaulted on the mortgage, that foreclosure is threatened, or that a foreclosure court procedure or sale has actually occurred. In many cases, the original owner may continue to collect rent from the unwitting tenants even after he has lost the building in foreclosure. A foreclosing bank may choose not to collect rent in hopes that it won't be viewed as the landlord of the building it now owns. Tenants often don't know what to pay or to whom. See May 30, 2007, article from the **Florida** *St. Petersburg Times*, "Renters, Too, Face Mortgage Fallout," and September 3, 2007, article from the *North County* (California) *Times*, "Foreclosures Put Renters in Limbo," both attached here.

In Massachusetts, we have seen banks refusing to accept rent and then suing the tenants for nonpayment of "use and occupancy" in an amount higher than the rent—an amount never agreed to by the tenants. Low-income tenants, especially, do not have the financial or emotional reserves to deal with these uncertainties. This happens even where there are Section 8 leases

(which courts have held survive foreclosure), but the banks, emboldened by the lack of clarity with all other tenancies, attempt to evict Section 8 households, anyway.

The foreclosing bank, often from another state or another country, refuses to recognize any responsibility to existing tenants, may refuse to pay the utility bills, and will not make repairs, no matter how serious the problem. Tenants are literally left in the dark, with no idea about whom to call in emergencies. See *Boston Herald* article, "Why Us? Tenants Say They're Foreclosure Victims," attached here.

A housing lawyer from **Minnesota** writes:

> One important problem is that lenders refuse to be landlords. That business model should be a thing of the past—it may have made some financial sense for lenders to simply vacate the property and turn it around. However, now that lenders have dozens of vacant properties that they can't even sell, it makes sense for them to change their business model. If lenders would agree to allow good tenants to stay, properties would likely be more marketable and would not cause a nuisance to the neighborhood.

A May 11, 2007, Minnesota Public Radio story describes how a Ramsey County, Minnesota, tenant knew nothing about a foreclosure—then her water was suddenly shut off and she was forced into a homeless shelter. See "Renters Put Out by Foreclosures," attached here.

In Brockton, Massachusetts, a legal services lawyer reports:

> Our office sees a lot of these cases. I recently represented a single mother, a domestic violence survivor who had always been an ideal tenant. She was up-to-date in her rent and didn't cause any problems. Her landlord was foreclosed upon and the bank stopped paying the electricity, which got shut off. After two weeks of trying to get the electric turned on (prior to our representation), the tenant actually had to call the electric company and establish an account for the entire building in her name, as the electric accounts weren't subdivided. The tenant was so diligent she even continued to pay her rent to her landlord for one month after the foreclosure happened. There is no reason for someone like this woman to have to end up facing eviction.

In Oakland, California, the City Attorney and local officials are alarmed as a growing number of households in foreclosed rental properties lose essential services and face displacement. See September 15, 2007, story in the Oakland *Inside Bay Area*, "Mortgage Crisis Hurting Tenants: Some Renters Illegally Evicted From Buildings in Foreclosure," attached here.

> As the subprime mortgage loan crisis rattles the financial and real estate markets and exposes the vulnerability of many home owners, it also is hitting a hapless population that had nothing to do with the loans—renters in buildings in foreclosure. Across Oakland, scores of renters like Bryson [the subject of the story] are being served eviction notices or being told to move out as banks take over buildings from defaulting landlords. . . . Tenants caught in between the banks and their errant landlords may face difficult straits, he said, including eviction. In some cases, building utilities have been turned off

> because landlords stopped paying the bills. "Some of the stories are very sad," Russo [the Oakland City Attorney] said. "A 75th Avenue apartment has not had water for two weeks, and a woman who is pregnant lives there. . . . The cases are accelerating," Russo said. "It's becoming a humanitarian crisis. . . . I think it is unethical and illegal for financial institutions to foreclose and shove tenants out," Russo said. "These folks in many cases paid their rents and did nothing wrong."

And, of course, neighborhoods where tenants are evicted en masse start to experience the effects as buildings empty out, property values drop, and blight takes over. Banks should understand that it is bad business practice to routinely evict tenants post-foreclosure if the lender wants to preserve value in the property. While it may take some work to be a property manager, the value of the foreclosed property is enhanced if it remains occupied while a new owner is found. This makes good business sense; vacant properties are vandalized more, thus making them less attractive to new buyers. And collecting rent from tenants should help offset other costs of foreclosure.

IV. The Problem Is Significant and Widespread.

In Minnesota, officials in Hennepin County keep careful track of foreclosure activity and report that a high percentage of recent foreclosures are on rental properties. A housing lawyer at the Foreclosure Relief Law Project of the Housing Preservation Project in St. Paul summarizes the findings:

> The impact of foreclosures on tenants is significant in Minnesota. In Hennepin County, which includes Minneapolis and the surrounding suburbs, there were 3,039 foreclosures in 2006 (this represented a nearly 100% increase over 2005). An astounding 38% of those foreclosures involved rental properties. The percentage of rental properties is even larger if you look at just the City's share of foreclosures. In Minneapolis, more than half (56%) of the 2006 foreclosures involved rental properties. (These figures are supplied by Hennepin County Taxpayer Services.)
>
> In the City of St. Paul (where foreclosures nearly tripled from 2005-2006), the percentage of foreclosed properties occupied by renters is disproportionately large. The City is divided into 17 districts, and the percentage of foreclosures involving rental property ranges from 30% to approximately 70%, with an average of about 40%. (This data supplied by the City Council's research team.)
>
> We have anecdotal evidence from Hennepin and Ramsey County homeless service providers telling us that more and more people are seeking shelter because their landlord lost the building to foreclosure. Legal Aid/Legal Service organizations tell us that the number of tenants calling for help because of a foreclosure has increased exponentially over the last several months.

Similarly, in Ramsey County, Minnesota, investor properties accounted for 43% of foreclosed mortgages. See May 11, 2007, Minnesota Public Radio story, "Renters Put Out by Foreclosures" (previously cited and attached).

When journalists from **Maryland**'s *Baltimore Sun* started to research this issue for a special report, they found that "[p]roperties belonging to 'nonowner occupiers'—usually investors—accounted for nearly 30 percent of the city homes that lenders were trying to foreclose on during the first three months of [2007]. . . ." See July 29, 2007, *Baltimore Sun* article, "Tougher Times for Housing Investors; Foreclosure Filings Rise in City Neighborhoods as Real Estate Market Sags," attached here.

In Chicago, the Executive Director of the Lawyers' Committee for Better Housing writes:

> We have a presence in eviction court every day, with a staff attorney and volunteers from Chicago law firms providing representation to 400-500 families each year. We are seeing a huge jump in the number of cases where tenants are being evicted due to the foreclosure of their landlord. Our social services specialist spoke with four tenants from the same building one day this month who had just been evicted due to foreclosure. Three of them were current on their rent and were good tenants. With 14-day orders of possession granted to the mortgage holder, they did not know what hit them, didn't know where to turn, and were at risk of homelessness. Seven of the last 46 tenants who contacted us regarding eviction hearings had landlords whose building had been foreclosed. This was over a two-week period.

Although we know of no comprehensive data collection in Massachusetts, the severity of the problem emerges from various sources. For example, during just one week in August, the Massachusetts Housing Court in the western region of the state saw 35 tenant/foreclosure evictions and the Legal Services Center in Boston got calls from 29 clients. In Suffolk County, during a recent 11-week period, 13 percent of the 526 foreclosure auctions advertised involved units occupied by Section 8 tenants assisted by the Metropolitan Boston Housing Partnership. This statistic represents only a portion of rented units involved in foreclosures, since it does not take into account the Section 8 tenancies administered by the Boston Housing Authority and, of course, all the non-subsidized tenancies in the county.

There is every reason to assume that the data from Minnesota and other places would be replicated elsewhere if other jurisdictions collected similar information, especially in urban areas. Although nationwide about 68% of residential units are homeowner units and 32% are rentals, in cities there are often more rentals. For example, the 2006 American Community Survey reports that about 59% of residential units in Boston are rentals, 54% in Houston, 58% in Cincinnati, and 60% in Los Angeles. Thus, it is safe to assume that the proportion of foreclosures affecting rental properties is significant in cities and, as in Hennepin County, also in nearby surrounding suburbs. The anecdotal information and media reports in this testimony do not represent a few isolated cases.

V. Recommendations.

The following are some initial, broad recommendations that we hope this Committee will consider:

First, as the Committee develops legislative and regulatory options to minimize and mitigate mortgage foreclosures, we ask you to include renters threatened with displacement due to foreclosure among the groups whom you may assist.

Second, we ask individual Committee members to confer with state and local officials in their districts about the issue of renters evicted from foreclosed properties and to encourage those officials to enact state laws or local ordinances to better protect tenants in foreclosed properties.

Third, we urge the Committee to support policies and work with federal oversight agencies to discourage foreclosing lenders from evicting their tenants and penalize foreclosing lenders who attempt to evict tenants in violation of applicable state or local law.

Fourth, we urge the Committee to create incentives for post-foreclosure lenders to negotiate with local affordable housing groups, municipal agencies, and others to maintain or re-develop their rental property as affordable housing.

VI. Conclusion.

Renters are generally in a more precarious position than homeowners. From 1997 to 2005, the number of renter households paying over half of their income for housing went from 1 million to 2.1 million. This latest mortgage foreclosure crisis makes this already untenable situation even worse. As the chair of the Center for Housing Policy recently observed in the *Housing Development Reporter*:

> This new study [from the Center] reveals that housing cost burdens have increased faster among America's working family renters than among working family homeowners. . . . Over the past several months, there has been a tremendous amount of attention given to the problems facing homeowners with subprime mortgages. . . . While these problems are significant and this attention is deserved, it is important not to lose track of the serious housing problems facing renters.

We hope that this testimony will focus attention on the dire predicament faced by renter households caught up in the mortgage problems discussed by this Committee today.

Thank you once again for the opportunity to testify before this Committee. I and my legal services and advocacy colleagues in Massachusetts and other states are available to answer any questions and assist in any way to mitigate the painful effect of foreclosure on residential tenants.

Online at: http://politicalaffairs.net/article/articleview/5849/1/32/

Atlanta Housing Authority Expands Landlord Scrutiny, Responds to Mortgage Crisis

By Matthew Cardinale

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9-17-07, 9:19 am

(APN) ATLANTA – The Atlanta Housing Authority (AHA) has expanded upon its scrutiny of landlords who want to house a family receiving a voucher from AHA, Atlanta Progressive News has learned.

One landlord who recently encountered the changes also told Atlanta Progressive News that the added scrutiny may discourage more landlords from accepting vouchers from AHA.

The move by AHA comes after weeks of exclusive coverage by Atlanta Progressive News of the mortgage crisis which has impacted AHA voucher-holders.

APN chronicled the story of Tamika "Cookie" Brewer, who received a foreclosure notice even though she was paying her rent on time and AHA was sending her landlord a voucher, because the landlord wasn't paying the mortgage.

Exactly four weeks after requesting information from AHA, APN today received an exclusive series of statements prepared by AHA spokesperson, Rick Write of the Alisias PR firm. This is the first time in five months AHA has responded to a press request from APN.

First, AHA estimates at least 209 voucher-holder families were affected by a foreclosure in the year 2007 alone. Resident President Diane Wright told APN she thinks that number is low.

"While AHA had due diligence practices in place, we certainly did not anticipate a national mortgage foreclosure crisis. As an asset manager of our size, we believe it is our responsibility to refine our due diligence practices," White wrote.

"These changes include increasing the frequency and scope of our landlord review process, receiving advance information before foreclosures occur, and enhancing the response time when a foreclosure notice has been issued," White wrote.

APN requested additional information on how AHA would receive such advance information and how it would increase the frequency and scope of the landlord review process, but AHA did not immediately reply.

The reason this was not clear from their statement is because the banks usually have no way of knowing whether there's a tenant--let alone an AHA voucher holder--in the property, JR Johnson, foreclosure specialist, had previously told APN. The bank usually deals directly with the borrower, that is, the landlord.

However, local real estate investor and blogger, Nancy Spivey, tells APN she was shocked at all the new requirements when she received the new AHA landlord paperwork from a tenant who was applying with a

voucher from AHA.

'They [the applicant] gave me the paperwork. Landlords have to fill out a lot of forms. Now they have to verify their corporations, give out an authorization to release information that the mortgage is in good standing, and get a credit check," Spivey told APN in a phone interview.

"I understand where they're coming from. It is a bad situation on both sides. But it does feel really invasive when you're the landlord. There are already a lot of things landlords have to jump through to rent on Section 8," Spivey said.

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"These days, everybody wants to check your credit. It's not a good thing for everyone to have their credit checked every time they turn around because it dings your score. And it's a huge office down there and identity theft is a huge issue right now," Spivey said.

Spivey also wrote about the matter on her blog at RealEstateInvestorsResource.blogspot.com.

Meanwhile, AHA announced they would not be going after landlords suspected of mortgage fraud in court, even though they were receiving a federal subsidy while not paying the mortgage, raising the issue of whether residents are held to higher standards than landlords.

AHA stopped short of promising each family affected by a foreclosure would be guaranteed transition assistance to a new apartment, but said each family would be reviewed for their eligibility.

"AHA has established an assistance initiative to help participants who are victims of the nation's foreclosure crisis. AHA assigns a professional to each affected family who will determine the type of assistance on a case-by-case basis. Such assistance will include: Application fee, Security deposit (refundable to AHA), Utility reconnection fees (up to three utilities), Moving services, [and] In emergency situations, AHA may provide funds to pay for temporary storage and temporary hotel stay," White wrote.

"This assistance is being provided voluntarily by AHA in its role as a corporate citizen and should not be misconstrued with assistance under the relocation program," White wrote.

Brewer eventually received assistance with moving into a new apartment after weeks of continuous coverage by Atlanta Progressive News.

However, within the last week, Brewer contacted APN to report that her new apartment was not in a safe environment. She said her apartment had been broken into, that she believed there were drug dealers in the area, and that the majority of units in the building were boarded up. Brewer said she recently contacted AHA for assistance with moving again.

Brewer was forced to locate this apartment on foot because AHA did not provide relocation search assistance, even though Brewer had a disability and medical condition. Thus, she applied at this apartment complex because it was nearby and she heard they were accepting vouchers.

Brewer's situation raises also the general issue of what quality of apartments will people be able to find with the vouchers, and how special needs and disabilities can make it even more difficult for some voucher holders to find apartments.

Now, if as some fear, landlords are discouraged by the added scrutiny unveiled by AHA, this difficulty of finding places to live with an AHA voucher may increase.

From Atlanta Progressive News

--About the author: Matthew Cardinale is the News Editor of The Atlanta Progressive News and may be reached at matthew@atlantaprogressivenews.com

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New law gives foreclosure notice to help renters

Legislation inspired by Daily Southtown columns allows tenants to stay in their homes for 120 days if their landlords default on mortgage payments

August 31, 2007

By Emily Udell Staff writer

Renters who live in buildings under foreclosure will be protected from eviction if their landlords default on mortgage payments thanks to a new law sponsored by Sen. Maggie Crotty (D-Oak Forest).

The legislation allows tenants who are up-to-date on rent payments to stay in their homes for 120 days after notice of a foreclosure hearing. Tenants could be evicted with little or no warning under previous law.

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"If somebody is making their rent payments and unbeknownst to them the landlords themselves aren't making their mortgage payments, I didn't think that's fair to give no notice to the renters," Crotty said.

She said she was inspired by a series of Daily Southtown columns about a Country Club Hills family evicted from its townhouse after the owner stopped making mortgage payments on the property. Kevin and Nyoka Williams watched as Cook County Sheriff's Department officers hauled their belongings onto their front lawn in March, leaving the couple and Nyoka's three children without a home.

The Williamses lived in the townhouse for several years and were up-to-date on their rent when the owner defaulted on the property's mortgage the year before.

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The new law is aimed at buffering people like them from landlords' financial troubles.

Under the new law, banks and mortgage companies will be required to inform tenants in a building of a foreclosure hearing. Mortgage holders had the option to include the names of tenants or "unknown occupants" on the foreclosure filings, which resulted in inconsistent notification of renters and sometimes gave tenants little or no time to move.

New law for 2008

John Bartlett, executive director of the Chicago Metropolitan Tenants Organization, said landlords who are losing a property often fail to alert the tenants of foreclosure for fear they will stop paying rent.

"I think it shifted the onus to banks and the other organizations that are foreclosing because they have to notify the tenant," he said. "I think that's very positive."

He said 120 days would be enough time for most renters to find new housing.

"So many tenants are being forced out of their homes on a very short notice," he said. "This will help give tenants time to find places to live and find places in their communities. In a tight rental market, that's not always easy."

The law is slated to take effect Jan. 1.

Regina Rizzo, who oversees the hot line at the tenants organization, said calls from renters living in foreclosed buildings have increased in the past seven months.

"It's been an abundance," she said. "Most of the time when the tenants call or walk in, they are in a panic."

The organization has received numerous calls from people who were given little or no notice before the mortgage holder took possession of a building under foreclosure, Rizzo said.

She said she is working on new guidelines for hot line volunteers to use because of the increased number of foreclosure-related calls.

Utilities cut off

Despite the protections instituted by the new law, renters still may suffer some fallout from bills after they have defaulted on their mortgages, Bartlett said.

Riverdale resident Rose Campbell worried the utilities in her former building would be cut (disconnection began to arrive after the property went into foreclosure in March.

"The mailbox is jam-packed," said Campbell, who was able to secure housing down the st apartment flooded with sewage.

Two families still live in the building, the 53-year-old nursing home aide said.

Crotty said she had not heard of problems with utility disconnection and planned to look

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In July, Illinois reported 5,530 foreclosures, up 10.2 percent from July 2006, according t
gathers data on foreclosures.

One in every 930 houses in Illinois was under foreclosure last month, putting the state at 1

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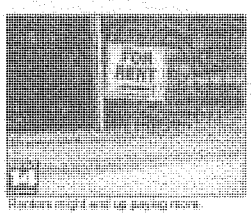
North Carolina
Aug 30, 2007

"Mortgage mess" hits renters
08/30/2007 05:11 PM
By: Jonathan Lowe



GREENSBORO -- The current "mortgage mess" seems to now be spreading to renters. A report released Thursday says rents are expected to rise over the next two years; as a result of the slumping housing market.

Just ask Greensboro property manager Sam Zealy, renters aren't safe from the "mortgage mess" domino-effect. "And we're finding some foreclosure applicants now for rental housing, that's a little bit unusual," Wrenn says.

A national study by the Center for Housing Policy says that's a growing trend. Along with more applicants comes increases in rent. The study says rates are expected to rise by 4 percent this year and next year too.

"That's certainly good for the landlord's, it's not as good as news for the tenants," Wrenn states.

Housing experts say the blame falls on the rise on stricter requirements to actually get a mortgage now and compound that with the folks who can no longer afford their mortgage and are facing foreclosure.

"So they're looking more, they're finding it hard to get funding for the house they may want so they're opting to rent longer," explains realtor Jeff White of Jeff White Realty.

Low-to-moderate wage earners are most likely to be affected, which raises another finding in the study: One in four renters are paying more than half their income on rent.

"Can I afford to fill up my car with gas this week or should I go ahead and ask my landlord to defer my rent, well that's probably not going to happen," says Wrenn.

Realtors say even in this market, there are opportunities.

"As rental rates are able to increase investors are happier and they'll go out and buy more investment properties which will bring more rental homes into the market which then will also keep rents at a reasonable rate," White says.

White adds that people who have faced foreclosure or bankruptcy can own another home. His advice: Take one to two years to re-build good credit and then try to re-enter the housing market.

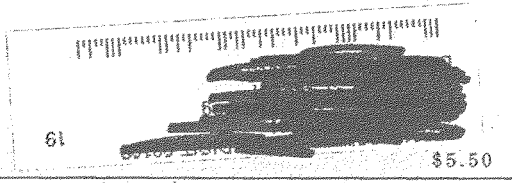
MASSACHUSETTS

"We need to find a way of streamlining and coordinating those resources [to reduce homelessness]."

CHRIS NORRIS, *Page 5*

"Today, someone can go in and apply for credit in your name and you have no recourse."

JAMES BLAKE, *Page 6*



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Tenants Displaced After Foreclosures

By Aglaia Pikounis

JOSEPH BARNWELL WAS SURprised to get a call from a real estate agent in early June telling him that his new landlord wanted to evict him.

Barnwell, who lives in a Dorchester apartment with his wife and three young children, didn't even know the property had changed hands. He later discovered the property at the corner of Blue Hill Avenue and Brunswick Street that he had been living in since last November had been foreclosed on. Now Barnwell doesn't know if he will be forced to move.

"I'd like a chance to remain here. It's close to everything we do in the area," said Barnwell, noting that the apartment is near his job and along a bus route.

DONNA BROOKS
'Generous' landlords

Tenant advocates are trying to help Barnwell, who they say is part of a growing group of renters being displaced by lenders who have foreclosed on properties.

Housing attorneys say they've seen an explosion of evictions that can be traced to foreclosures. The evictions are emerging as foreclosure activity statewide has surged.

"It's a huge issue. I would say in many ways, at least in Boston, the wave of foreclosures has had a larger effect on tenants than homeowners," said David Grossman, director of the Harvard Legal Aid Bureau.

Lenders filed 12,945 petitions to foreclose in Massachusetts during

Continued on Page 15

Massachusetts Tenants Being Displaced After Foreclosures

Continued from Page 1

the first half of the year, up 66 percent from the same period in 2006. While much attention has focused on helping struggling homeowners, tenants living in foreclosed properties have been overlooked, according to tenant advocates.

Advocates want to protect tenants from evictions, and they want lenders to negotiate with nonprofit groups willing to purchase the properties.

A Senate bill passed last month to combat foreclosures and mortgage fraud includes a section that requires new owners of foreclosed property to recognize existing tenants. Tenancies typically continue when homes are sold or refinanced, but with foreclosures it's a little less clear. So the bill seeks to apply the same tenant protections to renters living in foreclosed properties. The bill is before the House.

Judith Liben, a housing attorney with the Massachusetts Law Reform Institute, said the legislation doesn't prevent a new owner of a foreclosed property from seeking an eviction. It simply reminds them that they have to treat tenants just as landlords are required to, she said.

"We're hoping that there can be some solution in which it is clear to the lender or purchaser at foreclosure that the folks that live in these buildings are indeed tenants and they have to treat them as such – that they have to provide the basic services required," Liben said.

Grossman and other attorneys said lenders that foreclose on properties want them vacant in order to sell them.

A Sudden Explosion

Housing courts generally don't track evictions initiated by lenders who've foreclosed on properties. Clerks from housing courts in Massachusetts, however, say they have noticed an increase in evictions that can be traced to foreclosures.

"It appears that the evictions based upon foreclosures are up around 55 percent from 2006," said Robert Lewis, clerk of the Boston Housing Court. "In 2006, it appears that we had a lot of ... single-family homeowners who were evicted. It seems that now we're beginning to get more multifamily [situations] where the tenants are being evicted because the property was foreclosed upon."

Rafael Mares, an attorney with the WilmerHale Legal Services Center of Harvard Law School, estimates he sees 10 to 15 eviction cases each week in the Boston Housing Court involving tenants in foreclosed on properties.

"For a 10-year period, we didn't see any cases and then it suddenly exploded," said Mares, who is representing Barnwell.

Mares said tenants usually don't even know the property has gone through foreclosure. Instead, tenants receive a letter from the lender or the lender's real estate agent after the foreclosure telling them they have to move out.

The lenders typically offer the renter $500 to $1,500 to move out within a short amount of time, sometimes within weeks.

Usually, tenants think they have no other option because the notices seem so official and they end up moving, according to Mares.

But Mares said tenants can wait and try to negotiate with the new owner or force the new owner to file an eviction case.

"Every bank that we've dealt with in this context has a mantra that you need to empty the building before you can list the property," said Mares.

Donna Brooks, a Leominster-based Realtor who lists foreclosed properties for lenders in Middlesex and Worcester counties, said lenders want empty properties because it's easier to show them.

"The tenant doesn't have to let you show the property," said Brooks.

She also noted that lenders are reluctant to keep tenants when they don't know about their payment history. "They don't know if they're good tenants. They know nothing about them," she said.

And she said the fact that most lenders are offering some money to tenants is significant.

"They've been pretty generous. They don't have to offer anything," she said.

Still, Grossman and other advocates say it's unfair for tenants, who've paid their rent on time and done nothing wrong, to be thrown out. They say the few hundred dollars the lenders offer isn't nearly enough to cover moving expenses, a security deposit and the hassles of finding a new rental.

The foreclosures and evictions are leaving behind a trail of abandoned properties and destabilizing city neighborhoods, said Grossman.

"Legislation alone won't solve the problem. One way or another, banks have to be pressured to do the right thing, which is not to displace people from neighborhoods as part of the process of collecting on unpaid loans," he said.

Both Grossman and Mares attended a protest at Deutsche Bank's Boston offices last week. The protest was organized by City Life/Vida Urbana, a Jamaica Plain-based group that wants Deutsche Bank to stop evictions and to sell foreclosed properties to community-based organizations.

Mares said Deutsche Bank National Trust Co., U.S. Bank National Association and Wells Fargo are among the lenders he frequently sees bringing evictions in the Boston Housing Court.

In a prepared statement issued after the protest, Deutsche Bank maintained that even though it's listed in legal documents, it does not have an ownership stake in properties and has no say over foreclosures and evictions.

"[Deutsche Bank] National Trust Co. acts as trustee for securitization trusts and, in some cases, as custodian for the mortgage documents. The function of the trustee is largely an administrative one; the trust company has no ownership stake or beneficial interest in the underlying loans of a securitization, nor is it responsible for foreclosures or selling foreclosed property. Such decisions are made by the servicing companies, according to contracts for the different securitization trusts," the statement said. "Deutsche Bank is currently working to provide City Life with the names of the relevant servicers who are controlling the foreclosure proceedings on the properties in question."

For Barnwell, the Dorchester resident facing eviction, that's little comfort. Barnwell, who rents his apartment for $1,500 a month and says he's never missed a payment, thinks it will be tough to find another home to accommodate his family.

Deutsche Bank National Trust Co. filed a petition to foreclose on 80 Brunswick St., where Barnwell's apartment is located, Dec. 19 of last year. An auction was scheduled for March 16, according to The Warren Group, Banker & Tradesman's parent company. The Warren Group collects information from the Massachusetts Land Court.

The property's mortgage was assigned to Deutsche Bank National Trust Co. on May 29. No foreclosure deed has been filed.

Barnwell is getting help from Mares at the WilmerHale Legal Services Center. The center was able to negotiate with the Boston Water and Sewer Commission to temporarily restore water service after it was cut off when the owner stopped paying the bills. But water service is scheduled to be shut off again in mid-September unless the lender cooperates, according to Mares.

"I don't understand why we can't get this resolved in a fair manner that's beneficial to both parties," he said.

<<Back

NEWS 3 Watching Out For You
KVBC/DT • Las Vegas

Renter affected by high foreclosure rate

Aug 15, 2007 05:09 PM EDT

If you're not in the market to buy to buy a home you might think Nevada's high foreclosure rates don't affect you. Think again. News 3's Angela Martin shows us why a woman could be losing the home she just moved into.

"I don't have nowhere to go."

For now, Sheila Ellis is sleeping on an air mattresses in a North Las Vegas home. She just moved in two weeks ago and is house hunting again after spending $1,600 to rent the home. "We gave him the deposit and the first month's rent and we were here a week and were getting foreclosure mail in the mailbox," Sheila said.

Turns out the day before she signed a year long lease to rent the home it went into pre-foreclosure. She says the property manager knew about it. He says he didn't

"I (could) come home from work and there's a lock on the door with our property inside of the home. Staying here free no rent, sounds good, but you don't get nothing nowadays for free without paying for it," Sheila worries.

Her furniture is on its way from Chicago, but she's had to put that on hold while scrambling to find a new house. She's hoping to find one in the same school district so her 15-year-old won't have to transfer after the school year starts.

And she wants a refund for her trouble. "If it's $10 I still want it back," Sheila explains. "That's almost $1,700 that I gave him. We still want our money back so we can find something else. Being here two weeks today he should be willing to give me all my money back."

The property manager did not want to talk to us on camera, but he did agree to give Sheila her money back so she can find another place to live.

If you're interested in purchasing a home in foreclosure later this month, on the 25th there will be an auction. It's being put on by local real estate auctioneers and will held at the Fiesta casino and hotel in Henderson. The auction will include more than 60 properties. It starts at 10 am.

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Renters, too, face mortgage fallout

Unwary tenants find themselves caught in a widening web of fraud and foreclosure.

By SUSAN TAYLOR MARTIN
Published May 30, 2007

To a family from the concrete canyons of the Bronx, it seemed ideal: a spacious Tampa home with a big back yard for the kids. And it was available for rent with immediate occupancy.

Two months ago, Nikki DuFore and her husband paid the owner $3,000 and settled into the house with their three boys. But their stay may be short-lived. On May 19, they were served with notice that the bank seeks to foreclose because the owner is months behind in his mortgage payments.

"It was a shock," DuFore said. "We had just moved in, and now we're already having to look for another place. It's a big expense right now."

It used to be that tenants got all the scrutiny, with landlords demanding references, proof of employment and other assurances the rent would be paid.

But in Florida's topsy-turvy, fraud-plagued real estate market, it's the property owner who may warrant a closer look. Owners who can't pay their mortgages are leaving tenants like the DuFores in the lurch.

"We've been getting a lot of calls of late, and the amount of these calls is increasing because more people are in foreclosure," said Tom DiFiore, head of the housing and consumer unit of Bay Area Legal Services. "You should always be wary."

During the peak of the real estate boom, many buyers were lured into the market by 100 percent financing and risky types of adjustable rate loans. As the market cooled and property values fell, they found themselves stuck with steep payments on property no longer worth the mortgaged amount.

One result: an increase in the number of financially strapped owners trying to rent homes and condos they can't sell. Another result: tenants who find themselves defendants in foreclosure suits.

The ghost owner

Jason Wade can't believe it might be happening again.

Forced to leave one house because the lender foreclosed, he wound up in another rental whose owner is also behind in mortgage payments.

"We don't want to be here and have the same guy from the Sheriff's Office showing up to serve us with foreclosure

papers," said Wade, owner of an aquatic weed management company.

Wade and his girlfriend first rented from Victor Clavizzao, a loan officer and felon whose suspicious real estate transactions have been chronicled in the *St. Petersburg Times*. As Clavizzao's house went into foreclosure, the couple moved in April to another home less than a mile away in northeast St. Petersburg.

That house had been vacant since October, when it sold for $695,000 -- $315,000 more than it had sold for six months earlier despite the sagging market. Records show the house is mortgaged for the full $695,000 in the name of Heather Hall.

Wade and his girlfriend figured everything was on the up-and-up because they found the house through a Tampa property management company, DLG Management Services. But they thought it curious that they paid the $2,000 monthly rent to Billy Womack, not to Hall, the owner. It was also Womack, not Hall, who had paid the water bills while the house was empty.

There were other signs of potential problems. Mail, including late notices from lenders, piled up because Heather Hall never collected it or left a forwarding address. The 2006 property taxes, totaling nearly $8,000, went unpaid.

When Wade and his girlfriend said they wanted to meet Hall, Womack told them she was leaving the country for a few months. Wondering if Hall really existed, they stopped payment on the rent check.

Caught in family feud

Womack, 33, worked in Tampa nightclubs before pleading guilty in federal court in 2005 to possessing ecstasy with intent to distribute. He served seven months, emerging to start a new career in the property management business. His Web site urges investors and others to add to his list of properties "so we can All make some $$money$$!"

Among Womack's first clients were his brother and sister-in-law, whom he encouraged to buy 12 dilapidated houses in Tampa with 100 percent financing. According to a *Tampa Tribune* story in December, the couple didn't realize Womack had persuaded the sellers to accept lower prices, then bumped up the recorded sales prices by an average of $30,000 -- with the difference going to his company.

Womack's relatives were unable to rent out most of the houses, and 11 of the 12 are now in foreclosure. The couple could not be reached for comment. Womack, who is on probation until 2008, would not discuss what he says is "a family feud that went bad."

As for the St. Petersburg house, Womack e-mailed the tenants a statement dated May 22 in which Heather Hall authorized him to manage the property. The statement was notarized by Womack's attorney, Ivan Lenoir of Tampa, who said he met Hall only briefly and knows little about her except "that she is the owner."

Unable to afford to move again so soon, the tenants have decided to pay the rent even though they fear the house will go into foreclosure any day. Womack said he was not allowed to discuss financial matters regarding the property. He angrily cut off the conversation when the St. Petersburg Times asked to meet Heather Hall and speak with her in person.

"I don't think we need to talk anymore if you're going to dig into things that are not relevant," he said.

Avoiding eviction

Even if they suspect the owner has defaulted on the mortgage, tenants should continue paying the rent or they can be evicted.

"The reason is that a person in foreclosure can clear up the problem at any minute -- they can make back payments, they can refinance, they can file Chapter 13" bankruptcy, said DiFiore of Bay Area Legal Services. "You can get an eviction long before foreclosure is done, and that's why you have to continue paying rent."

The eviction process can take as little as 14 days. A foreclosure takes at least 90 days.

Tenants should also contact the lender to see if it's possible to stay in the house even if it is foreclosed. That's what Nikki DuFore did, only to be learn that the mortgage company is not interested in dealing with renters.

Now DuFore hopes to find some way to legally break her lease since the owners, Darwin and Celina Sealey, have not made any payments since December, according to the lender.

Sealey, a mortgage broker, could not be reached, and his wife, a real estate agent, declined to comment. The couple also have a house in Pasco County that is in foreclosure proceedings.

Do DuFore and her husband, Quwan Williams, a contractor, have any advice for others about to rent?

"Read the lease thoroughly," DuFore said. "And add on to the lease that the tenant is responsible for paying the rent but it's the owner's responsibility is to make sure the mortgage gets paid."

Susan Taylor Martin can be contacted at susan@sptimes.com.

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Friday, September 14, 2007

Last modified Monday, September 3, 2007 8:58 PM PDT

Foreclosures put renters in limbo

By: CHRIS BAGLEY - Staff Writer

MURRIETA -- Families renting houses from a group of hard-to-find investors are wondering who owns the roofs over their heads, where they should send their monthly rent checks and whether a series of foreclosures will force them to move in the next few weeks.

The families, at least a dozen of them, are living in houses that out-of-town investors bought with 100 percent financing between May 2006 and May 2007. The Californian has identified 70 houses in western Riverside County tied to Elias Ochoa, who ran the Corona branch of a mortgage brokerage until earlier June.

Ochoa and his clients borrowed a total of $39 million, and have defaulted on 40 of the 70 mortgages since April. Lenders recorded defaults on at least six houses in August, setting them up to be seized and sold by banks by late November.

In interviews last week, residents said their experiences in the houses had been bizarre from the beginning, when they responded to handmade "for rent" signs in the windows of the houses. Most said they didn't balk at first, but default notices and a series of strangers knocking at their doors this summer have set them on edge.

Of a dozen renters who spoke to The Californian, all said they had never met or spoken with the people whom Riverside County records identify as the landlords. Several said they had been writing checks to Solco Financial Services, Ochoa's mortgage brokerage, and then to a company called ABC Mortgage, Realty & Property Management, which shared Solco's office suite in Corona.

Ochoa hasn't responded to calls or e-mail messages left for him over the past two weeks. The Californian was able to locate only one of the 33 investors, Lisa Tomsha of Irvine, who didn't return calls seeking comment.

One investor who was typical for the group bought three Murrieta-area houses through Ochoa last year, according to a database used by local real estate agents. All three involved 100 percent financing, and the owner defaulted on all three this summer, according to foreclosureradar.com, a database of defaulted and bank-owned properties.

A couple living in one of the three houses said a man claiming to be the owner had called but refused to give out his own phone number or meet with them. The wife said she had called Ochoa's Corona office and left messages six times in May, asking where she should send a rent check.

Over the summer, a couple of weeks after the lender began to foreclose on the house, Ochoa dropped by in a Mercedes to pick up the rent check, but she refused to continue paying when Ochoa asked her to make out the monthly check to him personally, she said.

"I would really love to know who owns this house," said the woman, who asked that her name and address not be used for fear of retribution. Ochoa insisted that he himself owned the house, she said.

Several of the families who rented through Solco and ABC said the companies' representatives had made it surprisingly easy to move in. Renters in two of the houses said Paul Chenelia, who worked under Ochoa at Solco and then ABC, was lax in taking deposits and noting Social Security numbers for credit checks.

"We moved in," one woman said, "and that's when all hell broke loose."

Chenelia was one of two Ochoa employees who also appear to have bought investment houses through him. Chenelia and his wife, Cindy, bought two Murrieta houses in 2006 with 100 percent financing; they sold the two houses six months later -- for a total gain of $194,000 -- to other Ochoa clients, who also used 100 percent financing, according to tax records.

Chenelia wrote in an e-mail to The Californian that he had severed all ties with Solco, ABC and Ochoa, but didn't respond to specific questions or to a request for an interview.

Michael Soliz, who continues to own and operate Solco out of the Pasadena area, said Ochoa's Corona operation had been autonomous and that he was surprised when told of Ochoa's dealings in Riverside County.

Of the 70 houses identified by The Californian, Ochoa acted as the buyers' agent in 58 cases, according to the real estate database. Searches of title documents show that the same investors bought at least another 12 local houses in similar arrangements around the same time. In several cases, a house would sit empty for months, all while Ochoa arranged sales from one of his clients to another.

Murrieta real estate agent Bonnie Butterworth said ABC and Solco had apparently moved renters out of at least two of the houses and into other houses the company was managing. Butterworth, who specializes in selling defaulted houses to investors, said she first noticed the houses last month, when she began to see default notices and then began to knock on doors. Public records show that individual borrowers had bought several houses around the same time with 100 percent financing and then defaulted just a few months later, a fact that led Butterworth to suspect that they were linked.

"These people destroyed our property values," Butterworth said. "It's not just the unsuspecting homeowners. It's not just the unsuspecting tenants. It's affected every single person in this city."

-- Contact staff writer Chris Bagley at (951) 676-4315, Ext. 2615, or cbagley@californian.com.

See also:

Real estate group guts neighborhoods (Aug. 26, 2007)

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10-year T-note yield
4.74

For market information, see www.bostonherald.com

THE TICKER

■ In its first major move as the new owner of Chrysler, **Cerberus Capital Management** will name the former head of Home Depot, Bob Nardelli, as chairman of the board and chief executive officer of the Auburn Hills, Mich. automaker.

■ **U.S. airlines** reported the worst June flight delays since 2000, with 29 percent arriving late for reasons ranging from computer failures to storms to sick pilots.

■ **American Express Co.** agreed to pay $65 million to settle U.S. charges that two of its units failed to set up adequate safeguards against money laundering.

■ **Microsoft Corp.** does not have to pay $1.53 billion in damages to Alcatel-Lucent SA, a federal judge ruled yesterday, reversing a March jury decision that Microsoft programs infringe on Alcatel-Lucent's digital music patents.

■ McDonald's Corp. agreed to sell its **Boston Market** chain to buyout firm Sun Capital Partners Inc.

Why us? Tenants say they're foreclosure victims

By JERIS ZIMMENBERG

Sandi Bonsall figures her family will have to split up next month when the bank that foreclosed on the Revere condo they've been renting forces them out.

"We might have a place where my son can stay and another where my daughter can stay and I'll go to a friend's place — but then we'll be all over the place," said Bonsall, 58, who shares the unit with her teenage children, one adult daughter and one granddaughter. "It's unbelievable the position they put you in without even batting an eyelash."

Cases like Bonsall's represent a growing problem in the Bay State's foreclosure crisis: tenants who pay rent regularly, but still lose apartments when banks foreclose on landlords' buildings.

"The stories we're hearing are very difficult," said Judith Liben of the Massachusetts Law Reform Institute. "Tenants are usually told they have to leave, and maybe offered a little bit of money (not to fight evictions)."

Lenders that foreclose on properties typically move quickly to evict tenants and owner/occupants alike, figuring vacant homes sell faster.

Experts also say banks see themselves as lenders, not landlords — so they want to dump homes, not operate [illegible] Liben said banks often prove the [illegible] in buildings' landlord [illegible] two ties.

"The banks at [illegible] they're a landlord and don't think they have to act like one," she said.

Michael Kelley of Boston's Housing Discrimination Center estimates his agency has dealt with a few dozen such cases this year. "The numbers are relatively small, but they're growing quite a bit — enough for us to be concerned," he said.

Jeff Purcell of Greater Boston Legal Services said the group's pro-bono lawyers increasingly represent a half-dozen tenants facing such evictions.

Purcell said tenants rarely know that landlords have stopped mortgaging and handing over properties and notifying renters out.

"Tenants are completely out of the foreclosure picture," Purcell said. "Nobody calls; nobody tells them anything. I would characterize that as heartless."

Roxbury's John Patterson says he unwittingly rented space in a rooming house a bank had already seized, paying $500 a month to a "landlady" who no longer owned the place.

"I've been throwing my (rent) money out an open window," said Patterson, one of some 50 people who picketed financial giant Deutsche Bank's Boston offices yesterday to protest foreclosure evictions.

As for Bonsall, she doesn't understand why her landlord's bank can't just sell her unit as an investment property with her family in place.

"If they want us to stay and pay rent and sell the condo as occupied, that's fine," Bonsall said. "But they really shouldn't be able to throw you out unless you stop paying rent."

—jzimmenberg@bostonherald.com

ANGRY: Sandi Bonsall, seen with her 17-year-old son Mark, is being forced out of the condo she has been renting in Revere for 10 years because the bank has foreclosed on her landlord's property.

Minnesota

MINNESOTA PUBLIC RADIO

Renters put out by foreclosures

by Jessica Mador, Minnesota Public Radio
May 11, 2007

Renters are being forced out of their homes - often with little or no warning - even though their rent is paid up.

St. Paul, Minn. — Thelma Hill and her five children lived in a Duplex on Geranium Street in St. Paul. She was up to date on her rent and so was her neighbor in the other apartment. With no warning they got a water shut off notice. Then a sheriff's deputy showed up to serve foreclosure papers.

And then they found out the other utilities also had not been paid in months.

"It's kind of like a shocker because when you're paying rent and all your utilities are included, you're expecting the landlord to do what he's supposed to do," Hill says.

Despite repeated attempts to reach the landlord, Hill was unsuccessful. The landlord did not return calls from MPR either.

Hill decided she couldn't keep her kids in an apartment without running water. She had no other place to stay so she made her way to a homeless shelter more than 14 miles across town.

Hill says she and her kids now have a long commute by bus back to St. Paul for school and her job at a Burger King.

"It took me like five to 10 minutes to get there before. It takes me about an hour and 15 to get there now. It took my kids five minutes to get to school and it takes them 30 minutes to an hour to get to school. They have to be downstairs at 6:50 a.m. to catch the bus," Hill says.

Hill is typical of a hidden but growing problem. In Ramsey County last year, investor properties accounted for 43 percent of foreclosed mortgages. In Hennepin County officials estimate the number at about 47 percent for the first three months of this year. No figures are available for the state as a whole.

It is not clear how many of those properties had tenants. But experts predict the pace of total foreclosures will continue to increase, meaning more tenants could also be at risk of losing their homes in the future.

Abe Appert represents the landlord group Minnesota Multi Housing Association. Appert says he is not surprised that investors make up such a large proportion of foreclosures.

"A lot of it is attributable to pure investors who really just wanted to buy into the real estate investment game just like you would buy into the stock market or any other investment," he says.

Appert says many investors bought real estate hoping to make a quick

profit during the real estate boom.

Do research on your landlord so you will not end up in the same situation that I'm in.

- Thelma Hill

According to Appert, "they were trying to capitalize on what was a market opportunity and like all markets they cycle and the opportunity went away and so they got caught. Somebody always gets caught."

But with rental properties tenants are also getting caught.

When a rental property goes into foreclosure tenants still have six months before they have to move out. The law requires landlords to give tenants notice of eviction in advance but housing advocates say this often does not happen.

Minneapolis legal aid attorney Carol Johnson sees an increasing number of renters whose landlords are in foreclosure. She says many renters moved into a place unaware it was already in foreclosure at the time they signed their lease.

"I would say at least half the people have looked at me completely astonished and said, 'I didn't know this had happened. I wouldn't have rented from this person.' It's that last category of people who rented and had no idea any of this was going on, those are the real tough situations to try and explain to people. It really makes you mad," Johnson says.

Experts say many landlords are having problems with the kinds of subprime loans that have also forced homeowners into foreclosure. These are high-interest home loans with hidden fees and adjustable interest rates.

But some landlords defend using subprime loans to invest in rental properties.

Contractor and landlord Brian Kallioinen says the low teaser rate on these loans allow him to develop affordable housing in collaboration with a non-profit. He says his business requires him to carry a lot of debt, and that jacks up the interest rate he would pay on a standard loan.

"When you end up with an 8.25, 8.5 even a 9 percent interest rate, affordability is just out of reach," he says.

Kallioinen has dozens of tenants in Minneapolis and he has never been foreclosed on.

As a tenant caught up in foreclosure, Thelma Hill has this advice:

"Do research on your landlord so you will not end up in the same situation that I'm in."

After spending two months in a homeless shelter Hill says she hopes to be in a new place back in Saint Paul in June. But Housing advocates say they worry that the foreclosure boom will leave tenants with fewer affordable options in the future.

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CALIFORNIA

Mortgage crisis hurting tenants

Some renters illegally evicted from buildings in foreclosure

By Barbara Grady, STAFF WRITER
Inside Bay Area

Article Launched:09/15/2007 02:40:31 AM PDT

OAKLAND

TINA BRYSON was nine months pregnant when she leased an apartment in April on Congress Avenue in East Oakland. Little did she know the apartment she rented was in foreclosure.

Two months after her baby was born, Bryson received an eviction notice from the lender taking over the building, telling her she had 30 days to move out. By then, her landlord — with Bryson's

$1,365 deposit in hand — were nowhere to be found.

"This guy tells me that the house was in foreclosure before I rented it," a frightened Bryson said last month, balancing a pile of legal papers on one knee and a baby on the other. She is half-packed to move but does not know to where.

As the subprime mortgage loan crisis rattles the financial and real estate markets and exposes the vulnerability of many home owners, it also is hitting a hapless population that had nothing to do with the loans — renters in buildings in foreclosure.

Across Oakland, scores of renters like Bryson are being served eviction notices or being told to move out as banks take over buildings from defaulting landlords.

Yet Oakland's tough rental laws exclude foreclosure as a legal reason to

evict tenants, except in rare circumstances. These banks, or the brokers representing them, appear to be ignoring city law or hoping tenants don't know about them.

"We are getting quite a bit of evidence that there are many violations of Measure EE" — the city's voter-approved renters' rights ordinance, City Attorney John Russo said earlier this month. "The banks foreclose and the landlords take off."

Tenants caught in between the banks and their errant landlords may face difficult straits, he said, including eviction. In some cases, building utilities have been turned off because landlords stopped paying the bills.

"Some of the stories are very sad," Russo said. "A 75th Avenue apartment has not had water for two weeks, and a woman who is pregnant lives there."

Measure EE, the "just cause" eviction ordinance passed in 2002, specifies when eviction may occur. Except in dwellings built since 1980, the owner cannot evict rent-paying tenants who abide by rental agreements unless the owner occupies at least a third of the building or intends to move into the unit or move family into the unit. The measure also says landlords must abide by lease agreements unless tenants fail to pay rent, damage property or breach some other portion of a rental agreement.

Housing advocates, such as Oakland-based Sentinel Fair Housing, and the city attorney's office have been receiving a growing number of calls from distraught renters in apartment buildings in foreclosure. Sentinel and Russo's

office are working to inform tenants of their rights under Measure EE and often to negotiate on their behalf. But the caseload is growing exponentially.

"Last year, we didn't get any calls like these relating to foreclosure," said Mona Breed, Sentinel Fair Housing executive

director. The organization now receives about 40 such calls a month.

"The cases are accelerating," Russo said. "It's becoming a humanitarian crisis. We are going to go after this."

As a first step, his office joined with Sentinel and community group ACORN Housing on Sept. 10 to try to ascertain how big the problem may be and try to develop a strategy to combat it.

Russo and Breed said many of the woes experienced by renters are the result of subprime mortgages gone bad.

Subprime mortgages are considered high risk because they require no down payments or start with low introductory interest rates that are set higher in subsequent years. The loans are typically offered to borrowers who don't qualify for conventional loans, because of a compromised credit history or insufficient income. During California's decade-long housing boom, subprime mortgages became more common, as borrowers and lenders figured a real estate property's rising value would pay for itself.

But due to Oakland's rental laws, tenants have rights when landlords or building owners default on their loans.

In most cases, a renter has the right to stay put in an apartment building, even during foreclosure proceedings.

But if the situation becomes uncomfortable or even unlivable because of a potential loss of utilities, a tenant can negotiate a "cash for keys" settlement with the new landlord. Under such an arrangement, a bank or broker will typically pay the tenant a sum equal to about two months' rent to leave.

Sentinel has been helping tenants stay in their buildings or negotiate cash-for-keys settlements that reimburse moving costs.

In Bryson's case, she agreed to a cash-for-keys settlement in which she received $2,000 to move out and agreed not to file any claims against the new owner. Still, the money — about $635 more than the deposit she paid — was not enough to pay the first and last months' rent for a new apartment.

In other cases, Sentinel has emboldened tenants to claim their rights.

Edward Newton, a tenant at a four-unit complex at 7344 Weld St., said he and a few other tenants are not moving out even though the property was taken over by Countrywide Financial Corp. — a Calabasas-based mortgage lender that prided itself during the housing boom on extending mortgages to new home buyers who had trouble qualifying for mortgages elsewhere.

"I'm staying here," Newton said. "I read Measure EE."

When mortgage lenders like Countrywide, GMAC Mortgage and Chase Home Finance take repossession of apartment buildings and homes in default, they hire local real estate brokers to remove the tenants and prepare the buildings for sale. They frequently offer the brokers financial incentives to move tenants out quickly, according to documents obtained by The Oakland Tribune.

A letter from REO World BPO of Newport Beach, listed as asset manager for Chase Home Finance LLC, the bank taking over the foreclosed apartment building at 2638 75th Avenue, offered broker Dan Felton of Oakland a set of commissions and bonuses for quick removal of tenants.

"You will receive a bonus of up to $300 if you can procure successful cash-for-keys agreement with a move out time of 14 days," the letter said.

Felton, in a subsequent July 10 letter to tenants, told them they were required to leave. If they didn't, "You will be deemed to be unlawfully detaining the premises," the letter said, "which will result in the commencement of court proceedings against you."

Pressed for details on the statute they were using to evict tenants, Felton referred a reporter to an attorney for Chase.

"It appears this was a notice sent in error," said the attorney, Randall Naiman of San Diego. Naiman later rescinded the eviction notice.

However, not all brokers try eviction.

Broker Hal Hutchins of Associated Brokers is handling about 350 foreclosure properties — mostly repossessed apartment buildings — in the Bay Area, representing banks in most case.

"My job is to approach the people living there and find out if they are the owners and find out if they want to move and give them the money to move," Hutchins said. "I inform them of their rights under Measure EE."

Hutchins, who is handling Newton's building on Weld Street, offered Newton and other tenants $1,500 to move. Newton said that is not enough to move in Oakland.

Russo, for one, feels Oakland has been a victim of predatory lending, as some observers of the real estate market consider subprime mortgages. The loans, critics say, put vulnerable borrowers at great risk.

During the housing boom, Russo said, lenders specializing in subprime mortgages aggressively marketed here and persuaded people to borrow above their means by taking out high-risk loans.

Now, his office says, foreclosure rates in Oakland are double the national average and growing fast. The number of foreclosures in Oakland doubled in 2005 and 2006, hitting nearly 1,200.

Homeowners who may lose their homes when their mortgages overwhelm them are one casualty of the subprime mortgage meltdown, but tenants are another group of victims — ones that had no say in the borrowing or lending.

"I think it is unethical and illegal for financial institutions to foreclose and shove tenants out," Russo said. "These folks in many cases paid their rents and did nothing wrong."

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MARYLAND

The Baltimore Sun

July 29, 2007 Sunday
FINAL EDITION

TOUGHER TIMES FOR HOUSING INVESTORS; FORECLOSURE FILINGS RISE IN CITY NEIGHBORHOODS AS REAL ESTATE MARKET SAGS; SUN SPECIAL REPORT

BYLINE: Jamie Smith Hopkins, Sun Reporter

SECTION: TELEGRAPH; Pg. 1A

LENGTH: 1784 words

Real estate investors, leaping to buy Baltimore homes during the boom, helped fuel the frenzy and drive up prices in neighborhoods from Canton to Reservoir Hill.

Now they're part of the fallout.

Properties belonging to "nonowner occupiers" - usually investors - accounted for nearly 30 percent of the city homes that lenders were trying to foreclose on during the first three months of the year, according to a Sun analysis of state court and assessment data. Caught by the market slowdown and in some cases blindsided by other problems, they defaulted on loans for more than 250 homes.

And they are disproportionately affecting a handful of city neighborhoods, both trendy and troubled.

In popular Canton, for instance, investor-owned real estate added up to more than half the 25 homes on the court foreclosure-filing rolls. At least eight of those properties - most bought during the housing boom - belong to a single investor.

"Some people just got left holding the bag," said T. Guy Cook, owner of Parkville-based Advance America Property & Finance LLC, whose niche is lending to Baltimore real estate investors. "It was inevitable. You knew it was going to happen - it's like musical chairs."

The rising tide of foreclosures has swept up investors both novice and experienced, though it appears that the newcomers are far more numerous. They were "the most giddy of all," jumping in too late and paying too much, Cook said. Many defaulted loans are on properties bought in late 2005 and in 2006, as the housing market began to hit the brakes.

"It's been a nightmare," said Ndabezinhle Moyo, a Baltimore resident who began investing last year in several city neighborhoods. After a series of setbacks, he's fighting to save four of his rentals - plus his own home - from foreclosure. "I was OK up until December. From December, I basically couldn't make a single payment for anything till about April."

Robert Strupp, director of research and policy at the Community Law Center in Baltimore, suspects that the pool of investors in foreclosure is only going to grow because they bought the majority of homes sold in the city in the past few years.

"We may just be seeing the early ... number," said Strupp, who chairs the enforcement committee of the Baltimore Homeownership Preservation Coalition.

Foreclosure, dreadful for property owners, isn't great for the surrounding neighborhoods either. As lenders seize

properties in default, they're adding to the homes for sale in an already-saturated market.

And though owners in default on their mortgages might still manage to save their property or sell, a foreclosure filing is a clear sign of financial distress.

Baltimore, which saw foreclosure filings drop markedly during the housing boom, just recorded its first increase in years. Filings for all real estate, including some apartments and commercial properties, rose 22 percent in the first three months of the year, compared with the same period last year.

To gauge how many of those involved investors, The Sun melded the foreclosure filings with state property assessment records as of January to focus on filings for nonowner-occupied homes. While a nonowner-occupied unit might not be held by investors - the term includes vacant homes people have inherited or once lived in - it's the best yardstick of investor activity. If anything, lenders say, investors are undercounted because some buyers falsely claim they're the occupants to get a break on mortgage terms and property taxes.

Nonowner occupiers hold nearly 40 percent of city homes, according to state records, so they're not falling into foreclosure out of proportion to their numbers - at least not yet. Twenty-nine percent of foreclosure filings in the first quarter were for homes owned by nonowner occupiers.

But some neighborhoods once considered hot investments are feeling an outsized impact, including Canton, the upscale waterfront destination that drew rehabbers like a magnet; Washington Village and Reservoir Hill, transitional neighborhoods that some saw as the Next Big Things; and struggling Broadway East and McElderry Park, with cheap homes that investors thought were bargains because the east side's under-construction biotech park is nearby.

The high proportion of pinched investors in Canton, Reservoir Hill and Washington Village propelled those neighborhoods into the top 10 in Baltimore for total foreclosure filings.

Investors who descended on certain areas to buy, buy, buy during the housing boom helped drive prices up even further at the time, said Mark Fleming, chief economist with First American CoreLogic, a firm that helps the mortgage-lending industry manage risk and fraud.

"They artificially inflated values, in essence, because of their interest in bidding it up to get it away from the other investor," he said. "If you have concentrated investors in certain areas and then house prices start to move south or sideways, the ramification is their greater willingness to walk. It basically creates more volatility."

Interthinx Inc., a California mortgage fraud detection company, said just over 30 percent of the Baltimore loan applications it looked at in the first five months of the year had possible "property valuation" problems - often inflated values. That compares with 8 percent nationwide.

Interthinx believes inflated values are a mix of fraud and honest overpricing. The report identified other types of potential fraud in Baltimore, including investors posing as owner occupiers.

The city was battered in the late 1990s and early part of the decade when unscrupulous investors bought homes and then quickly resold them for far more than their value with the help of forged documents or false appraisals. But investors can be victims of fraud, too, said Ann Fulmer, vice president of industry relations at Interthinx. She's seen a number of cases recently in the United States involving people recruited into investment clubs run by con artists.

"They end up getting inflated property, and then the orchestrators just disappear," she said.

Strupp, with the Community Law Center, believes that investors are also falling prey to bad financing. He doesn't mean subprime loans - though investors do face higher interest rates than homeowners because they're seen as a bigger risk. He's concerned about the terms offered by some "hard-money" lenders, companies and individuals that specialize in financing investor real estate purchases. He's seen loan documents allowing the lenders to demand all the money back with only 90 days' notice.

"There are inexperienced investors who are going to end up ... and may already be, losing the houses because they can't turn them around before these balloons come due," said Strupp, who saw several investors with such loans file for bankruptcy recently to avoid foreclosure.

In a strong market, real estate investors who make bad deals can get out quickly without much harm done. But prices

aren't increasing at a double-digit clip anymore, and sales have slowed. In the 21224 ZIP code, which includes Canton, units on the market in June outnumbered sales 7 to 1. The average home took more than 100 days to sell, three times as long as it did two years ago at the height of the boom.

"A lot of people [who] got in - put a lot of money into fixing up houses and have loans - can't sell them, they can't rent them for enough to cover mortgages, and they're stuck," said Alan Chantker, president of the Mid-Atlantic Real Estate Investors Association and a Baltimore rehabber. "They may have thought they were going to be in and out of the home in six months, nine months - and then it turns into a year, a year and a half."

When the market was still hot, a Washington Village home Chantker sold to another investor was quickly resold to a third investor - for a lot more money. Now that example of boom-time euphoria is a cautionary tale for the slump. The last buyer paid too much, struggled with contractors and couldn't sell, Chantker said. He thinks she eventually gave the property up to her hard-money lender.

"I don't think the property even got properly finished," he said. "She just ran out of money."

Moyo, 40, can relate after going into default on multiple homes.

He began investing in Baltimore rental homes last year, something he'd dreamed of doing since renovating his Fells Point house in 2005. He jumped in full time after leaving a job in the grocery business, quickly buying nine properties and signing contracts to acquire more.

Then everything went south.

His new tenants, he found, were either paying much less rent than the sellers claimed, or they weren't paying at all. Contractors disappeared after accepting down payments for work. And he was too optimistic about at least one of the neighborhoods he bought into, rehabbing for a classier clientele than he could get on a street with boarded-up properties and a flashing police camera.

As cash got tight and Moyo fell behind on his mortgages, lenders tried to foreclose on many of his rentals and his own home, which he had borrowed against to start buying.

"I've invested all my life savings," said Moyo, who is working with the lenders to try to hold onto his properties. "I have to try. ... I have to continue to fight."

He said he has at least $10,000 in mortgage payments a month and more than $1 million in debt hanging over him. He has tapped into his 401(k). His wife, a nurse, is working overtime to keep them afloat.

Moyo - a slight man with a quick smile - remains hopeful despite it all. He thinks he can still turn investing into the profitable business he's wanted since his childhood in southern Africa.

Little by little, he's removing nonpaying tenants. A handful of men and women who help him clean up after evictions descended recently on his Belair-Edison rowhouse to give it a thorough scrub, shaking their heads over the tenant who filled the place with furniture and flat-screen TVs but rarely paid rent.

"Living like a millionaire," asked Ernestine Glenn as she waited for cleaning supplies.

Moyo has a plan for this place: market it as two units, attract working professionals and collect $1,300 in monthly rent combined. He'll check for criminal records, insist on a signed lease and get a security deposit upfront - he's learned all that the hard way.

But getting his head above water is easier planned than done.

Earlier that day, representatives from the sheriff's office declared that they could not remove a tenant from one of Moyo's homes in the Broadway East area until the facade's missing street numbers were replaced and the request to evict refiled.

"In this business, nothing is ever smooth," Moyo said later. "As I find out on a daily basis."

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SUBPRIME CRISIS:
LENDERS AND INVESTMENT BANKERS BUILT IT, SOLD IT AND NOW THEY NEED TO FIX IT

Testimony By: Bruce Marks, CEO of NACA

My name is Bruce Marks. I am the CEO of the Neighborhood Assistance Corporation of America (NACA). NACA is a non-profit community advocacy and mortgage company. We were the first organization to expose predatory lending back in 1991 in Boston, Massachusetts. We exposed the lending practices of Fleet Bank and after a four and one-half year war, we won. As a result Fleet initiated a huge lending program, made many of the victims of its predatory lending whole, settled the law suits, and provided NACA with a mortgage commitment that became the foundation of our program. NACA has continued the campaigns against the largest lenders in the country, including Bank of Boston, The Associates, Ford, First Union and others.

SUBPRIME CRISIS IMPACT:
The human side of the subprime crisis is that over two million homeowners are at risk of losing their homes. If immediate action is not taken, the repercussions of allowing this meltdown will affect virtually every community, drive our economy into recession and impact economies oversees. The most effective and just remedy is for the lenders and investors who created and profited from the subprime crisis to restructure the loans. This does not require tax payer dollars to bail out an industry that has profited hugely from this scheme.

We need to clearly understand how we have come to the brink of a massive financial crisis. The subprime industry consists of trillions of dollars in mortgages, but the business was never about creating homeownership. It was always about generating billions of dollars in fees and huge profits. Since these mortgages were never structured to be affordable over the long-term, the financing only provided for temporary occupancy with the foreseeable and inevitable result for many homeowners being foreclosure and financial devastation.

SUBPRIME LENDING INDUSTRY:
There are six major players that are financially connected in the subprime lending. They are the borrowers, brokers, lenders, investment bankers, rating agencies and investors. The ones at most risk of loss (i.e. short end of the stick) are the borrowers and the investors. The brokers, lenders, investment bankers and rating agencies have already profited by charging billions of dollars in fees stolen from the borrowers and, to a lesser extent, the investors (i.e. pension funds, insurance funds and others). The investors purchased loan securitizations believing they would get returns much greater than the conventional returns. If they had actually read the prospectuses and documents they would not have purchased these loans since it was clear that they are not affordable and this crisis was just a matter of time. The silent players who facilitated this scheme are the regulators. They were not just asleep at the switch, but refused to exercise their authority in limiting the inevitable subprime lending crisis.

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The scheme was structured as follows: Financial players are always looking to create new products. Around five years ago, subprime mortgages packaged as secured debt obligations dramatically increased. They were based on what world-wide investors considered the safest investment: American Real Estate. These subprime mortgage products were designed to, in theory, yield significantly higher returns than other investments with virtually no risk.

The demand was tremendous – far beyond expectations. Investors from around the world were demanding more and more of this product. The initial product was not enough to satisfy the demand. The next version was an adjustable rate mortgage resetting at higher rates, but this still could not produce enough product. Next came the negative amortization product through option ARMs where borrowers increase their mortgage debt over time. Even this could not satisfy the world-wide demand. The last version was the no verification document or "liar loan." These loans were so outrageous and unrealistic that they began defaulting almost immediately. Thus in February 2007, the investor community and public got the first indication of the beginning of this crisis.

The marketing of these defective products was also insidious. To generate the huge numbers of borrowers, people with an intense desire or need for homeownership were targeted and exploited. They were often low and moderate income or minority borrowers. To target these borrowers they created a financial structure that encouraged mortgage brokers to exploit their own communities. Mortgage brokers were paid primarily through back-end points or yield-spread premiums (YSP). Brokers knew what the best rate would be for the borrower – par rate (i.e market rate). But in order to get any significant compensation they needed to convince the borrower (i.e. lie) that the lowest rate the borrower could get was actually much higher then the available rate. The higher the rate the more the YSP and income.

Not only were the interest rates unaffordable, but the overall mortgage amount was also unaffordable. Borrowers were encouraged to borrow more than they wanted and more than they could afford. While in the past community banks limited the amount borrowed to what could realistically be paid, the new players made more money the greater the loan amount. Since the brokers, lenders and investment bankers made a percent of the loan amount and investors just wanted more product, they were throwing huge amounts of money at borrowers. Who can blame the borrowers when the most "reputable" and powerful financial institutions were encouraging them to borrow more and more. To keep borrowers from refinancing into a more affordable loans and to pay back the YSP paid to the brokers, lenders implemented steep pre-payment penalties. To keep investor's appetite ravenous for more product, there was an affordability or teaser period of two to three years. Thus, they created the illusion that these securitized debt obligations were and would continue to perform. In fact borrowers were making their payments at these affordable rates, but would be unable to at interest rates greater than 10%. Who can afford double digit interest rates over the long-term?

RESPONSIBILITY FOR SUBPRIME CRISIS

Some in Congress and the Administration are apologists for the lending industry, portraying this crisis as one created by "risky borrowers" taking advantage of generous lenders. Nothing

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could be further from the truth. These hard-working Americans did not design these "exotic" products and package them for world-wide investments. Blaming borrowers would be the same as if car a maker designs and sells cars which suddenly go into over-drive causing a huge number of fatal accidents, and rather than having a massive industry recall to fix the defective car, we penalize the car owners as negligent drivers.

This subprime crisis is not about "risky borrowers." It is about risky and greedy lending. These "exotic" products are unique in their type and magnitude. The vast majority are adjustable rate mortgages (ARMs), but these ARMs are not like the adjustable rate mortgages we used to know, for they do not decrease if the prime rate or other indexes go down. These are Strangulation ARMs that are structured to always increase resulting in foreclosure or financial ruin for the majority of borrowers. They are initially affordable but dramatically increase over three to four years to more than 10% even if the lending indexes decrease. There was no perceived subprime crisis prior to 2007 when the initial payments were affordable. Homeowners could afford the rates they were charged initially at 6, 7, or 8 percent. But double-digit interest rates over the long-term will transform anyone into an at-risk borrower. The borrowers became "risky borrowers" due to the greed of the brokers, lenders, investment bankers and investors. This is not about risky borrowers this is about risky loans. This is not about subprime borrowers but about subprime lenders. This is not about irresponsible borrowers it is about irresponsible lending. This is about greed.

To protect their investments the brokers, lenders and rating agencies employed their full arsenal to prevent state legislatures from enacting consumer protection legislation and reforms. January 16, 2003 was a significant day in their campaign. On this day, Standard and Poor's stated that they would not rate any loans originated or serviced in Georgia as a result of the consumer safeguards the Georgia legislature had enacted the previous year. Particularly egregious from S&P's perspective was the requirement that investors would be responsible for violations in the origination of the loan. Moodys and Fitch soon followed, which provided the justification to gut the law in the subsequent legislative session.

COUNTRYWIDE:

These loans – trillion of dollars worth – have generated huge profits for the brokers who originated the loans, the lenders who purchased them, the rating agencies that evaluated them, and the investment bankers who packaged and sold them to investors. The New York Times investigative articles on Countrywide, the country's largest mortgage company, detailed how they structured employee incentives that exploited borrowers by imposing large costs on the borrowers, and pushed many into unaffordable mortgages. Additionally, the billions of dollars in bonuses paid out last year by the investment bankers reflect the profitability of the subprime lending market.

Countrywide has become the prime example for both predatory lending and predatory servicing. This is emblematic of the magnitude of the crisis given that they are the country's largest lender. Their size has allowed them to attracted billions of dollars in loans and investments to try to stay afloat. Now Countrywide is feeling the effects of financial stress. It is

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ironic that Angelo Mozilo, Countrywide CEO, who must now borrow on subprime terms on the commercial market can barely survive, while he expects hundreds of thousands of hard working borrowers with unaffordable sub-prime loans to survive on such terms. In fact, it is our understanding, Treasury Secretary Paulson asked Bank of America's CEO, Ken Lewis to purchase Countrywide this past August. That would be equivalent to Countrywide's loss mitigation strategy of selling someone's home at a loss to prevent foreclosure or in Countrywide's circumstances – Bankruptcy.

It is unconscionable to consider any form of bailout of Countrywide or even provide them with additional credit without requiring dramatic policy changes and restructuring of the loans they have made and service to the many hardworking homeowners that currently are being squeezed by their Strangulation ARMS and other predatory products. Even in light in the current crisis when the borrowers seek assistance all Countrywide does is request more money. Thus people deplete their 401ks, and borrow from friends and family to give Countrywide more money on a mortgage that will never be affordable. Their greed shows no limits.

SUBPRIME CRISIS SOLUTION

These defective products, like in the car recall analogy, require the recall-restructuring of loans on a massive scale. Developing a borrower focused solution based on what the borrower can afford is the only viable remedy. This requires lenders who service the loans to reduce the interest rate and/or reduce the outstanding mortgage balance to what the homeowner can afford. This can accurately be determined by documenting the homeowner's net income, required debt payments, necessary expenses with the remaining amount available for the mortgage payment.

Even though this is the best solution, lenders refuse to restructure loans, and in order to prevent foreclosures demand more money while maintaining the unaffordable mortgage. In light of this continued exploitation, the regulators must exercise their power to require lenders to restructure their loans. This remedy addresses the interests of all parties involved: the investor can obtain a reasonable return, homeowners can keep their homes, and the local tax base can be maintained.

SUBPRIME CRISIS GOVERNMENT AND GSE PROPOSALS

The plans put forth by the Administration and Congress will have no significant impact on this crisis. The President's plan focuses on the Federal Housing Administration ("FHA"). The number of loans they will be able to do will be a small percentage of the need. In addition, the numbers will dwindle as home values continue to decline and borrower's credit become worse. The initiatives to expand the authority of Fannie Mae and Freddie Mac will have even less of an impact on this crisis. The increase in their portfolio limits and conforming loan limits have the primary impact of increasing their profits and returns for their shareholders. Before any consideration of benefiting their bottom lines the following needs to occur:

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1. Disclosure:
    a. Amount of subprime loans they have in their portfolio and what they have securitized.
    b. The performance of their subprime loans.
    c. Results of their workout solutions.

2. Prohibitions on purchasing loans with the following:
    a. Pre-payment penalties.
    b. Back-end points or yield spread premiums.
    c. Loans that do not provide a net tangible benefit to the borrower.
    d. Loans that are not qualified at fully-indexed rates.

3. Create a refinance Product with the following criteria:
    a. Conventional interest rate
    b. Two late payments over past 12 months
    c. Can have up to a 90 day late

4. Loss Mitigation Standard for subprime loans:
    a. Stop all resets.
    b. Restructure loans to what the homeowners can afford based on a debt to income formula or budget.
    c. Eliminate all pre-payment penalties.

5. Setting a National Standard for Mortgage lending
   Fannie and Freddie are now in a position to set a national standard on how lending needs to be done nationwide. Lenders do not have the alternative options for selling their loans and will adhere to what standard Fannie and Freddie set. Thus all lenders who sell their loans to Fannie or Freddie must establish and adhere to a policy for their business that is the loss mitigation standard stated above.

Congress should not expand Fannie Mae and Freddie Mac's lending authority until they commit to require lenders who place loans with them to also restructure loans and eliminate their predatory practices. Also, any expanded authority for the GSE's should prevent them from engaging in subprime lending. The GSE's need to keep to their primary mission of expanding homeownership for low and moderate income people on affordable terms. This means addressing the needs of subprime borrowers by providing loans at the conventional rate. There should be no economic incentive to push borrowers into the "more profitable" subprime loans. In fact, the notion that higher rates compensate for increased credit risk has not materialized. High rates for subprime borrowers have become a self-full-filling prophesy with greater defaults.

The argument that these are contractual obligations that must be met highlights the fundamental decision that politicians and decision-makers need to make. Do they represent

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the lenders and investors who created this crisis or the homeowners who are at risk of foreclosure? The reality is that if these loans are not restructured the investors will have a virtually worthless investment. Restructuring makes sense for all the parties.

The difficulty has been on who has the authority to force the restructuring. These securitized debt obligations were structured to operate on automatic pilot. Thus there is no apparent manual override to restructure the loans so that the borrower can keep their home and the investor can obtain a reasonable return. The lenders who service these loans can restructure them if they are at risk of default, but few servicers are doing so. They persist in continuing their predatory practices by demanding money from borrowers to prevent foreclosures on loans that are not affordable. Thus predatory servicers are in fact stealing the future from borrowers who are using their retirement savings and borrowing from family and friends to keep their home. Fannie Mae and Freddie Mac can and must be part of the solution.

The regulators have a responsibility to insure safety and soundness. If immediate action is not taken and millions of homeowners will lose their homes, communities will be devastated, tens of millions of other homeowners will not be able to sell or refinance due to significantly reduced property values, and the safety and soundness of our financial institutions will be impacted. In addition, allowing these foreclosures to go forward will have a devastating impact on the tax base of communities throughout the country affecting the many services funded through property taxes. The Office of Thrift Supervision (OTS), Office of the Comptroller of the Currency (OCC), Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) need to make sure that all of the financial institutions they regulate adhere to the above Loss Mit policy and Limitations for subprime loans.

NACA has begun this process by bringing to Countrywide's regulator, the Office of Thrift Supervision (OTS), Countrywide borrowers who need their loans restructured. NACA will be submitting thousands of more cases to both the OTS and other regulators to force lenders to restructure their loans. For non-cooperative lenders the regulators can and must impose "Cease and Desist" orders.

Also the major substantive legislation needed immediately is to allow bankruptcy judges to restructure unaffordable loans. It is outrageous that judge's can modify mortgages on investment properties not residential mortgages.

NACA MODEL– THE RIGHT WAY TO DO "SUBPRIME LENDING"

NACA has done lending the right way. We lend to what the mortgage industry considers "subprime borrowers". We provide prime loans to such borrowers and they become prime borrowers. The NACA terms are the best in the industry. We provide one mortgage product and we counsel people into this product. The mortgage is:

- No Downpayment
- No Closing Costs (paid by the lender)
- No Fees
- No Perfect Credit

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At a below market fixed rate. The current rate is 5.50% 30yr fixed (as of 9/18/07).

While the mortgage market has shutdown in the sub-prime area and many conventional lenders have imposed tighter criteria, NACA continues to move forward without changes. We have become the standard for how lending should be done. We have over thirty offices nationwide and are rapidly expanding.

NACA has commitments for NACA's mortgage product of $10 Billion from the two largest banks in the country – Bank of America and Citigroup. This is for both purchase and refinance. NACA has also stepped forth with a One Billion dollar commitment to refinance borrowers out of their predatory loans on the best terms available.

CONCLUSION

This is a crash, but it is in slow motion. Massive foreclosures DO NOT need to happen. There is still time to prevent them. Borrowers are not asking for a handout, all they are asking for is to make their mortgages affordable. A fixed rate that provides a reasonable profit for the lender and long-term homeownership for the borrowers.

All politician's need to take a stand, from the Congress, to the presidential candidates, to the city counselor. They must stand with the homeowners to force the restructuring of these loans and prevent massive number of foreclosures. NACA is again leading the charge against the predatory lenders. We ask that the hundreds of thousands of borrowers and who have an unaffordable loan to come forward. So many people blame themselves; so many people are embarrassed; so many people do not believe that they have options. It is not their fault. They must come out of the shadows and join the fight! Contact NACA at www.naca.com. There is hope.

Everyone needs to be concerned even if they do not have a subprime or predatory loan. Neighborhoods are being devastated and it will only get worse. Politicians and regulators have ignored the plight of over two million homeowners who are at risk of foreclosure. The restructuring of loans is straightforward, attainable, and can be done at no cost to the taxpayer. This puts the responsibility where it rightly belongs – with the lenders and investors who created the crisis. As this crisis deepens, Congress and the Administration need to consider dramatic legislative and executive action to override any barriers that prevent the restructuring of massive numbers of borrowers at risk of foreclosure.

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Opening Statement as Submitted to the U.S. House Committee on Financial Services
by
Daniel H. Mudd
President and CEO, Fannie Mae
September 20, 2007

Chairman Frank, Ranking Member Bachus, members of the Committee, thank you for the opportunity to testify today.

These are tough times for the housing and mortgage markets, for families trying to buy homes or struggling to stay in them, and for companies and employees that serve these economically important industries. Many investors have fled the mortgage market, drying up the flow of financing – the liquidity – for subprime, jumbo and even affordable conventional, conforming loans.

While most of the prime, conventional, conforming market we serve is working and remains relatively liquid, borrowers who don't qualify for or can't afford a standard long-term, fixed-rate prime loan have dwindling options. According to one recent estimate, subprime and Alt-A originations will drop from $700 billion in the first half of this year to $300 billion in the second half. With about $600 billion in subprime loans slated to reset by the end of 2008, this precipitous drop in subprime lending means that many subprime borrowers who could otherwise refinance into better loans could be out of luck. The mortgage markets are not going to be there for these borrowers, unless there is a boost of liquidity and long-term mortgage investors regain confidence.

For the broader housing market, and the economy in general, this lack of liquidity could have far-reaching effects. The credit markets tend not to operate in distinct buckets, despite labels such as prime, jumbo or Alt-A. History shows that a lack of liquidity in one part of the market has a ripple effect on the entire market. Borrowing costs increase for everyone.

Congress chartered Fannie Mae, and I quote from page one of that Charter, to "provide stability in the secondary market for residential mortgages"; to "respond appropriately to the private capital market"; to "provide ongoing assistance to the secondary market for residential mortgages by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing"; and to "promote access to mortgage credit throughout the Nation."

We shorthand that to "liquidity, affordability and stability." That is all we do, and we do it only in the U.S. mortgage market.

As a number of observers have pointed out, the mortgage market operated smoothly through financial crunches before, such as in 1998, and in other times of distress. But not so this time. Liquidity is not returning.

We think more can be done, and we want to do our part to help provide stability and liquidity across the mortgage market. Some steps we've taken already include the following:

- Since the beginning of the year we have helped lenders refinance about $6.5 billion of subprime ARMs into prime loans through our HomeStay initiative, helping more than 33,000 homeowners avoid subprime payment shock. We've also significantly increased our funding and technical support to qualified counseling agencies that are helping struggling homeowners get into the right loan or avoid problems with their current loan. We offer our Home Counselor Online service free to these organizations as well as lenders.

- We have committed to fund $450 million in mortgage rescue packages from housing finance agencies in Ohio, Massachusetts and New York. With more and more lenders exiting the subprime business, these packages serve as a vital escape hatch. These programs can offer a way of keeping people in their homes with a loan they can manage.

- As you know, many borrowers are already in trouble. Through August, our loan servicers have renegotiated loans for more than 27,000 seriously delinquent borrowers — more than 750 loan workouts a week — to keep them in their homes. These loss mitigation efforts keep about half of our seriously delinquent borrowers out of foreclosure. But while we do all we can to prevent the loss of a home, we don't always succeed. Should it come to that, we and our servicer partners work with the borrower to sell the home to recover some of the value, or at least avoid having a foreclosure on record.

- For the secondary market we serve, our mortgage-backed security business is currently operating at record volumes as demand for conforming product increases. Holdings by other investors of our mortgage-backed securities have grown $170 billion so far this year. But packaging loans into securities isn't a cure for all parts of the conforming market and it can't address all the liquidity needs. So, where possible, under the limits of our portfolio ceiling, we have sought to fund affordable multifamily housing mortgages and affordable single-family loans in instances where other buyers have exited the market.

We think the President's foreclosure prevention initiative is an important step, and we look forward to working with the Administration to make it successful by continuing to work with our lending partners and our loan servicers to identify potentially troubled borrowers and avert defaults.

But as I said, we'd like to do more to fulfill our mission to provide liquidity, stability and affordability. One of our primary tools, since our creation in 1938, has been buying and holding mortgages and mortgage-backed securities in our portfolio. However, as you know, our portfolio has been capped since May of 2006 under a consent agreement with

our regulator, OFHEO, while we fixed our accounting and internal control weaknesses and caught up on our financial reports with the SEC.

OFHEO's decision yesterday to change the formula for the portfolio cap is directionally helpful because it provides us some limited flexibility. However, given the extent of the disruption, the market needs a broader, more comprehensive approach so that we can more fully address the ongoing turmoil and bring liquidity to the mortgage market.

We believe having the flexibility to increase our portfolio by at least 10 percent would make a meaningful difference. For instance, it would allow us to be a more active long-term investor in subprime refinance loans, affordable multifamily loans and other critical sectors of the mortgage market where investment capital has dried up.

We are fast closing in on the time when the terms of the OFHEO consent agreement will be satisfied. The fact is we have made enormous progress, and we have put in place procedures designed to ensure continued compliance with the requirements of the agreement. We have issued audited financials up through 2006. We have vastly reduced our material control weaknesses. A key item is to get caught up on our SEC filings, and we are close to doing that. Our 2006 10K report is filed, and we expect to file our 2007 quarterly SEC reports by year-end. At that time, we would anticipate the cap being removed, thus allowing us full flexibility to respond to the needs of the market and fulfill our mission.

Our mortgage portfolio provides liquidity by raising capital from investors, and then using the money to buy residential mortgages from lenders. We earn an investment return from holding the loans. By providing a stable, long-term home for mortgage assets, we free up lenders to make more loans. This increases the availability and lowers the costs of mortgages. Yes, we're only one of many investors in the market competing to buy mortgages. But when others pull out, the funds effectively dry up and it becomes more difficult and more costly for lenders to make loans. When that happens, our mandate is to step in, keep liquidity flowing and the market stable.

We have done so many times in the past, including the recent past. During the liquidity crisis in 1998, our portfolio grew by about $100 billion, or more than 30 percent, to provide secondary market support when others withdrew it. Our portfolio has had periods of expansion and contraction in response to market demands. For instance, our portfolio reached an all-time high of $917 billion in September 2003, another year when liquidity tightened. In 2005, demand for mortgage assets from other mortgage investors increased substantially. The market had plenty of liquidity. Our portfolio declined.

I am confident we could provide more liquidity help to the home finance market today without taking risks we are not capable of managing. Our purchases would comply with all relevant regulatory guidance, and be consistent with the internal controls framework we have established with OFHEO. We are not the only answer to the liquidity crunch, but we can play a part in a measured, safe and sound way.

Some have suggested an increase in the GSE conforming loan limit above the current $417,000 to address liquidity issues beyond the conforming market. We leave it to Congress to determine our proper loan limit, but I want to be clear – we would support such an increase, and we would be prepared to act.

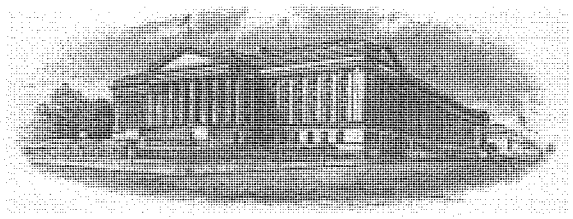
Looking ahead, I am confident we can get through this critical chapter for housing, and I believe the best years for housing are still ahead. The mortgage market is returning to its senses, with products, prices, underwriting and investing that serve homebuyers for the long run.

To be sure, while I have spoken mostly about Fannie Mae and the role we should play, I want to emphasize that there are important roles for many institutions in this crisis. Turning to the industry broadly, a number of steps can be taken now to improve the long-term health of the home finance system. The bad actors — individuals and institutions that have broken rules or violated the consumer's trust — should be prosecuted. More sources of liquidity should be tapped. Transparency and clear disclosures can be put into place for both consumers and investors. On that note, the Mortgage Bankers Association's "Project Clarity" is a laudable effort. And a return to credit fundamentals seems to be underway. My fear is that amidst all the change, reform and improvement, we will lose sight of what brought us so far — a commitment to decent, affordable housing for all Americans.

The need for safe, affordable mortgage lending will only grow with this growing nation. Affordable housing is beyond the reach of two-thirds of the low- to moderate-income families in America, and the difference between what families can afford and what a home costs is growing, not shrinking. Our affordable products for lower-income and credit-blemished borrowers help bridge this gap, offering fixed-rate loans on manageable terms. We've already helped our lender customers make almost $53 billion of such loans so far this year.

Affordable lending will drive the growth of homeownership in this country, if we can minimize the long-term impact of the current crisis. The turbulence in subprime should not derail the effort to provide flexible, affordable and sustainable mortgages, now or in the years ahead. The need is great, and through this period and in the years ahead, Fannie Mae is committed to doing our part.

Thank you.



U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL 10 a.m. (EDT), September 20, 2007
CONTACT Brookly McLaughlin, (202) 622-2920

TESTIMONY OF TREASURY SECRETARY HENRY M. PAULSON, JR. BEFORE THE HOUSE COMMITTEE ON FINANCIAL SERVICES ON THE LEGISLATIVE AND REGULATORY OPTIONS FOR MINIMIZING AND MITIGATING MORTGAGE FORECLOSURES

Washington- Chairman Frank, Ranking Member Bachus, Members of the Committee, good morning. I very much appreciate the opportunity to appear before you today to present the Treasury Department's perspective on the recent events in the credit and mortgage markets and their impact upon consumers and the economy. I am also pleased to be here today with my Cabinet colleague, Secretary Jackson, and with my fellow President's Working Group Member, Chairman Bernanke.

Credit Markets and the Overall Economy

Recently, there has been an adjustment taking place in the overall credit market and the mortgage market in particular. The current market turbulence stems from financial practices, but unlike many previous episodes of market volatility, takes place against a backdrop of a healthy U.S. economy and strong global growth. In the United States, the unemployment rate is at 4.6 percent, close to its lowest reading in 6 years. Growth in real gross domestic product was 4.0 percent at an annual rate in the second quarter, supported by strong gains in business investment and exports. Core inflation is under control. Since August 2003, 8.2 million jobs have been created and over the past 12 months, 1.6 million jobs have been created. Real wages have increased 2.2 percent over the past 12 months. In the corporate sector, earnings continue to outperform expectations and default rates on corporate credits of all kinds are at historically low levels. The Federal government's fiscal deficit is declining and well below long-term averages as a share of the economy, reflecting strong revenue growth and the continued strength of the U.S. economy.

The global economy also remains strong, with annual growth at around 5 percent and with many emerging market economies growing even more rapidly than the global average. The advanced economies also continue to perform well, with unemployment down sharply in Europe, helping to make growth of the last several years the strongest since the early 1970s.

Credit markets play a vitally important role in the efficient operation of our economy by intermediating funds between investors and borrowers. Credit market participants are constantly evaluating their views on risk and their appetite for risk. Larger fundamental reappraisals in the pricing and appetite of risk

have taken place numerous times over our nation's history, which is fundamentally the way that markets work. We are in the process of another such reappraisal period today.

As has been well documented, the current credit market reappraisal started in the subprime mortgage market. The performance of subprime mortgages deteriorated, as a result of higher than expected delinquencies and defaults. This introduced greater uncertainty regarding both the future prospects of subprime mortgage-backed securities and the methodologies the credit rating agencies used to rate these securities. These factors led investors fundamentally to reassess the risk of these securities and subsequently to reassess price. Compounding the challenge was the increased complexity and opacity of many of the mortgage backed securities investment strategies and instruments. The combination of uncertainty and complexity resulted in few investors willing to put capital at risk.

Given the interconnectedness of the various components of our capital markets, these concerns over subprime mortgages and related securities had an impact on investors' confidence and assumptions about the credit quality and value of other assets. Consistent with expectations, we have witnessed a reassessment of risk, and hence a subsequent revaluation across capital markets globally. Certain asset classes were able to reassess fairly quickly and investors have greater confidence in their fundamental assessments. In such markets, liquidity has returned and markets are operating in a more customary fashion. Good examples of these would include most world equity markets, sovereign debt markets, and even investment grade corporate debt. Alternatively, certain markets are still operating under stress with impaired liquidity. These would include the jumbo mortgage market, the leveraged loan market, and the asset backed commercial paper market.

Given the importance of credit markets to the functioning of our economy, when we experience a fundamental reappraisal like we have over the last several weeks, it is essential that policymakers evaluate the potential impact on the economy. Chairman Bernanke can provide additional details, but the Federal Reserve undertook several measures – providing additional reserves through open market operations, lowering the discount rate, and changing practices associated with discount rate borrowing – to increase liquidity and promote the orderly functioning of financial markets. Additionally, this week, the Federal Reserve lowered its target for the federal funds rate by 50 basis points and approved another 50-basis-point decrease in the discount rate. The Federal Reserve's actions have helped to stabilize financial markets.

At the Treasury Department, we have been closely analyzing the global capital markets on a daily basis. As Chair of the President's Working Group (PWG) on Financial Markets, I have been in regular contact with members of the of the PWG, which includes Federal Reserve Chairman Bernanke, Securities and Exchange Commission Chairman Cox, and Commodity Futures Trading Commission Acting Chairman Lukken. I also have been in frequent contact with other Federal regulators, including the heads of the OCC, OTS, FDIC, and the Federal Reserve Bank of New York. These contacts complement information gathered from market participants, finance ministers, and other participants in the global marketplace. I have been keeping the President apprised as well. Enhanced communication is vitally important for understanding how markets are operating, where disruptions are occurring, and evaluating what actions, if any, should be considered.

As I have said before, the recent reappraisal of risk could result in some modest penalty to economic growth. However, as I noted at the outset, the economy was in strong condition going into the recent period of volatility, and while certain sectors like housing are undergoing a transition, overall economic fundamentals remain solid. It will take time for the current reappraisal to work itself out, but in my view the underlying strength of the economy should allow for continued growth.

Challenges in the Mortgage Market and the Administration's Plan

While the current reappraisal of risk in the credit markets will work itself out over time, the transition taking place in the mortgage market is causing difficulties for many borrowers and we are quite focused on this issue. This will be especially so for borrowers who took out subprime adjustable rate mortgages in recent years.

We should not lose sight of the fact that the subprime mortgage market improved access to credit and homeownership for millions of Americans. Starting in the early 1990s, consumers with less-than-perfect credit histories were able to gain easier access to mortgage credit at interest rates above prime borrower rates. Individuals and families could use this new source of credit to tap previously illiquid home equity wealth through refinancing or to purchase homes. Subprime mortgage origination volume increased from less than 5 percent, or $35 billion, of total mortgage origination volume in 1994 to nearly 20 percent or $625 billion, in 2005. During this time period homeownership rates also increased, growing from 64 percent in 1994 to 69 percent today, some of which was due to expanded opportunities in the subprime mortgage market.

The growth in the subprime mortgage market (and the mortgage market generally) was facilitated to a large degree by securitization, a process by which individual loans are transformed into securities. In a typical private label mortgage securitization, the mortgage originator transfers loans to a securitization sponsor, who pools together mortgages into mortgage-backed securities, and sells pieces, or tranches, of these securities to investors. In this way, the securitization process allows for the creation of securities that better match investor preferences for particular types of risk, which broadens the availability of capital. The benefits of such development are (1) increased capital for mortgages resulting in more products and lower costs, and (2) greater dispersion of investor risk. While these are net benefits, securitization also has introduced some challenges which are described later and are the focus of additional work for the PWG.

Further expanding the potential investor base was the development of another structured product, the collateralized debt obligation (CDO), which purchases asset-backed instruments, such as mortgage-backed securities. Mortgage-backed CDOs, nearly 40 percent of the entire $500 billion CDO market in 2006, have been one of the major purchasers of mortgage-backed securities, in particular the lower-rated tranches. For both individual mortgage-backed securities and CDOs, the credit rating agencies work closely with the sponsor to rate the credit risk of various pieces of the transaction.

A key challenge in the current subprime mortgage market (and to a lesser extent in the prime market) is the significant amount of hybrid adjustable rate mortgages that will be resetting in the next few years. Hybrid adjustable rate mortgages have a fixed rate of interest, often free of amortization payments, for an initial period, resetting at an adjustable rate for the remaining term of the loan. The most popular hybrid adjustable rate mortgage was the 2/28 – a fixed rate for two years, then an adjustable rate for the remaining 28 years of the mortgage. The fixed rate of interest in the first two-year period was typically lower than the initial adjustable rate in the reset period, and it often had an even lower teaser rate at the outset.

Hybrid adjustable rate mortgages can be a useful product, and, in the past, rising house prices often enabled borrowers with hybrid adjustable rate mortgages to refinance on more attractive terms prior to the first reset. However, the recent trend of a decline in house price appreciation (or depreciation in home values) has made refinancing more difficult. Other problems in the subprime market (and in some cases in the prime market) include lax underwriting standards, especially in 2005 and 2006, which have led to a significant amount of early defaults. Finally, while this is not a new issue, mortgage fraud continues to be a problem and may have increased with growth in the subprime market over the past few years. Some of the most egregious individual stories in the subprime mortgage market involve some type of fraudulent activity that is already illegal. A combination of these factors has led to a significant spike in mortgage delinquencies and foreclosure starts. Much of the increase is concentrated in

subprime adjustable rate products, and it is also concentrated in areas of the country that are experiencing some degree of economic difficulty or a decline in housing prices.

To address the current situation, President Bush recently announced an aggressive plan to help as many homeowners as possible stay in their homes and to improve our mortgage finance system for the future – the HomeOwner Protection Effort (HOPE). As part of HOPE, the Treasury Department has, in coordination with the Department of Housing and Urban Development (HUD), started working on a new foreclosure prevention initiative to help struggling borrowers. The goal is to expand mortgage financing options and to identify and reach struggling homeowners before they face hardships, helping them understand their financing options, and helping them to find a mortgage product that keeps them in their home. Community organizations, mortgage servicers, and mortgage finance entities all play key roles in helping borrowers avoid foreclosure. Community organizations, such as mortgage counselors, work with struggling borrowers to help them identify all the options available to them. Mortgage servicers are often the first contact with borrowers and they have tools available to help borrowers who are in trouble. And mortgage finance entities, whether it is the Federal Housing Administration (FHA), government sponsored enterprises (GSEs) such as Fannie Mae and Freddie Mac, or insured depository institutions, all develop mortgage products that borrowers can use to refinance existing obligations. I and other Treasury officials have held important and useful meetings with these organizations to understand the challenges borrowers face and to explore ways to help them. We will continue to do so in an effort to minimize foreclosures.

We are working very hard to try to help as many Americans as possible keep their homes. We have learned several things already, two of which I would like to take an opportunity to share today.

First, it is clear to everyone that the earlier we identify struggling borrowers, the more likely they will be able to modify their mortgage or refinance into a more affordable mortgage. If we wait until borrowers miss several payments, their credit profiles will be tarnished and they will have far fewer refinancing options.

Second, many borrowers mistakenly believe that their lender wants to repossess their house in foreclosure. Foreclosure is tough on families, bad for communities, and very costly for lenders. The vast majority of lenders would rather find a way to help the homeowner stay in their home than foreclose. Yet according to most of the servicers and counselors we have spoken to, 50 percent of those who lose their home to foreclosure never contacted their mortgage servicer or a mortgage counselor for help. Often times borrowers are fearful of foreclosure and not aware that their lender may be able to work out a solution – such as a lowered interest rate or a payment plan. Clearly, we need a concerted effort to reach those who might have trouble meeting their payments and urge them to look for help before they get behind on their payments. There is a public service announcement running now, encouraging homeowners to call for help. I went to Chicago last week and held an event to publicize the availability of homeownership counseling. I plan to do more to urge people to be proactive, and I urge all of you to hold events in your districts, highlighting the availability and importance of mortgage counseling.

In addition, as part of HOPE, the Treasury Department has been working closely with Congress to change temporarily a provision of the federal tax code that currently considers cancelled mortgage debt on a primary residence as taxable income. Today, if borrowers are able to secure a loan modification or refinancing that involves a write down of existing principal, they could be subject to federal income tax liability on the value of the write-down. Moving forward, by providing much-needed tax relief to homeowners that are faced with this situation, we will remove an obstacle to keeping more borrowers in their homes. As President Bush has said, "when your home is losing value and your family is under financial stress, the last thing you need to do is to be hit with higher taxes."

Finally, the President has asked me to lead efforts of the President's Working Group on Financial Markets in examining some of the broader market issues associated with the challenges in the mortgage market, which include: the role of credit rating agencies; and how securitization has changed the mortgage industry and related business practices.

Secretary Jackson can provide additional details on HUD's efforts related to HOPE including FHA modernization legislation, the new FHA-Secure initiative, and reforms to the Real Estate Settlement Procedures Act (RESPA).

Considering Other Issues to Address Mortgage Market Issues

The Role of Government Sponsored Enterprises (GSEs)

The President directed Secretary Jackson and me to work with all mortgage market participants to see what can be done to help struggling homeowners stay in their homes. Given that the GSEs play a significant role in the mortgage market, we believe they can be helpful in assisting many homeowners in this period. In fact, Fannie Mae and Freddie Mac were created in part to assist in these types of situations.[1]

Fannie Mae and Freddie Mac were established in part to help provide a degree of liquidity to the secondary market for home mortgages to increase the capital available for home mortgage financing. To perform that mission, Congress granted the GSEs benefits and imposed constraints. The benefits include exemptions from state and local taxes, conditional lines of credit with the Treasury Department, and the ability of banks to make unlimited investments in GSE debt securities. But the most important benefit is the market's perception that they are somehow backed by the Federal government, even though this is not the case. This benefit, unfortunately referred to as the "implicit" government guarantee, is the one that provides the GSEs with a funding advantage over other mortgage market participants.

The constraints imposed on the GSEs include that they: are limited to operating in the secondary mortgage market; can only purchase or guarantee loans below the conforming loan limit set by Congress (currently $417,000 or lower); and must have credit enhancements if the loan-to-value ratio exceeds 80 percent. In addition, they are also subject to safety and soundness oversight, and they must meet affordable housing goals.

Fannie Mae and Freddie Mac operate in the secondary mortgage market by providing credit guarantees on mortgage-backed securities (MBS) or by directly investing in mortgages and mortgage-related securities through their retained mortgage portfolios. In the credit guarantee business, Fannie Mae and Freddie Mac generally enter into to swap agreements with mortgage lenders under which individual mortgages are transformed into MBS guaranteed by the GSEs. Fannie Mae and Freddie Mac also have the ability to purchase mortgages and package them into MBS. In the mortgage investment business, Fannie Mae and Freddie Mac issue debt securities to fund an investment portfolio of mortgage-related securities. In comparison to the credit guarantee business where credit risk is the main exposure, the mortgage investment business involves both credit and interest rate risk. The mortgage investment businesses of Fannie Mae and Freddie Mac presents the greatest potential risks, while at the same time having a much less clear connection to their housing mission than the credit guarantee business.

The GSEs are an unusual construct – they are government-sponsored with a public service mission, but they are also publicly held companies that have to answer to boards of directors and shareholders. If we

[1] The Federal Home Loan Banks (FHLBanks) have also played an important role by providing a source of liquidity to FHLBank members (primarily insured depository institutions). As of August 31, 2007, advances (collateralized loans to members) outstanding for the FHLBanks on a combined basis were $769 billion, up by $110 billion from July 31, 2007

knew then what we know now, we likely would not have designed entities like the GSEs that have private ownership but are required to undertake a public mission. These competing interests are too difficult to manage, and the potential long-term market distortions and public policy concerns are too significant. The tension born by this construct is highlighted in the current situation in the subprime mortgage market. On the one hand, assisting subprime borrowers is at the heart of their affordable housing mission. On the other hand, these mortgages do pose greater risks, which if not managed correctly could lead to less return for shareholders.

We all understand that the GSEs have had some accounting and risk management problems in recent years. To some extent these problems are a result of their unusual construct – the private sector goal of increasing earnings led to the rapid growth in the GSEs' retained mortgage portfolios, and contributed to a lack of focus on internal controls and risk management. I see no benefit in restating these issues which have been well publicized and documented. It is worth noting, however, that the new managements at both institutions have improved their operations. Despite these improvements, however, there are still legitimate concerns about the systemic risk posed by the GSEs' retained portfolios due to their large size and the lack of ordinary and effective market discipline.

Turning to current market conditions, the conforming loan market, which is the segment of the mortgage market in which the GESs primarily operate, has continued to function well during periods of market stress. This should not be a surprise. Investors do not take on the credit risk of the underlying mortgages when they purchase GSE-guaranteed mortgage backed securities. In contrast, in the non-GSE mortgage market, the securitizing, packaging, and trading of credit risk have created an increased amount of complexity. As we have seen, market participants are growing more cautious and deliberative in evaluating credit risk in non-GSE securitized instruments.

We are starting to see encouraging signs that other markets, such as the jumbo mortgage market (loans greater than $417,000), are loosening up but these markets are not functioning as normal. While some financial institutions are more willing to take these loans onto their balance sheets than they were weeks ago, others are in a sense compelled to do so because the demand for jumbo and other non-conforming mortgage backed securities (and other asset backed securities) has broken down and liquidity concerns remain. Over time, we expect market conditions to improve. In other areas, such as subprime, this process will take even longer. Market liquidity will adjust as investors reassess risks and return, relative to the underlying fundamentals. But all of this will take time as markets digest new information.

As we work to alleviate stress in these markets, we naturally must ask what the GSEs can do toward that end. And to the extent we see room for them to do more, any consideration of a change in policy must find a balance between competing and distinct concerns, including: the temporary needs of today's market; the legitimate public policy question of how much of the mortgage market should be directly or indirectly influenced by GSEs, which the market perceives as being backed by the federal government; and the issues of size, systemic risk and longer-term market distortions that will occur by inserting perceived government intervention.

And, just as important, how will we change market participants' expectations and behavior if they assume, rightly or wrongly, that there is a risk that their own market functions would be displaced by the GSEs at any point in time? The existence of government influence certainly helps when confidence in credit quality is causing marketplace stress. However, this "benefit" is not without cost in the form of a reduction in market discipline and competition, innovation, and efficiency.

Some have suggested that the GSEs should be permitted to inject some liquidity into the jumbo mortgage market. There is little question that allowing the GSEs to securitize jumbo mortgages would give a short term lift which would be helpful to a segment of the housing market that has shown some recent improvement but is not functioning as normal. GSE entry into this sector would improve liquidity. The jumbo mortgage market traditionally has been a very profitable part of the mortgage

market, with low default rates. For that reason it seems logical that this market will right itself in the weeks and months ahead. Therefore, consideration of this issue should be limited to a provision that is temporary and is part of legislation strengthening the regulatory structure. If it goes beyond that, it raises difficult public policy issues and could be seen as detracting from the GSEs' affordable housing mission and displacing private sector participation, which the Administration does not support.

The borrowers who are facing the greatest stress today are those who have less-than-perfect credit, and also those who have little equity in their homes, due to a decline in house price appreciation or a depreciation in home values. These difficulties are not limited solely to subprime mortgages, but are also surfacing among some prime jumbo mortgage holders. Anything the GSEs do to provide liquidity in this area, then, would mean taking on more risk. Therefore, such steps, and any additional authority permitting such steps, must be contemplated only in conjunction with legislation that addresses the inadequate regulatory structure of the GSEs.

The current GSE regulator has less authority than a federal bank regulator. Many argue that a good solution would be for the GSEs to be regulated in a manner consistent with regulation of large national banks. However, in our view, the GSE regulator should have more tools available than does a bank regulator to take into account the unique characteristics and tensions of the GSEs.

This Committee and the House of Representatives worked very hard to pass a meaningful GSE regulatory reform bill. In our view, the House bill is not perfect, but it goes a long way in addressing the issues that must be considered. The Senate now must act. The case cannot be stronger for the Senate to take up GSE reform legislation.

It would be unreasonable and irresponsible to expand the GSEs' businesses without addressing the fundamental problems of their regulatory structure. I would welcome this debate and repeat our request for the Congress to send the President a strong GSE reform bill. I frankly am disappointed that we have not had further engagement on these important issues.

Helping Struggling Homeowners

We also have been discussing with the GSEs how they might play a meaningful role to help struggling borrowers keep their homes. Of course, there are a number of constraints on the GSEs ability to help, especially where struggling homeowners have little equity in their homes. Many mortgages were originated with high loan-to-value ratios, and the declines in house price appreciation (or depreciation in home values) have put additional pressure on the current loan-to-value ratios of all types of mortgages. The GSE charters require that they have adequate credit enhancement on any loans they securitize or purchase that have a high loan-to-value ratio (greater than 80 percent LTVs). Changing this would require legislation. Again, I would welcome the debate in Congress about whether the GSEs should have the ability to go deeper into the credit spectrum to help current homeowners and to support further their affordable housing mission. This debate should be part of the broader regulatory reform discussion because allowing the GSEs to take on more risk elevates the importance of having adequate regulatory oversight.

Another, perhaps larger, constraint on their ability to assist borrowers is their own internal underwriting standards. Many of these borrowers represent significant credit risk, and present greater risk management issues for the GSEs in comparison to the traditional prime market. To undertake more business to assist these borrowers, the GSEs would have to reevaluate their own underwriting standards and develop new products that can help reach troubled homebuyers. By guaranteeing these types of products they would increase the flow of liquidity available to refinance some subprime borrowers into mortgages they can afford. We are encouraging the GSEs to do more. However, we recognize that the GSE management teams must also answer to their boards of directors and their shareholders in making

these business decisions. We would expect the GSEs to evaluate fully the risks associated with any new initiatives in that context along with their public purpose mission.

In financing mortgages for either of these two types of struggling homeowners – those with credit problems or those with little equity in their homes – the GSEs would be taking on greater risk. Legislation that encourages them to assume more risk must also create an appropriate regulator to provide the proper regulatory oversight. We should not create tomorrow's problem as we construct today's solution.

Portfolio Caps

Recently, there have been calls on the Administration and the Office of Federal Housing Enterprise Oversight (OFHEO), the GSEs' independent regulator, from some policymakers and market participants to undertake certain actions to expand the market segments in which the GSEs may operate. Most prominently, the Administration has been asked to lift the temporary caps on the GSEs' retained portfolios.

It is important to note that the portfolio caps were imposed by the GSEs' independent regulator because of the well-publicized and documented concerns that I referred to earlier. It is also important to note that this regulatory decision does not affect their securitization activities at all.

I view the GSEs' requests for an increase in their investment portfolio as legitimate from a business perspective, but less so from a public policy perspective. From a business perspective, when mortgage spreads widen, growth in the GSEs' retained mortgage portfolio provides enhanced profit opportunities given the GSEs' debt funding advantage. Thus, the business motivation for this request is clear and sound.

Whether this request will have a positive impact on the mortgage market is much less clear. There is already ample liquidity in the prime conforming marketplace, the marketplace in which the GSEs concentrate their investment portfolio business. The securitization efforts of Fannie Mae and Freddie Mac have been a huge contributor to this liquidity. The more efficient use of their capital to ease current market strains is in the guarantee business, where each dollar of capital goes further in adding liquidity.

Given that the prime conforming market is functioning well, I would largely characterize the portfolio cap debate as misplaced. It is easy for some to point to lifting the portfolio caps as a "solution" to a complicated problem that, regrettably, needs more time to work out. This portfolio cap issue is something that the regulator should look at and continue to evaluate. Just yesterday, OFHEO announced steps to adjust Fannie Mae's investment portfolio cap and to provide more flexibility to both enterprises with regard to the management of their investment portfolios. I hope that both GSEs will use this new flexibility to provide liquidity to parts of the market experiencing the most strain.

This matter is not something that requires Congressional action. This is a regulatory decision, and it is being addressed where it should be, at OFHEO. Generally speaking, the caps may be lifted, at OFHEO's discretion, when each GSE becomes up-to-date and current in their filings with the SEC. My understanding is that because of the good work of the new management teams, both enterprises likely will complete their restatements some time in 2008. Because this regulatory matter does not impose negative consequences on the overall economy, I see no reason for legislative intervention.

At the Treasury Department, we are very open to ways to enable the GSEs to do more to relieve the strains in the mortgage markets. Our discussions have been thoughtful and constructive. They understand that this is a critical moment for them to demonstrate their ability to make a meaningful difference in the affordable housing market.

Mortgage Origination Issues

As noted earlier, securitization has fundamentally altered the process of obtaining a mortgage. Securitization has led to innovation in product design and increased capital availability. Of course, the decentralized nature of the mortgage market also presents certain challenges as many different participants – mortgage brokers, mortgage banks, insured depository institutions, investment banks, and ratings agencies – play a role in the mortgage process.

As we evaluate ways to improve the mortgage process in the future, we must look broadly across all participants in the process. While there are many issues that can be considered, I would arrange them in three broad segments: (1) disclosure provided to the borrower; (2) market practices; and (3) capital markets aspects. A thorough evaluation will require looking at each of the segments.

Importance of Disclosure

Adequate disclosures are a key component in fully empowering consumers to shop for the best mortgage product and promoting competition among mortgage originators. Our current system provides a voluminous amount of disclosure, but still consumers are confused about key aspects of their mortgage loans.

We need to work toward simplified disclosures that provide consumers information about key features of their mortgage. The key is not more disclosure, the key is better disclosure and this might be a case where less is more. Taking it as a given that many people will not read all (or even most) of the disclosure documents, we should try to evaluate what type of information is most critical for a lending decision to be consummated. Some of the proposals to create a one-page mortgage disclosure have been designed with this goal in mind.

As we consider new legislative proposals for enhanced or simplified disclosures, we should be fully aware of the efforts that are currently underway to improve disclosures. The Federal Reserve is engaged in a comprehensive review of the disclosure regime underlying the Truth in Lending Act, with the goal of developing disclosures that more effectively help consumers understand their loan terms. Chairman Bernanke and I have discussed this issue and I have confidence that he and the Federal Reserve will work diligently to achieve this goal. I am sure that Chairman Bernanke can provide additional details on the scope of the Federal Reserve's efforts.

Similarly, as described in Secretary Jackson's testimony HUD is engaged in an effort to propose RESPA reforms that would promote comparative shopping by consumers for the best loan terms, provide clearer disclosures, limit settlement cost increases, and require fee disclosures.

Simplified and meaningful disclosures should be in everyone's interest. The question is not whether we should strive for this goal, but more so the best way to achieve this goal.

Market Practices

Many of the most egregious problems related to mortgage fraud – such as falsifying income, inflating appraisals, or deceiving customers – are currently illegal under existing statutes. Federal agencies such as HUD, the Department of Justice, and the Federal Trade Commission are aggressively pursuing perpetrators of mortgage fraud. State authorities have also taken numerous actions. At the most basic level, we must ensure that our law enforcement agencies have the resources necessary to fight mortgage fraud at all levels.

Another issue that should be considered is inconsistency in the practices of participants in the mortgage market. Mortgage brokers have often been singled out as the main problem, and it appears that many of the mortgages that are currently under stress were arranged by mortgage brokers. But that is not the complete story as in many cases mortgage brokers were arranging loans based on lax underwriting standards developed by mortgage originators who could then fund these loans through securitization transactions arranged by investment banks. Nonetheless, issues of mortgage fraud, whether committed by mortgage brokers or other mortgage originators, have been a long-standing problem, and much of the focus has been on entities that are licensed at the state-level, where the degree of regulation varies.

Unfortunately, this is not a new problem, although the scale of the problem we are facing today is larger. It is especially difficult for States to monitor the actions of individuals that move their operations across state boundaries. In response to this problem, State regulators have started an effort geared toward uniform licensing and education requirements for mortgage brokers. We support this effort, but it remains unclear whether State regulators will be able to complete successfully this task on a national basis. Additional efforts to encourage the development of a more consistent licensing, education, and monitoring system for mortgage originators are worth considering and such a system could help to weed out some of the bad actors.

As we take a closer look at what caused some of the problems in the subprime market we should look at all aspects of the transaction. Much of the focus has been on practices of mortgage brokers and originators. I have no doubt that some mortgage brokers and originators engaged in deceptive and predatory practices in marketing loans to people that they did not understand or have the ability to repay. Just as important, and not said as often, I have no doubt that there was an abundance of borrower-level fraud as well. Some people chose to inflate their income or mislead a lender into thinking the property was to be owner occupied as opposed to being an investment property. Both of these practices have a profoundly negative effect on the mortgage market.

There are legitimate calls for creating a uniform national predatory lending standard. This is a very important issue that is quite complex. Great care must be taken when considering a national predatory lending standard or banning certain practices so as to not overly constrain credit availability. What some people consider a predatory practice or loan could be a useful product for some borrowers as long as they fully understand it. Achieving the right balance here is critically important.

The Federal Reserve is engaged in a comprehensive review of its authority under the Home Ownership and Equity Protection Act (HOEPA), including its authority to define broadly unfair and deceptive practices that would apply to the entire mortgage industry. I have spoken with Chairman Bernanke and I have confidence that he will carefully consider what actions to take in this area. It is clear that the Federal Reserve has the ability to reach all mortgage loan originators through a rulemaking under HOEPA. This provides the Federal Reserve with the opportunity to inject greater uniformity and objective standards into the mortgage origination process.

Capital Markets Issues

As I noted earlier, capital markets generally, and mortgage markets more specifically, have changed dramatically in the last 25 years. We at the Treasury Department are committed to being a leading force in better understanding some of the important issues raised during the recent period of market disruption. The PWG has already begun reviewing four important issues. First is financial institutions' liquidity, market and credit risk practices, including treatment of complex credit products and conduits. The second is accounting and valuation procedures for financial derivative instruments, particularly for complex, narrowly traded products that become difficult to price in times of stress. Third is basic supervisory oversight principles for regulated financial entities, especially given exposures to off-balance sheet, contingent claims. And fourth is the role of credit rating agencies in evaluating structured

finance products. In addition, because these issues have global consequences, we have asked the Financial Stability Forum (FSF) – a body of finance ministries, central banks and regulatory bodies from leading financial centers created after the Asian financial crisis – to also examine these issues.

Conclusion

Mr. Chairman, in conclusion, I want to thank you for holding this hearing. Under the President's leadership, the Administration is working diligently to help mitigate the impact of rising foreclosures on homeowners and the economy. I appreciate having the opportunity to present the Treasury Department's perspectives on these important issues and look forward to working with this Committee and the Congress in the weeks and months ahead. Thank you and I welcome your questions.

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Testimony of

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To the Committee on Financial Services
United States House of Representatives

Hearing on Legislative and Regulatory Options Regarding Mortgage Foreclosures

September 20, 2007

Mr. Chairman, Ranking Member Bachus and members of the Committee, thank you for the opportunity to be here today. I am Alex Pollock, a Resident Fellow at the American Enterprise Institute, and these are my personal views. Before joining AEI, I spent 35 years in banking, including 12 years as President and CEO of the Federal Home Loan Bank of Chicago, and am a Past President of the International Union for Housing Finance. I have both experienced and studied many credit cycles, of which the housing and subprime mortgage boom and bust is the latest example.

To put the problems in context: The severe mortgage and housing industry problems we are experiencing can best be understood as the deflation of a classic asset bubble, the asset in this case of course being houses and condominiums. The boom is always marked by rapid and unsustainable price increases, inducing and in turn fueled by a credit overexpansion; the inevitable bust follows with defaults, losses and a credit contraction.

Possible political responses to the problems fall into two categories:

First, in addition to monetary policy, temporary programs to bridge and partially offset the impact of the bust, and to reduce the risk of a housing sector debt deflation. I will consider some of these, including using the FHA and Fannie Mae and Freddie Mac as sources for refinancing subprime mortgages in imminent or actual default.

Second, long term steps to fundamentally improve the functioning of the mortgage market. I will repeat a very simple but powerful proposal: a one-page mortgage disclosure which tells borrowers what they really need to know about their mortgage loan

in a clear and straightforward way. This will both better equip borrowers to protect themselves and make the mortgage market more efficient.

Subprime Mortgages as a Classic Boom and Bust

Needless to say, the unsustainable expansion of subprime mortgage credit and the great American house price inflation of the new 21st century are both over. Former enthusiasm at rising home ownership rates and financial innovation (now a little hard to remember) have been replaced by large financial losses, a credit market panic, layoffs, closing or bankruptcy of scores of subprime lenders, accelerating delinquencies and foreclosures, a deep recession in the homebuilding industry, tightening or disappearing liquidity, and of course, recriminations.

Typical estimates of the credit losses involved are about $100 billion. This does not count losses in market value of mortgage securities or the macroeconomic effects. Rising foreclosures are also an obvious social and political issue.

All these elements display the classic patterns of recurring credit overexpansions and their aftermath, as colorfully discussed by students of financial cycles like Charles Kindleberger, Walter Bagehot and Hyman Minsky. Such expansions are always based on optimism and the euphoric belief in the ever-rising price of some asset class—in this case, houses and condominiums. This appears to offer a surefire way for lenders, investors, borrowers and speculators to make money, and indeed they do, for a while. As long as prices always rise, everyone can be a winner.

A good example of such thinking was the 2005 book by an expert housing economist entitled, Are You Missing the Real Estate Boom? Why the Boom Will Not Bust and Why Property Values Will Continue to Climb Through the Rest of the Decade.

It is important to remember that the boom gets going because people experience financial success. Subprime borrowers could get loans to buy houses they would otherwise be unable to and then benefit from the subsequent price appreciation. A borrower who took out a very risky 100% LTV adjustable rate mortgage with a teaser rate to buy a house which subsequently appreciated 30% or 40%, now had substantial equity and a successful outcome as a result of taking risk.

This time, we had several years of remarkably rising house prices—the greatest house price inflation ever, according to Robert Shiller, who has certainly been insightful in this matter. The total value of residential real estate about doubled between 1999 and 2006, increasing by $10 trillion. The great price inflation stimulated the lenders, the investors, the borrowers and the speculators. If the price of an asset is always rising, the risk of loans seems less and less, even as the risk is in fact increasing, and more leverage always seems better.

Of course, we know what always happens next: the increased risk comes home to roost, prices fall, and there is a hangover of defaults, failures, dispossession of unwise or unlucky borrowers, revelations of fraud and swindles, and the search for the guilty. You would think we would learn, but we don't. Then come late-cycle political reactions.

With regard to the last point, since 1970 we have had the Emergency Home Finance Act of 1970, the Emergency Housing Act of 1975, the Emergency Housing Assistance Act of 1983, and the Emergency Housing Assistance Act of 1988. (I do not count the Hurricane Katrina Emergency Housing Act of 2005, a special case.) Kindleberger estimated that over the centuries, financial crises recur about once a decade on average, and so apparently do emergency housing acts. It seems probable to me that, given the current problems, this fall will bring an emergency housing act of 2007.

A year ago, it was common to say that while house prices would periodically fall on a regional basis, they could not on a national basis, because that had not happened in the large U.S. market since the Great Depression. Well, now house prices are falling on a national basis, as measured by the S&P/Case-Shiller national index.

House sales have dropped steeply, and for-sale inventories of new and existing houses and condominiums are high. At the same time, rising mortgage delinquencies and defaults, along with the collapse of funding through securitization, have caused lenders to drop subprime products or exit the business altogether and generally raise credit standards. This has sharply reduced mortgage credit availability and thus housing demand.

With excess supply and falling demand, it is not difficult to arrive at a forecast of further drops in house prices. The recent Goldman Sachs housing forecast, pointing out "substantial excess supply" and that "credit is being rationed," projects that average house prices will fall 7% a year through 2008. This is along with projected falling home sales and housing starts.

Professor Shiller has suggested that this cycle could see "more than a 15% real drop in national home price indicies." Certainly a return to long term trends in house values would imply a significant adjustment.

The June 30, 2007 National Delinquency Survey of the Mortgage Bankers Association reports a total of 1,090,300 seriously delinquent mortgages. Serious delinquency means loans 90 days or more past due plus loans in foreclosure. Of the total, 575,200 are subprime loans. Thus subprime mortgages, which represent about 14% of mortgage loans, are 53% of serious delinquencies.

The survey reports 618,900 loans in foreclosure, of which 342,500 or 55% are subprime.

The ratio of subprime loans in foreclosure peaked in 2002 at about 9%, compared to its current level of 5.5%. Seriously delinquent subprime loans peaked during 2002 at

11.9%, compared to the current 9.3%. These ratios at this point are not as bad as five years ago, but they are still rising.

A systematic regularity of mortgage finance is that adjustable rate loans have higher defaults and losses than fixed rate loans within each quality class.

We may array the June 30, 2007 serious delinquency ratios as follows:

Prime fixed	0.67%	Prime ARMs	2.02%
FHA fixed	4.76%	FHA ARMs	6.95%
Subprime fixed	5.84%	Subprime ARMs	12.40%

The particular problem of subprime ARMs leaps out of the numbers. Also notice that FHA and subprime serious delinquency ratios for fixed rate loans are not radically different. The FHA is predominately a fixed rate lender, whereas subprime is about 53% ARMs. The total range is remarkable: the subprime ARM serious delinquency ratio is over 18 times that of prime fixed rate loans.

A central problem is that during the boom the subprime market got very much larger than it used to be. In the years of credit overexpansion, it grew to $1.3 trillion in outstanding loans, up over 8 times from its $150 billion in 2000. So the financial and political impact of the subprime level of delinquency and foreclosure is much greater.

The scale of the whole market is impressive. American residential mortgage market is the biggest credit market in the world, with about $10 trillion in outstanding loans. Residential real estate is a huge asset class, with an aggregate value of about $21 trillion, and is of course the single largest component of the wealth of most households. A 15% average house price decline would mean a more than $3 trillion loss of wealth for U.S. households, which would be especially painful for those who are highly leveraged. It would certainly put a crimp in getting cash to spend through cash-out refinancing and home equity loans.

Policy Responses

There are two categories of possible responses: temporary programs to bridge the bust, and fundamental, long term improvements.

1. Temporary Programs

The Federal Reserve and other central banks have already provided significant amount of liquidity support to the panicky international credit markets, which are suffering from not knowing who is in trouble from leveraged speculations in subprime securities and from great uncertainty about what such securities are worth. The Fed has lowered its target fed

funds rate. Lower short term rates make it cheaper to carry leveraged positions in securities unable to be sold at prices acceptable to the seller and help ease the panic.

In any case, panics are by nature temporary and the liquidity crisis won't last forever. Large losses will be taken, who is broke and who is solvent sorted out, risks reassessed, models rewritten, and revised clearing prices discovered. Market actors will get back into business trading with and lending to each other again. Liquidity will return for markets in prime instruments. An astute long-time observer of finance, Don Shackelford, has predicted that "the panic about credit markets will be a memory by Thanksgiving."

He may well be right; however, the severe problems with subprime mortgages and securities made out of them, related defaults and foreclosures, and falling house prices will continue long past then.

Falling house prices tend to cause higher mortgage defaults, especially if loans were made, as they were, with small or no down payments, and especially if a substantial proportion of loans were to speculative buyers, as they were. So the U.S. appears to risk a process in which defaults on mortgages, and securities made of mortgages, cause tightening credit (as well as houses dumped on the market through foreclosure), tight credit reduces demand, which induces falling house prices, which cause more defaults, more credit tightening, lower house prices.... In other words, there is risk of a self-reinforcing downward cycle, or debt deflation, in the housing sector.

To try to bridge the bust and ameliorate the downward cycle is a reasonable project with much historical precedent. History is clear that governments always intervene in some fashion.

But what fashion makes sense? Intervention should be temporary, inhibit as little as possible personal choice and the long run innovation and efficiency of the market, and should not bail out careless lenders and investors or speculative borrowers.

To help bridge the bust with an appropriate means of refinancing adjustable rate subprime mortgages is a project worth pursuing. A recent survey of mortgage brokers found that of home purchase closings they had scheduled for August, 2007, 56% of subprime homebuyers had canceled closings. Of subprime borrowers trying to refinance adjustable rate mortgages with resetting interest rates, the survey found that 64% of the subprime homeowners were unable to do so.

President Bush, numerous members of Congress, and the FHA itself have suggested using the FHA as the means to create a refinancing capability for subprime mortgages. This makes sense because the FHA itself is, and has been since its creation in 1934, a subprime mortgage lending institution. Of course, they didn't call it that, but historically if you couldn't qualify for a prime loan, you went to the FHA.

We noted above that the latest MBA survey shows that serious delinquencies for fixed rate FHA and subprime loans are similar. So are total past due loans: 14.54% of

subprime loans are past due, as are 12.40% of FHA loans. The difference is in the foreclosure inventory: although both are far over the prime foreclosure ratio of 0.59%, the 5.52% for subprime is two and a half times the 2.15% for the FHA. The FHA, being itself the principal credit risk taker, logically has more ability to practice forbearance and loss mitigation.

But with falling house prices, the amount the FHA could responsibly refinance is liable to be less than the outstanding principal owed on the subprime mortgage. Here the owners of these mortgages, typically investors in structured MBS issued by a securitization trust, need to take a loss for the difference. Investors in such speculative instruments should not be bailed out, and the loss in economic value has occurred already: it is a matter of its becoming a realized haircut.

Here we run up against the complications of the laws, regulations and contracts governing mortgages in securitized form and the duties of the agents for the investors. The mortgage servicers who actually deal with the borrower, but are not themselves the owner of the mortgage, have the ability as agent to make loan modifications for loans in default or imminent default. But the standard of their fiduciary duty is to maximize the returns to the bondholders of the securitized mortgage trust.

To accept less than full repayment in settlement of a troubled loan from the proceeds of an FHA refinancing, the mortgage servicer would have to be quite confident that this was a clearly better outcome for the bondholders than proceeding to foreclosure. Fortunately, from this particular point of view, foreclosure is an extremely expensive process for the investors.

Thus I believe that a special program in which the FHA could refinance 97% of the current value of the house, and the investors would accept a loss on any difference between that and the principal owed, would be an alternative distinctly preferable to foreclosure for the investors, as well as obviously so for the borrowers. This would allow the borrowers to go forward with a small positive equity in the property and a loan of more appropriate size. That such a program would be accompanied by risk-based FHA insurance premiums seems reasonable to me.

Putting this in the context of the evolution of the mortgage market, the Mortgage Bankers Association has reported that subprime mortgages grew from 2.4% to 13.7% of total mortgage loans between 2000 and 2006. But the proportion of prime loans also increased, from 72.6% to 76.6%. What went down? It was the market share of the government's FHA (and much smaller VA) programs, which fell from 25.2% to only 9.7%. The combined share of subprime plus FHA-VA stayed more or less the same, but within that, subprime took a lot of market share away from the government alternatives.

That was during the boom. Now in the bust, the FHA, the creation of the great bust of the 1930s, would take that market share back.

Let me turn to Fannie Mae and Freddie Mac.

Two proposals regarding Fannie and Freddie are relevant as temporary bridge programs: to increase their conforming loan limits and to relax their mortgage portfolio caps. Both of these represent great profit opportunities for Fannie and Freddie, and it is the fiduciary duty of their managements to their shareholders to push these ideas as strongly as possible.

I do not favor an increase in the conforming loan limit, because it would principally operate to expand the government's credit into the prime jumbo loan market and, as discussed above, I believe the markets for prime assets will fairly quickly recover from panic on their own.

Relaxing the portfolio caps is more interesting and capable of being focused on the key issue of refinancing subprime ARMs. As odd as it may seem coming from an AEI fellow, I do favor granting Fannie and Freddie a special increased mortgage portfolio authorization, strictly limited, however, to a segregated portfolio solely devoted to refinancing subprime ARMs. Such a special authorization might be for $100 billion each, and include the ability to purchase FHA-insured subprime ARM refinancings. FHA loans would then have both a Ginnie Mae and a Fannie-Freddie funding channel.

As a last point, actual purchase of subprime mortgages by a special government fund has sometimes been proposed. A very interesting historical example of such a program was the Home Owners' Loan Corporation, created by the Home Owners' Loan Act of 1933. The HOLA bought defaulted mortgages from lenders in exchange for its own bonds, but would refinance not more than 80% of what it considered the long term value of the property. It ended up purchasing 20% of all the mortgages in the nation, from which we can see that our problems, however serious, don't even begin to approach those of the 1930s.

2. A Simple Proposal for Fundamental Improvement of the Mortgage Market

The mortgage market, like all financial markets, is constantly experimenting with how much risk there should be, how risk is distributed, and how it trades off with financial success or failure.

Nothing is more apparent than that we want the long term growth, innovation and economic well being for ordinary people that only market experimentation can create, even though this involves boom and bust cycles which can be avoided only in hindsight.

Should ordinary people be free to take a risk in order to own a home, if they want to? Yes, provided they understand what they are getting into. (This is a pretty modest risk, to say the least, compared to those our immigrant and pioneer ancestors took!)

Should lenders be able to make risky loans to people with poor credit records, if they want to? Yes, provided they tell borrowers the truth about what the loan obligation involves in a straightforward, clear way.

A market economy based on voluntary exchange and contracts requires that the parties understand the contracts they are entering into. In particular, a good mortgage finance system requires that the borrowers understand how the loan will work and how much of their income it will demand.

It is utterly clear than that the current American mortgage system does not achieve this. Rather it provides an intimidating experience of being overwhelmed and befuddled by a huge stack of documents in confusing language and small type presented to us for signature at a mortgage closing. This complexity results from legal and compliance requirements; ironically, past regulatory attempts to insure full disclosure have made the problem worse. This is because they attempt full, rather than relevant, disclosure.

Trying to describe 100% of the details in legalese and bureaucratese results in essentially zero actual information transfer to the borrower. The FTC recently completed a very instructive study of standard mortgage loan disclosure documents, concluding that "both prime and subprime borrowers failed to understand key loan terms."

Among the remarkable specifics, they found that:

"About a third could not identify the interest rate"

"Half could not correctly identify the loan amount"

"Two-thirds did not recognize that they would be charged a prepayment penalty" and

"Nearly nine-tenths could not identify the total amount of up-front charges."

This is a fundamental failure of the American mortgage finance system. It is especially important in, though by no means limited to, the subprime mortgage market.

To have informed borrowers who can better protect themselves, the key information must be simply stated and clear, in regular-sized type, and presented from the perspective of what commitments the borrower is making and what that means relative to household income. The borrowers can then "underwrite themselves" for the loan. They have a natural incentive to do so—we need to ensure they have the relevant intelligible, practical information.

Disclosures should focus on the financial impact on the borrower, not the technical description of the mortgage loan. They should include the monthly cost of the loan payments, including principal, interest, taxes and insurance--both at the beginning rate and the fully-indexed rate-- and express this as a percentage of the borrower's household

income. That household income itself should be prominently confirmed. It is also essential clearly to disclose any prepayment penalties.

This can be done on one page. I propose, as I have in previous House testimony, a one-page form, "Basic Facts About Your Mortgage Loan," to do this. (The proposal also contains an attachment with brief explanations of the mortgage vocabulary and some avuncular advice for borrowers.) Borrowers should have to receive the completed form, signed by the lender, well before the closing.

A copy of the proposed form accompanies this testimony.

I appreciate very much, Ranking Member Bachus, that you and your co-sponsors included this proposal in HR 3012 and, Congressmen McHenry and Green, that you have announced you are working on a bill which would require the one-page disclosure.

I believe this requirement would help achieve the required clarity, make borrowers better able to protect themselves by understanding what the mortgage really means to them, and at the same time would promote a more efficient mortgage finance system. This seems to me a completely bipartisan idea, which should be implemented as a fundamental reform, whatever else is done or not done.

Thank you again for the opportunity to share these views.

Accompanying attachment: One-Page Form ("Basic Facts About Your Mortgage Loan")

THE BASIC FACTS ABOUT YOUR MORTGAGE LOAN

Borrower: _____ Property address: _____

_____ _____

_____

Lender: _____

Amount of loan: $ _____, which is _____ % of the property's appraised value.

Your loan is for _____ years.

The type of loan you have: _____

Your beginning interest rate is_____ %. This rate is good for _____ months/years. The rate and your payment can go higher on _____ and each _____ months after that.

Today's estimate of how high the rate will go, called the fully indexed rate, is _____ %.

The maximum possible rate on your loan is _____%.

THIS LOAN IS BASED ON YOUR MONTHLY INCOME OF $ _____ .

Your beginning rate = a monthly loan payment of $_____ = _____ % of your income.

-including taxes and insurance this is about $_____ = _____ % of your income.

The fully-indexed rate = a loan payment of $_____ = _____ % of your income.

-including taxes and insurance this is about $_____ = _____ % of your income.*

*This is called your fully indexed housing expense ratio.

Special factors you must be aware of:

-A prepayment fee of _____ must be paid if_____ .

-A "balloon payment" of $ _____ to pay off your loan will be due on _____ .

-You do/do not have a "payment option" loan. If you do, make sure you really understand what this means. Start with the definition on page 3.

Total "points" plus estimated other costs and fees due at closing are $ _____ .

FOR QUESTIONS CONTACT: Name: _____

Phone:_____ e-mail:_____

See definitions of underlined terms and guidelines on pages 2–3.

DO NOT SIGN THIS IF YOU DON'T UNDERSTAND IT!

_____

Borrower Date

_____ _____

Authorized Signer of Lender Date Borrower Date

The Basic Facts about Your Mortgage Loan

This form gives you the basic facts, but some mortgage forms may use terms not listed here. For a good, borrower-friendly information source, try the Mortgage Professor online (www.mtgprofessor.com), which includes detailed explanations of the technical mortgage terms in its glossary and much other helpful information.

Definitions and Guidelines Used in This Form

The *appraised value* is what a professional appraisal estimates the house could be sold for in today's market.

The *type of loan* determines whether and by how much your interest rate can increase. If it can, your monthly payments will also increase—sometimes by a lot. For example, in a thirty-year fixed rate loan, the interest rate is always the same. In a one-year ARM, it will change every year. Other kinds of loans have various patterns, but the interest rate may go up a lot. Make sure you understand what type of loan you're getting.

The *beginning interest rate* is the interest you are paying at the beginning of the loan. Especially if it is a low introductory or "teaser" rate, it is the rate which you will hear the most about from ads and salespeople. But how long is it good for and when will rates increase? In many types of loans, the rate will go up by a lot. You need to know.

The *fully-indexed rate* is an essential indicator of what will happen to your interest rate and your monthly payments. It is today's estimate of how high the interest rate on an adjustable rate mortgage will go. It is calculated by taking a defined "index rate" and adding a certain number of percentage points, called the "margin." For example, if your formula is the one-year Treasury rate plus 3 percent, and today the one-year Treasury rate is 5 percent, your fully-indexed rate is 5% + 3% = 8%. At the time the loan is being made, the fully indexed rate will *always* be higher than a beginning "teaser" rate.

The index rates are public, published rates, so you can study their history to see how much they change over time. If the index rate stays the same as today, the rate on your loan will automatically rise to the fully-indexed rate over time. Since the index rate itself can go up and down, you cannot be sure what the future adjustable rate will be. In any case, you must *make sure you can afford the fully-indexed rate*, not just the beginning rate, which is often called a "teaser" rate for good reason.

The *maximum possible rate* is the highest your interest rate can go. Most loans with adjustable rates have a defined maximum rate or "lifetime cap." You need to think about what it would take to make your interest rate go this high. How likely do you think that is?

Your *monthly income* means your gross, pre-tax income per month for your household. This should be an amount which you can most probably sustain over many years. Make sure the monthly income shown on this form is correct!

Your *monthly payment including taxes and insurance* is the amount you must pay every month for interest, repayment of loan principal, house insurance premiums, and property taxes. Expressed as a percent of your monthly income, this is called your housing expense ratio. Over time, in addition to any possible increases in your interest rate and how fast you must repay principal, your insurance premiums and property taxes will tend to increase. Of course, your monthly income may also increase. How much do you expect it to?

Your *fully-indexed housing expense ratio* is a key measure of whether you can afford this loan. It is the percent of your monthly income it will take to pay interest at the fully-indexed rate, plus repayment of principal, house insurance, and property taxes. The time-tested market standard for this ratio is 28 percent; the greater your ratio is, the riskier the loan is for you.

A *prepayment fee* is an additional fee imposed by the lender if you pay your loan off early. Most

mortgages in America have no prepayment fee. If yours does, make sure you understand how it would work before you sign this form.

A *"balloon payment"* means that a large repayment of loan principal is due at the end of the loan. For example, a seven-year balloon means that the whole remaining loan principal, a very large amount, must be paid at the end of the seventh year. This almost always means that you have to get a new loan to make the balloon payment.

A *"payment option" loan* means that in the years immediately after securing a mortgage loan, you can pay even less than the interest you are being charged. The unpaid interest is added to your loan, so the amount you owe gets bigger. This is called "negative amortization." The very low payments in early years create the risk of very large increases in your monthly payment later. Payment option loans are typically advertised using only the very low beginning or "teaser" required payment, which is less than the interest rate. You absolutely need to know four things: (1) How long is the beginning payment good for? (2) What happens then? (3) How much is added to my loan if I pay the minimum rate? (4) What is the fully-indexed rate?

"Points" are a fee the borrower pays the lender at closing, expressed as a percent of the loan. For example, two points mean you will pay an upfront fee equal to 2 percent of the loan. In addition, mortgages usually involve a number of *other costs and fees* which must be paid at closing.

Closing is when the loan is actually made and all the documents are signed.

The *For Questions Contact* section gives you the name, phone number, and e-mail address of someone specifically assigned by your lender to answer your questions and explain the complications of mortgage loans. Don't be shy: contact this person if you have any questions.

Finally, *do not sign this form if you do not understand it.* You are committing yourself to pay large amounts of money over years to come and pledging your house as collateral so the lender can take it if you don't pay. Ask questions until you are sure you know what your commitments really are and how they compare to your income. Until then, do not sign.

Statement of

John M. Robbins, CMB
Chairman, Mortgage Bankers Association

Before the

Committee on Financial Services,
United States House of Representatives

Hearing on
"Legislative and Regulatory Options for Minimizing and Mitigating Mortgage Foreclosures"

On

September 20, 2007

1919 Pennsylvania Avenue, NW | Washington, DC 20006-3404 | www.mortgagebankers.org | (202) 557-2700

Chairman Frank, Ranking Member Bachus and members of the Committee, my name is John Robbins and I am Chairman of the Mortgage Bankers Association (MBA), the national trade association for the real estate finance industry.[1] I am also Co-head and Special Counsel of Vertice, a division of Wachovia Securities. Previously, I was Chief Executive Officer of American Mortgage Network (AmNet), a San Diego-based wholesale mortgage bank that I co-founded. Wachovia Bank bought AmNet in 2005.

I have been in the mortgage business for 36 years, through the many critical market-shaking events we have all witnessed and the usual boom and bust cycles of real estate. Today's market is the toughest environment I have ever seen. We have two immediate problems: how to help homeowners, particularly resident homeowners, avoid foreclosure and stay in their homes, and how to restore liquidity and stability to the full mortgage market and other credit markets going forward.

We are encouraged by the President's "New Steps to Help Homeowners Avoid Foreclosure," announced on August 31 (the "President's initiative"), and we endorse many of the measures in that initiative in our testimony here. The President's initiative and the Cabinet-level attention it will involve, along with the actions Congress can take, will help to alleviate the painful state of the mortgage market for many consumers, the industry and investors.

Current Market Background

The growing level of mortgage delinquencies, and concerns that credit was not appropriately priced or rated, resulted in a withdrawal by investors from nearly all mortgage securities that were not guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. While some liquidity has returned to the jumbo market, generally borrowers in the non-conforming world of the jumbo, Alt-A and subprime[2] loans are currently finding it difficult or impossible to get loans.

MBA's recent National Delinquency Survey (NDS) showed an increase during the second quarter of this year in delinquency and foreclosure rates in almost every

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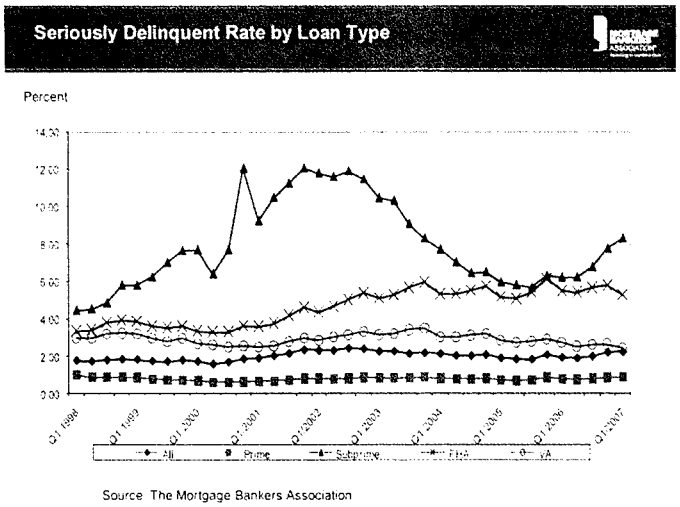
[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

[2] A jumbo loan is a loan above the current conforming loan limit of $417,000. Jumbo loans cannot be purchased by Fannie Mae or Freddie Mac; as a result, they carry a slightly higher interest rate to attract other investors. Alt-A loans are made to people who are of high credit quality, but for one reason or another they do not qualify for conventional financing. Such a borrower might not document income, for example. A subprime loan is made to a borrower with little or no credit history, blemished credit or other factors that cause the borrower to not qualify for conventional financing.

category we track (see chart below). Less than one percent of prime loans surveyed were in the seriously delinquent category but 9.27 percent of subprime loans were seriously delinquent.



Source: The Mortgage Bankers Association

Of the millions of loans in delinquency, some belong to resident homeowners and some belong to investors. According to data released by the MBA this month, Florida, Nevada, California and Arizona have had much higher shares of mortgage defaults from non-owner occupied loans than the national average. For example, as of the end of June, Nevada had the highest rates of mortgage defaults on non-owner occupied loans for both prime (32 percent) and subprime loans (24 percent). The national rates for prime and subprime non-owner occupied loans were 16 percent and 12 percent, respectively.

MBA anticipates that a high level of delinquencies will continue through 2008 but will stabilize, along with home prices, by the end of next year. We do not believe that the drop in home price appreciation and the high level of delinquencies will, in themselves, result in a nationwide recession. However, to the extent that the poor performance of mortgages has raised investor concerns and acted as a catalyst for a reassessment of credit assumptions across the entire capital markets, we acknowledge the potential for adverse ramifications beyond the mortgage sector and throughout the economy. In addition, the decreased availability of funds for cash-out refinancing will slow the growth of consumer spending.

It will take time to stabilize housing prices and the mortgage market. In the next two years, loans will be refinanced, modified or otherwise worked out wherever there is a

way to spare borrowers and investors the pain and loss of foreclosure. But foreclosures will take place, particularly where homeowners have little equity in their homes or they are unable to sustain even a modified mortgage. Even if the liquidity crisis that began last month were alleviated today, there would still be rough waters ahead for some borrowers, lenders and investors.

For today's borrowers, funding for new or refinanced Alt-A and subprime loans is largely unavailable because mortgage products designed for those markets have been eliminated by regulators or the market, and underwriting standards have been tightened. For subprime borrowers trying to refinance their mortgages, home prices have depreciated in some cases below the amounts currently owed. Therefore, some borrowers in trouble on mortgages they planned to refinance are finding that option closed.

While investors are again beginning to purchase prime jumbo loans and mortgage-backed securities (MBS) backed by jumbo loans, jumbo mortgage interest rates are one-half to three-quarters of a percent higher now (relative to conforming mortgage rates) than they have been in recent years, reflecting continued investor concerns about the mortgage market.

Securitization through Fannie Mae and Freddie Mac has increased considerably in recent months. Furthermore, our members report that the GSEs are purchasing conforming mortgages for their portfolios and providing liquidity for some Alt-A mortgages. We are grateful that we have the liquidity facilities of the GSEs but the GSEs are charging fees commensurate with perceived credit risks and are only one part of what needs to be a comprehensive solution.

In the last two years, the GSEs issued less than half of all mortgage-backed securities. The hundreds of billions of dollars of non-GSE, or "non-agency," MBS that are not currently being issued leave an enormous vacuum in funding for the mortgage market, especially for nonprime borrowers. MBA believes it is urgent that we work together with the Administration and Congress to use the facilities of the government housing programs and the GSEs to assist borrowers, investors and the industry to recover as rapidly as possible from the current setbacks.

In my testimony, I discuss MBA's views of the President's initiative and make some suggestions about other ways Congress and the Administration could help.

MBA's Analysis of the President's Proposals to Help Homeowners

MBA supports the direction of the President's recent proposal to assist troubled borrowers. MBA, in fact, has long advocated for many of these changes – such as Federal Housing Administration (FHA) modernization, improving mortgage disclosures, improving financial literacy and RESPA reform – even before the recent troubles in the subprime mortgage market. In addition to the elements in the President's proposal, MBA supports other important measures not addressed by the

President that should be carried out to assist borrowers and to tackle the liquidity issues in the mortgage market.

In the proposal, the President called on Congress to pass pending bills that would modernize the FHA and allow temporary tax relief to borrowers who have had mortgage debt cancelled. Moreover, he announced the launch of a new foreclosure avoidance initiative spearheaded by the Department of Housing and Urban Development (HUD) and the Treasury Department.

The President also noted that federal banking regulators have been working to ensure that lenders provide homeowners with complete, accurate and understandable information about their mortgages and to strengthen mortgage lending standards.

Finally, the President announced that he and his Administration are: (1) working on new proposed rules under the Real Estate Settlement Procedures Act (RESPA) that would promote comparison shopping by consumers, provide clearer disclosures, limit settlement cost increases and require fee disclosures; (2) supporting state-based efforts to create a comprehensive mortgage broker registration system; (3) creating a Presidential Council on Financial Literacy composed of leading private sector individuals who can promote financial literacy and that the President supports the efforts of public and private sector groups that are promoting financial literacy, specifically including the Administration's budget proposal $120 million to go to NeighborWorks; (4) committed to pursuing fraud and wrongdoing in the mortgage industry; and (5) using the President's Working Group on Financial Markets to look at the role of the rating agencies and asset securitization in the liquidity crisis.

MBA hails all of these initiatives which complement MBA's long-standing efforts on behalf of the mortgage industry. MBA profoundly believes that better financial literacy, greater transparency in the mortgage process, better licensing of originators and uniform national lending standards offer the greatest promise to improve the mortgage process while protecting and reducing costs to consumers. MBA looks forward to working with the President and Congress to protect homeowners and improve the mortgage financing system.

FHA Modernization

As this Committee knows, MBA fully supports FHA modernization. We applaud the Committee for passing H.R. 1852, the "Expanding American Homeownership Act of 2007." FHA reform would allow the agency to unleash its full potential, serving a greater number of low- to moderate-income and minority families, in addition to subprime borrowers. It is essential that FHA have the tools and flexibility to adjust its products and programs to meet the evolving needs of borrowers, in addition to having the resources to upgrade its technology and hire the best staff possible.

FHA has recently made significant improvements to its regulations and operations. FHA has streamlined the insurance endorsement process, improved appraisal

requirements and removed some unnecessary regulations. With MBA's strong support, FHA has also launched the FHASecure initiative. This new program is helping creditworthy borrowers with no instances of late payments prior to the reset of the rate on their subprime adjustable rate mortgage (ARM) refinance their loan. Although a temporary program, FHASecure will provide homeowners in difficult financial situations with refinancing opportunities while increasing liquidity in the mortgage market. These are all positive changes that have already begun to show real benefits.

FHA has tremendous strides in the past several years, after many years of stagnation. Nonetheless, we recognize that more work lies ahead. FHA and its Commissioner, Brian Montgomery, have shown a commitment to address those issues that are within the agency's statutory mandate. There is much, though, that is beyond FHA's control and needs Congressional action.

Passage of FHA modernization by Congress is critical because it will give FHA and Commissioner Montgomery a full arsenal of tools to further its homeownership mission. Modernization will allow FHA to expand its programs to cover borrowers with higher cost loans, those who may find their loans resetting and will have difficulty paying their mortgage and will otherwise allow the agency to assist borrowers who might be able to qualify for an FHA refinancing program. In short, FHA can play a crucial role in helping otherwise stranded borrowers keep their homes.

Tax Reform to Assist Trouble Borrowers

Current tax law provides that a taxpayer receives ordinary income in the amount of any debt discharged, unless such borrower is insolvent at the time of discharge (or has non-recourse debt). Historically, mortgage companies often faced having to discharge debt upon foreclosure of a mortgage that exceeds the fair market value of the property. Other situations could give rise to discharge of mortgage indebtedness including the creditor's voluntary write-downs of the debt or acceptance of a short sales or deed in lieu of foreclosure. Whether a borrower with recourse debt incurs such a tax liability for this discharge depends on whether the borrower is solvent at the time of discharge.

While we support the President's effort to assist troubled borrowers, any tax code change must be done in a way that preserves incentives for borrowers to work with their lender on loss mitigation options and does not encourage foreclosures. We also caution that loss mitigation activities that result in debt forgiveness should be treated the same under the proposed tax exemption as debt that is discharged as a result of foreclosure, deeds in lieu of foreclosure or short sales.

President's New Foreclosure Prevention Initiative

MBA supports the President's plan to launch a new foreclosure prevention initiative. MBA has long advocated that early detection of and communication with borrowers who are having trouble making payments increases the possibility of loss mitigation and

successful loan modifications, which can prevent a foreclosure and keep the family in their home.

No one, from the borrower, community, lender to investor wins in a foreclosure. In fact, a 2003 Federal Reserve study notes that "estimated losses on foreclosures range from 30 percent to 60 percent of the outstanding loan balance because of legal fees, foregone interest, and property expenses."[3] From a pure economic basis alone lenders, servicers and investors do not desire foreclosures.

MBA and its partners have been leading the way to provide assistance for homeowners facing foreclosure and to help stabilize and preserve the subprime mortgage credit system.

For instance, MBA has met with Fannie Mae and Freddie Mac, FHA, our largest servicers, many legislative and executive branch officials, consumer groups and civil rights leaders to discuss solutions. We did so both separately and as a participant in a housing summit convened by Senate Banking Committee Chairman Christopher Dodd where an agreement was reached on principles for mortgage lenders and servicers to assist troubled borrowers.

MBA also has partnered with NeighborWorks America, a national nonprofit organization created by Congress, to help troubled borrowers. Specifically, MBA has dedicated financial and staff resources to help promote a free mortgage counseling hotline, 888-995-HOPE, which is staffed by the Homeownership Preservation Foundation and provides a helpful place for troubled borrowers to turn.

As mentioned previously, MBA believes that early contact is key to avoiding foreclosures. Unfortunately, many borrowers fail to contact their lender or servicer in times of trouble, thereby further worsening an already difficult situation. A 2005 Freddie Mac study determined that, despite ongoing efforts by lenders and servicers, over half of borrowers in foreclosure proceedings have had no contact with their servicer.[4] This lack of contact is one of the biggest challenges servicers face in trying to help borrowers and stop foreclosures. To help address this issue, MBA and NeighborWorks are working to establish foreclosure intervention programs in cities with high rates of foreclosure and we are conducting a national public education campaign with the National Ad Council to improve contact rates for homeowners in financial distress.

The Regulators' Guidance

As the President indicated, the federal financial regulators recently issued guidance concerning regulated institutions' use of nontraditional mortgage products – payment

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[3] Foreclosing on Opportunity: State Laws and Mortgage Credit, Karen M. Pence, Board of Governors of the Federal Reserve System, May 13, 2003.

[4] Foreclosure Avoidance Research, Freddie Mac, 2005.

option and interest-only loans. The regulators later issued a Statement on Subprime Mortgage Lending. The guidance and statement had a significant effect on underwriting and drastically curtailed the availability of higher risk loan features.

Following both actions, the Conference of State Bank Supervisors (CSBS) and the American Association of Mortgage Regulators (AARMR) recommended adoption of parallel guidance by state regulators to apply to state regulated lenders. In the short time since the CSBS/AARMR requests, more than 38 states and District of Columbia agencies have adopted the nontraditional guidance and more than 29 agencies have indicated they will adopt the subprime statement. Additionally, as of last week, OFHEO is requiring that mortgages purchased by Fannie Mae and Freddie Mac comply with the guidance.

This federal and state action has had an enormous effect on the market by requiring stronger underwriting, tightening management controls and increased consumer protections. Congress should consider the extent to which the market and regulators have already addressed the key consumer protection questions before crafting any legislative response that might further restrict consumer credit options.

Improved Financial Literacy

MBA welcomes and shares the President's commitment to financial literacy. As financial services and products continue to evolve and expand, it is increasingly important for Americans to receive a solid foundation of financial education. MBA believes this must be a part of school curriculum, particularly at the secondary level. Additionally, resources must continue to be made available to adults to help ensure an ongoing understanding of key credit terms and differences in the costs and use of various types of products.

Aimed at helping current and potential homeowners, MBA maintains a Web site for education about the mortgage process at www.HomeLoanLearningCenter.com. Recently, MBA updated and expanded this site to provide better information on the array of adjustable, payment option and interest-only products available in today's market. For this purpose, MBA commissioned focus group testing to create the Simple Facts®, a new short, readable publication that describes in plain language the risks and rewards of fixed versus adjustable loans as well as other products and product features. MBA also developed a companion tool for the Web site, the Simple Calculator®, that allows borrowers to calculate and compare payments (including interest, principal and escrow) initially and, if they adjust, throughout their mortgage obligation.

MBA stands ready to assist the President and Congress with issues related to the financial education of all Americans.

Improving Disclosures Under the Nontraditional and Subprime Guidance

MBA has been long committed to developing meaningful mortgage disclosures that contain relevant, easily understood information that a consumer can use to shop and compare mortgage loans. To achieve this end, MBA supported the efforts of the banking regulators to improve disclosures for nontraditional and subprime loans.

The regulators' guidance and statement require that mortgage product descriptions and advertisements provide clear, detailed information about all of the costs, terms, features and risks of a mortgage to the borrower. MBA agrees and in its comments emphasized that consumers should be informed of: (1) "payment shock" including how the new payment will be calculated when the fixed payment period expires; (2) prepayment penalties – how they will be calculated and when they will be imposed; (3) balloon payments – the existence of any; (4) any costs of reduced documentation – any pricing premium attached to such a loan; and (5) responsibility for taxes and insurance – the borrower's responsibility to pay them and, if they are not escrowed, the fact that substantial amounts will be needed to pay them.

Later, when a consumer is shopping for a loan, clear and balanced generic information addressing all of the points raised in the Statement should be provided. At the time of application and at closing, borrowers should also be provided clear and balanced loan-specific information on all of the points raised in the Guidance and Statement. There is a tradeoff between how early a disclosure is provided and how reliable it is. Loan-specific information is more reliable at the time of loan application than before application.

RESPA Reform

MBA welcomes the President's commitment to RESPA reform. MBA long has been a supporter of such reform. As currently written, both the Real Estate Settlement Procedures Act (RESPA) and Truth in Lending Act (TILA) requirements are confusing to consumers and cumbersome for industry practitioners. Comprehensive reform of RESPA and TILA should improve access to mortgage finance and accommodate technological changes that can benefit consumers, while at the same time quelling essentially fruitless litigation that continues to plague the industry and increase costs to consumers. Moreover, by making the mortgage transaction more transparent to the consumer, reform could also significantly reduce the incidence of abusive lending practices.

Since the Secretary of HUD withdrew the Department's RESPA reform proposal in 2004, MBA has worked closely with a task force of MBA members to develop a range of RESPA reform options to improve the settlement process and reduce costs for the mortgage industry and consumers. MBA's own RESPA initiatives since 2004 have resulted in options including a simplified and comparable good faith estimate (GFE) and HUD-1 that would group charges according to their purposes and recipients so costs can be readily compared among loan providers. These changes could be accompanied

by a greater or lesser degree of regulatory changes to limit increases in charges and bring efficiencies to the market to lower consumer costs. MBA has invited ongoing member comment on the proposed forms which may be found at www.mortgagebankers.org/respa.htm.

MBA looks forward to working with HUD on its specific proposals to assure that they achieve their objectives and benefit consumers.

Mortgage Broker Disclosure

For almost a decade, MBA, as well as HUD, has advocated a clear disclosure under RESPA to be provided to the consumer concerning the functions and compensation of mortgage brokers. Such a disclosure would advise the consumer of whether the broker is or is not the borrower's agent and of the total compensation that the broker receives. MBA supports providing such a disclosure to potential borrowers early enough in the transaction to facilitate comparison shopping. Mortgage brokers, unlike lenders, hold themselves out as intermediaries who shop for borrowers. Such a disclosure should alert the consumer to the fact that a broker may receive a higher fee depending on the interest rate of the mortgage and inform the consumer of whether the broker is in deed acting as the consumer's agent. For example, mortgage brokers in California are required to provide such "agency relationship" disclosures.

Moreover, if a mortgage broker holds himself out as an agent, MBA believes it is appropriate for the broker to be treated as an agent under the law. While some have sought to create a fiduciary duty for mortgage brokers in all cases, MBA believes that greater transparency along these lines (including a declaration of agency, or not) is a better approach than imposing an undefined standard or standards on mortgage brokers, which could increase costs to borrowers. In any case, the imposition of a fiduciary duty on mortgage *bankers* to borrowers would not work. Bankers owe such duties to their investors and stockholders and could not bear a countervailing duty.

Comprehensive Reform of the Mortgage Process

MBA regards RESPA reform as a key step in reforming the mortgage process, but by no means the only one needed. Reform to truly simplify and improve the mortgage process will not be accomplished until disclosures under TILA and other federal and state laws are overhauled, greatly simplified and harmonized, so that the disclosures are read, understood and useful to consumers.

One possibility that has been suggested to shorten the process of comprehensive reform is the development of a simple one-page disclosure that would summarize relevant information from the various disclosures including rate, cost and loan feature information. Such a disclosure would help the consumer understand the deal offered and comparison shop—and create better competition to benefit consumers. MBA would support such an approach concomitant with a review of the mortgage process.

A common feature of most allegations of predatory lending is that the borrower was either confused or deliberately misled about key features of the loan. If the borrower receives a clear disclosure or disclosure of these key features early in the transaction, it will be far more difficult for an abusive originator to misrepresent the terms of the loan, and the borrower will have time to seek financing from other sources if the terms are unfavorable.

Instead of having the benefit of a simple disclosure or disclosures, consumers today confront a maze of information when they apply for and close on a mortgage. Sadly, without streamlining, every new layer of disclosure simply increases the likelihood that the consumer will merely initial all of them without even a cursory reading. In effect, predators are given the ability to hide in plain sight. For this reason, disclosures do not need to be added; they need to be combined, streamlined and made much more user friendly.

For these reasons, MBA strongly urges that the President, Congress and regulators work toward a more comprehensive approach to improving the mortgage disclosure process for consumers. Such an approach is the best means of assuring that virtually all consumers receive the same degree of information and that a level playing field of disclosure requirements is established for all industry originators.

Two Federal Trade Commission (FTC) economists recently concluded, after reviewing studies on mortgage disclosures, that "[c]urrent mortgage disclosures fail to convey key mortgage costs to many consumers." These economists also concluded that "[i]t is possible to design better disclosures that significantly improve consumer recognition of mortgage costs."[5] MBA agrees.

Improved Licensing of Loan Originators

MBA shares the President's commitment to improved licensing of mortgage brokers. In fact, MBA believes that all loan originators, mortgage brokers as well as lenders, should be registered and subject to a licensing regime, regardless of the parent company's charter and with licensing exceptions only for those already subject to rigorous regulatory or secondary market requirements, such as FHA-approved Direct Endorsement lenders, Fannie Mae- or Freddie Mac-approved sellers, or those lenders who maintain a net worth equal to or greater than $5,000,000 or total assets equal to or greater than $25,000,000. Ensuring that all loan originators fall under rigorous requirements, whether state or federal, would ensure that all mortgage professionals have the education and professionalism required to serve consumers. A nationwide

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[5] James M. Lacko & Janis K. Pappalardo, Bureau of Economics, Federal Trade Commission, *Information Regulation is Tricky: Lessons from Mortgage Disclosure Research*, presentation before the Behavioral Economics and Consumer Conference, Federal Trade Commission, Washington, D.C. (Apr. 20, 2007); *see also* James M. Lacko & Janis K. Pappalardo, *The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment*, Federal Trade Commission Bureau of Economics Staff Report (2004), *available at* http://www.ftc.gov/os/2004/01/0301/030123mortgagefullrpt.pdf.

registry regime would provide a powerful tool, for both regulators and industry participants, to track and bar unscrupulous actors.

MBA also believes all originators should have the financial wherewithal to serve borrowers and lenders and provide them redress if necessary. Currently, FHA requires brokers who wish to offer FHA-insured products to have a net worth of at least $63,000, plus $25,000 for each branch office. MBA supports establishing a nationwide financial net-worth requirement for all mortgage brokers consistent with these requirements. These requirements would provide greater protection for consumers and lenders dealing with mortgage brokers. Additional protection can be provided by a bond against which aggrieved consumers and lenders can make a claim. A number of states already require brokers to maintain a level of bonding. MBA supports requiring brokers to maintain a bond worth $75,000 or an amount equal to ten percent of the broker's annual loan volume, whichever is higher. In many cases, bonding requires a financial audit. Such an audit is not only further assurance of financial wherewithal, but that an originator is operating consistent with existing FHA regulations.

In 2005, the CSBS and AARMR began developing the National Mortgage Licensing System (NMLS). This system will provide a uniform application and annual renewal process for residential mortgage lenders and brokers. Additionally, it will store critical information in a central repository accessible to state and federal mortgage regulators. As of June 2007, 31 states had indicated their intention to participate, and the NMLS is scheduled to be up and running at the beginning of 2008. MBA is actively engaged with CSBS and AARMR in their important work on this project.

The President's Working Group on Financial Markets

The President's initiative includes a mandate for Secretary Paulson to lead a working group of Federal Reserve Chairman Bernanke, Securities and Exchange Commission Chairman Cox and Commodity Futures Trading Commission Acting Chairman Lukken. We are enthusiastic about the prospects for this working group which will examine the role of the credit rating agencies and how asset securitization has changed the mortgage industry and business practices.

MBA believes that the future stability of the financial markets and of our economy rest on the ability of government to develop a regulatory structure that fits the instruments and entities that provide liquidity in today's mortgage market. Approximately two-thirds of mortgages have been securitized in recent years. Only through this mechanism has the mortgage lending industry been able to raise the funds needed for the multi-trillion dollar residential mortgage market.

Electronic engineering and technology have created a financial market in which mortgage principal and interest are manipulated to form deal structures consisting of hundreds of classes of securities, deals that further crunch bits and pieces of earlier deals and derivatives that relatively few of us even understand. The acronyms are

baffling and the mathematical explanations used to describe the function of today's more complex financial instruments are increasingly complicated.

A staggering amount of money is tied up in instruments that did not exist 20 years ago in anything like the form they do today and sometimes it is managed by entities that did not exist a generation ago. While regulators have some catching up to do, the fundamental goals are the same as they were when securities laws were written in 1933 and 1934.

At MBA, we support the power of the free market, but we know that some regulation is essential for that market to work well. We believe that the role of the regulator is to: 1) guard the financial system against the risk of instability: 2) provide consumer protection, particularly to retail investors and investors that may lack some of the analytical tools critical to investment decisions today: 3) assure market integrity through transparency and accurate financial disclosure with regard to instruments and entities. These goals are fundamental and do not change even when the market becomes sophisticated.

In order to achieve these goals in a modern financial environment, the President's working group will need to grapple with the fact that the environment of finance has changed radically. Recently developed financial instruments, such as collateralized debt obligations (CDOs), and increasingly powerful entities, such as hedge funds, will be examined.

Other MBA Recommendations

MBA applauds the President's decision to take on the difficult issues currently surrounding the mortgage market and troubled borrowers. Importantly, MBA believes there are other measures that should be undertaken by Congress, federal regulators and executive agencies to augment the President's proposal to protect consumers and increase liquidity in the mortgage market. They include:

- Congress should pass a single consumer protection standard to combat predatory lending; the numerous measures in place and proposed at the state and local levels create confusion in the market and are not as helpful to consumers as would be a single national standard. We are committed to continuing to work with Congress on appropriate standards of liability;
- The GSE portfolio caps should be temporarily increased, subject to the Office of Federal Housing Enterprise Oversight's (OFHEO) approval and to investment parameters that assure that the additional capacity is used to alleviate the problems of borrowers and industry in the current liquidity crisis;
- Congress should complete work on the GSE reform legislation, to provide certainty regarding safety and soundness to the enterprises and their investors and to the housing market about what the rules of the road will be in the longterm;

- While MBA does not have a specific recommendation for legislation related to rating agencies at this time, we believe there is room for improvement in the rating of asset-backed securities and we would welcome the opportunity to discuss this topic with market players and with Congress.
- Make the amount of the Department of Veteran Affairs' (VA) home loan guaranty entitlement consistent between refinances and purchases. Today, purchase money mortgages that exceed $144,000 receive guaranty entitlement of 25 percent of the loan up to the conforming loan limit of $417,000. However, if the borrower wishes to refinance a non-VA loan, the maximum guaranty is limited to $36,000, resulting in a *de facto* $144,000 maximum loan cap;
- Make the loan-to-value (LTV) eligibility the same for both VA home purchases and loan refinances, even if the borrower's current loan is not VA-guaranteed. (NOTE: The refinance of a non-VA loan is limited to 90 percent LTV (plus funding fee), whereas a refinance of (1) a construction loan; (2) a land sales contract; (3) a loan assumed by a veteran that has a higher interest rate than the rate of the proposed loan; and (4) an existing VA that results in an VA-guaranteed interest rate reduction refinance loan is eligible for 100 percent LTV financing, plus funding fee and other enumerated costs. Purchase money VA mortgages are eligible for 100 percent LTV financing, plus funding fee and other enumerated costs);
- Allow USDA Rural Development to refinance borrowers who are eligible for the USDA Section 502 loan program, but do not have a USDA loan currently. Statutorily, Rural Development is not permitted to refinance a borrower that does not already have an existing USDA Section 502 loan;
- Eliminate the restriction on Section 502 Guaranteed loans that refinances must be for interest rate reduction only. This prohibits the financing of home repairs into the debt as part of a refinance; and
- Congress should ensure that all mortgage insurance premiums continue to be deductible from federal income taxes. This tax provision expires at the end of this year.

Balancing Consumer Protections and Credit Availability

While we all share the same goals of stabilizing the market, helping borrowers who are in distress and ensuring that situations like this do not occur in the future, we would caution against a response that would limit consumer borrowing options and cause long-term harm to the housing market.

Assignee liability standards in current law have effectively eliminated certain loans from the market by essentially setting a cap on interest rates, as the experience from the Home Owners Equity Protection Act (HOEPA)[6] demonstrates. Some have suggested that an assignee liability standard could be created that would allow for

[6] HOEPA creates an assignee liability standard for "high cost" mortgages. The vast majority of lenders no longer make such loans; those that do have no purchasers in the secondary market. Lenders who make these loans are forced to hold them in their portfolios. In effect, HOEPA serves as a federal usury ceiling.

the continued offering of credit in a certain "policed" set of loans. Our fear is that the unintended result will be to essentially eliminate secondary market funding for those loans, as MBS issuers and investors instead focus their limited resources in areas that do not bring about any new or untested liabilities, even if those liabilities are limited.

Pushing more loans into HOEPA "high cost" status will also further reduce the financing options available to borrowers. While many who advocate taking this action believe that the impact will be to lower costs on all mortgage borrowers, the actual impact will be to eliminate funding options for some borrowers while raising costs for the market as a whole.

Conclusion

I genuinely appreciate the opportunity to appear before the Committee to discuss the situation in the mortgage market and MBA's views of the President's recent proposal to help borrowers avoid foreclosure. As I said, the situation in the market is very serious. It is having severe consequences not only borrowers, but on my industry and the global capital markets. It will take a long time to work through the problems in the market, and it will take the active participation of the regulators, secondary market, mortgage bankers, borrowers and every other part of the real estate finance system.

MBA supports the President's proposals to assist troubled homeowners and protect borrowers. We urge the Administration, regulators and Congress to implement other policies that can further alleviate the current liquidity crisis, help borrowers avoid foreclosure, and improve the mortgage market moving forward. We commend you for holding this hearing and urge you to hold more, examining discreet parts of this investor confidence situation. Thank you.

TESTIMONY OF

RICHARD F. SYRON

CHAIRMAN AND CEO, FREDDIE MAC

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

SEPTEMBER 20, 2007

TESTIMONY OF RICHARD F. SYRON
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES
SEPTEMBER 20, 2007

Chairman Frank, Ranking Member Bachus, Members of the Committee. Thank you for the opportunity to discuss legislative and regulatory options for mitigating mortgage foreclosure.

Since I last testified in April, the problems in the subprime market have worsened, and there are indications they are spreading to the broader economy.

Outside the market supported by Freddie Mac and Fannie Mae, mortgage money is either unavailable – or available only at high rates. Numerous lenders have closed their doors. Hundreds of thousands of subprime borrowers have entered the foreclosure process already this year – and many more will hit their interest-rate resets in the coming months.

Amid this turmoil, Freddie Mac is taking concrete steps to stabilize markets, support our lenders – and assist as many borrowers as possible.

In February we were the first investor to announce tightened lending standards to limit payment shock for subprime borrowers, and help ensure these borrowers can afford and keep their homes. We will invest only in securities backed by short-term adjustable-rate subprime mortgages that have been underwritten to a fully-indexed, fully-amortizing level.

In April we committed to purchase up to $20 billion in more consumer-friendly mortgages that will provide better choices for subprime borrowers. We began delivering on that commitment this summer with our new mortgage offering, called SafeStep.

We are also working hard to ensure there is no disruption in the supply of mortgage funds. We have increased our purchases of mortgages and mortgage-related securities, which reached a high of $40 billion in June. In August we offered needed support to the Alt-A market by providing a 90-day forward purchase commitment, which will allow borrowers to "lock in" their rate. We're also seeing sizeable increases in our purchases of mortgages to borrowers with weaker credit.

Finally, we remain dedicated to helping borrowers avoid foreclosure. Year to date, we have modified over 27,000 mortgages – for a total of 194,400 since the beginning of 2004.

These efforts will cushion the negative effects on borrowers and communities, but they are not a panacea. The problems in subprime are complex and long in the making. Following a lengthy period of strong house-price growth and a glut of liquidity, a major market correction is underway. Payroll job losses in August – the first reported decline in four years – should serve as a wake-up call that we've got real problems on our hands – particularly in some communities.

In considering how to respond to these challenges, I have a few thoughts.

First, solutions need to deal with both aspects of the crisis – borrower foreclosures and mortgage market liquidity. Not all families are in the same set of circumstances. We should carefully determine which borrowers can be helped – and by what mechanism.

Some efforts are already working. For example, we're hearing that mortgage servicers are acting proactively to contact subprime borrowers well in advance of the reset date. And there's greater flexibility on the part of investors to permit modifications, thanks to the SEC's recent clarification of this issue.

Second, solutions should avoid creating perverse incentives. Many lenders and investors bear responsibilities that must be taken into account. We need to help homeowners – not bail out investors.

Third, to avoid getting into this situation again, as a nation, we need to have an honest discussion about how much homeownership is actually sustainable – and how best to achieve it.

Finally, certain legislative and regulatory solutions would help alleviate the mortgage credit crunch, help borrowers and restore investor confidence. The President's plan for modifying FHA is a start, as well as enhanced borrower education and tax code changes that will help alleviate the strain on borrowers who have benefited from debt forgiveness.

But the problems loom large, and more needs to be done. The GSEs can play a larger role in this regard. Lifting the caps on GSE portfolio growth would provide a needed back-stop bid for mortgages, sending a positive signal to the markets.

Similarly, a temporary lifting of the conforming loan limit would enable us to provide needed liquidity to a segment of the jumbo market. As shown in the attached chart, jumbo mortgages have become significantly more expensive relative to those in the conforming market. The 92 basis point difference between rates on jumbo and conforming mortgages far exceeds any such spike in the past 20 years. In high cost areas in particular, a temporary lifting of the conforming loan limit might prevent declines in home prices that could lead to additional defaults.

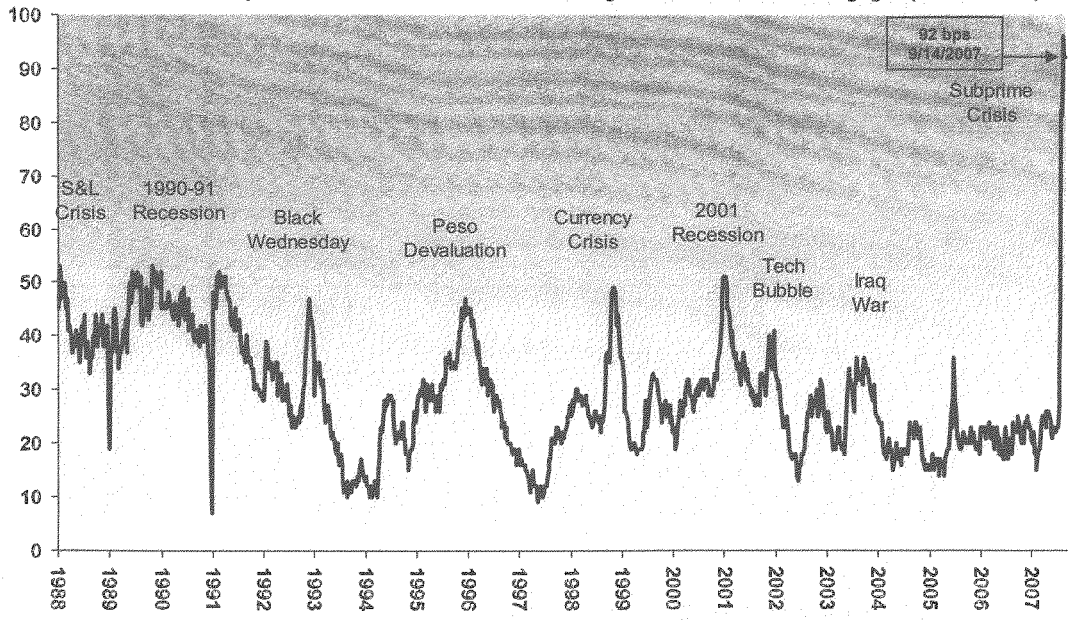
In closing, let me say that a bipartisan Congress chartered Freddie Mac to keep mortgage markets stable and functioning, especially in a time like this. Freddie Mac can't solve the whole problem, but we are an important piece of a comprehensive solution. Our job is to provide stable and affordable mortgage financing for families in your cities, towns and rural communities. That is exactly what we are doing – and will continue to try to do.

Thank you again for the opportunity to appear before the Committee today on an issue critical both to homeowners and the broader economy.

Freddie Mac
We make home possible™

Jumbo Rates Have Spiked to Record Levels

Effective Interest Rate Spread Between Jumbo and Conforming 30-Year Fixed-Rate Mortgages (Basis Points)



Source: HSH Associates(last data week ending September 14, 2007)

Note: Effective spread adds fees and points to the interest rate.

Office of the Chief Economist

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PETE MILLS
SENIOR VICE PRESIDENT
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October 17, 2007

The Honorable Barney Frank
Chairman, House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Frank:

Thank you for providing the opportunity to clarify for the record the scope of Countrywide's efforts to help customers experiencing mortgage repayment troubles to keep their homes. At the September 20, 2007 hearing entitled Legislative and Regulatory Options for Minimizing and Mitigating Mortgage Foreclosures one of the witnesses asserted that Countrywide "says that they have assisted 35,000 people, but now they say that half of those were assisted by a deed in lieu of foreclosure or a short sale, so they were forced out of their home."

As you know, prior to the hearing we provided a detailed briefing to your Committee staff, as well as to more than a dozen other members of the Committee and/or their staff. The briefing (attached) contained detailed information about the company's efforts to contact borrowers in financial distress – both directly and through partnerships with community groups and counseling agencies – and to offer them solutions designed to help them keep their homes and rebuild a solid mortgage payment history. The briefing also contained detailed metrics on the number of borrowers assisted and the types of assistance offered, including descriptions of the various workout and foreclosure avoidance options.

As shown in the chart below (and on page 18 of the briefing), Countrywide projects that in 2007 it will complete nearly 68,000 foreclosure avoidance transactions. Only 13% of those transactions are projected to involve the borrower losing their home through a deed in lieu of foreclosure or a short sale. I would note that these types of transactions are predominantly triggered by life events that have caused borrowers to become seriously delinquent on their mortgages and jeopardized their ability to sustain homeownership.

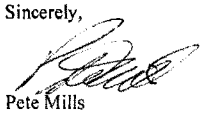
Foreclosure Avoidance Transactions – 2006-07

Specific Workout Options	2006	2007 (projected)
Modifications	14,040	24,390
Short Sales	3,619	7,908
Long Term Repays	9,750	14,838
Repay to Mod	2,825	3,054
Special Forbearance	2,715	4,788
Partial Claims	3,788	4,208
Deed in Lieu	606	1,122
Total*	50,084	67,806

(*total includes miscellaneous workout options not shown)

As noted, in the days prior to the hearing, Countrywide contacted more than a dozen offices to discuss our home retention activities. Based on the feedback received during these briefings, Countrywide was one of the few companies providing such detailed information. As such, it important to us that the Committee record accurately reflect Countrywide's actual successes in home retention. We appreciate the opportunity to submit this information.

Sincerely,



Pete Mills
Executive Vice President
Public Affairs

PM:sf

cc: The Honorable Spencer Bachus, Ranking Member

Countrywide

Countrywide's Homeownership Preservation Efforts

Month End August 2007

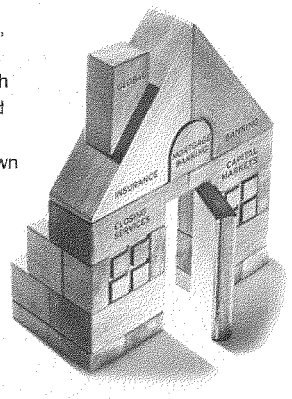
Public Affairs 9/20/2007 8:58:12 AM

Countrywide Financial Corporation: Corporate Overview

"Countrywide is a diversified financial services company serving consumers and institutions, with mortgage origination and servicing at its core"

- ***Total Fundings $463 billion in 2006***
- ***Servicing Portfolio $1.4 trillion***
  - ***8.8 million loans as of 6/30/07***
- ***Over 900 Retail Loan Offices nationally***
- ***Over 50,000 employees nationally***

Founded on the belief that all Americans should have the opportunity to own a home, Countrywide was formed by Angelo Mozilo and David Loeb in 1969. Their vision, which is captured in the company name, extended well beyond their single office operation in Los Angeles. Today, Countrywide has grown to more than 50,000 employees with 900 retail offices nationwide.



Countrywide HOME LOANS

Countrywide Financial Corporation: Corporate Overview (cont.)

- Home Mortgages
  - Prime home lending remains Countrywide's focus. In 2006:
    - 91.2% of all fundings were prime loans ($422 billion)
    - 8.8% were non-prime loans ($40 billion)
    - Currently non-prime loans are less than 5% of production – GSE and FHA/VA eligible
  - Countrywide funds loan through retail branches, wholesale mortgage brokers and purchases from community banks and mortgage bankers. In 2006:
    - Retail Originations: 34%
    - Wholesale Originations: 21%
    - Correspondent Purchases: 40%
    - Other (Bank, Capital Markets) 5%
- Loan Closing Services
  - Credit reports, appraisal services and flood hazard certifications for Countrywide and other lenders
- Banking
  - Countrywide Bank: $90 billion in assets; $60 billion in deposits (as of 6/30/07).
- Insurance Services
  - Homeowners, Life and Auto
- Capital Markets Group
  - Underwriting and trading of mortgage securities; primary dealer for Treasury securities

Countrywide HOME LOANS

Summary – Countrywide's Homeownership Preservation Efforts

At Countrywide, helping customers sustain homeownership is equally as important as helping them achieve the dream of homeownership. The Company's homeownership preservation efforts encompass:

- Implementing internal foreclosure prevention strategies.
- Building relationships with non-profit organizations and community groups.
- Partnering with housing policy professionals, local and community leaders.
- Partnering with others in the mortgage industry.
- Offering borrowers in need viable options to foreclosure.

Countrywide HOME LOANS

Internal Efforts

The Home Retention Division employs a dedicated team of trained counselors, who are available to assist homeowners who have fallen behind on monthly payments.

- The Mission: Our mission is directly reflected in our departmental names -- the Home Retention Division and the HOPE Team: **H**elping homeowners, **O**ffering solutions, **P**reventing foreclosures, and **E**nvisioning success--spell out our mission.
- The Staff: More than 2,600 dedicated counselors available to speak with borrowers.
- The Training: Continuous training for counselors in classroom setting, by computer based training and video presentation.
- The Tools: A home-grown loan servicing platform provides flexibility to make quick adjustments to a variety of loan products.

Early Intervention

Early contact and open communications with borrowers is the most critical step in helping to prevent default. We need to understand our borrower's specific needs and circumstances in order to prescribe a viable solution. Countrywide proactively reaches out to borrowers through:

- Personalized Resource Mailings: Personal letters and cards that offer borrowers the choice to contact Countrywide, a HUD approved housing agency or non-profit housing organization.
  - **928,000 letters sent in the month of August 2007**
- Outbound Calls: Counselors make numerous attempts to reach out to delinquent borrowers through calling campaigns.
  - **Approximately 9.8 million call attempts for August 2007**
- Automated Efforts: Countrywide also offers customers the ability to make promises to pay or send payment via automation.
  - **More than 560,000 promises or payments through speech phone system and the website in the month of August 2007**

Early Intervention

(Continued)

- Other Regular Mailings:
  - **Monthly Statements**: Messages on monthly statements (paper and online) inform borrowers of any pending changes to their loan product.
  - **Reset Letters**: Provided 180, 90 and 45 days in advance of the reset, these notices inform borrowers that their adjustable rate loan(s) will soon reset, provide an estimate of the likely rate/payment increase at current rates, and provide resource numbers to call Countrywide or a loan counselor for assistance.
  - **Negative Amortization Letters**: To alert borrowers that their principle will soon pass the 100%, 103%, and 106% Loan-to-Value ratio thresholds, and advise them of the potential consequences and steps they can take reduce or eliminate negative amortization.

Customer Outreach

Countrywide extends its outreach campaigns to distressed homeowners in their local communities:

- Branch Visits: Small teams of counselors travel to Countrywide branch offices to meet with homeowners who need assistance. Launched in 1999, this program which targets communities with high delinquency rates has already assisted hundreds of homeowners.
- Seminars: Countrywide hosts (or co-hosts along with local nonprofits and other lenders) homeownership preservation seminars, to educate borrowers on strategies to maintain homeownership, in communities experiencing high rates of default.
  - In 2007, branch visits and seminars have already been held in Atlanta, Dallas, Detroit, Fresno, Las Vegas, New Orleans, Philadelphia, New York City and Charlotte, NC.
  - In September 2007, events are planned for Detroit, MI; Dover, Seaford, and New Castle County/Wilmington, DE; and in Toledo, Akron, Cincinnati and Nelsonville, OH.

Countrywide HOME LOANS

Customer Outreach

Countrywide also employs creative efforts to reach out to borrowers:

- Spanish Language: Countrywide employs Spanish language phone teams, sends letters in Spanish and provides automated phone services and a website in Spanish in an effort to engage our Spanish speaking customers.
- DVDs: Countrywide has developed a DVD that is sent to certain customers, when traditional contact can not be made. The DVD features the different types of solutions for borrowers.
- 1-888-995-HOPE: The Homeownership Preservation Foundation averages eight calls a day from Countrywide borrowers.
  - A pilot project with HPF is currently targeting the referral of 36,000 borrowers (from a variety of lenders) to HPF for assistance.

External Efforts

Recognizing that borrowers in trouble may be reluctant to contact their lender, Countrywide partners with a number of reputable national, regional and local nonprofit organizations to help reach borrowers in need.

- Consumer Groups: Countrywide is actively working with a number of consumer housing/counseling groups across the country including NeighborWorks, Homeownership Preservation Foundation, HOPE Foundation, and various NHS, NFCC, and ACORN affiliates. Countrywide's toll free number for Agencies to reach a dedicated Home Retention staffer, is 877-327-9225.
- Referrals: Customers can be referred to nonprofit counseling agencies who can assist them in curing their debts, improving their credit and advising them on financial decisions.

Other Outreach Efforts

Our primary strategy is to encourage borrowers in trouble to reach out to <u>someone</u>. If not their lender, then a nonprofit credit counselor or organization who can work with the borrower and the lender to prevent foreclosure.

- Counselor Training: Since counselors have a more holistic view of debt and credit, one of the most successful methods for reducing foreclosures is to provide nonprofit counselors with training on the types of loan workout programs available and the required information/documentation to gather prior to contacting the borrower's lender.
  - **Trainings have been held in California, Georgia, New York, Ohio, and Texas**
- External Resources: Mailers make customers aware that they can obtain assistance by calling the HPF 1-888-995-HOPE hotline to speak with a representative of the Homeowners Preservation Foundation and it's partner organizations.
- 3-1-1: Countrywide works with regional 3-1-1 hotline operations to assure borrowers get referrals to nonprofit counseling agencies.

Alternatives to Foreclosure: Workout Options

Our primary goal is to help borrowers maintain homeownership, while still providing an acceptable return to our investor. Foreclosure is a losing proposition for all parties involved.

For homeowners who do fall into default, there are options:

- Repayment Plan: An agreement between the borrower and lender outlining how to handle missed payments. Generally, these agreements require higher payments than the regular amount for a short period of time until the loan is brought current.
- Forbearance: A specified period of time (usually 3 to 6 months) that allows borrowers to make either lower payments or no payments at all. It is usually the case that later payments will be higher than the original monthly home loan payment until the loan is brought current.
- Loan Modification: Changes to one or more of the terms of a home loan that will bring a defaulted loan current. Modifications might include: reducing the interest rate of the loan and/or changing the loan product (for example from an adjustable rate to a fixed rate).

Alternatives to Foreclosure: Other Options

Occasionally, financial hardships make it impossible to maintain a home. In some cases the owner may have decided to move or relocate to a new area and no longer wants to maintain the home. The following options are available to those who cannot afford or do not want to keep their home:

- Assumption of the Loan: Transferring a house to a new buyer who agrees to take responsibility for the existing home loan. Not all loans are assumable, so this option must first be discussed with the loan servicer.
- Sale of the Property: If the borrower is willing to sell the home in order to avoid foreclosure, it is possible that the sale can be approved even if the home is worth less than what is owed on it. This is called a Short Sale and has important tax implications. We recommend the homeowner seeks advice from a financial or tax advisor before selling the property.
- Deed-in-Lieu of Foreclosure: This takes place when a borrower voluntarily gives the deed to the property to the lender, though it has the same impact on credit records as a regular foreclosure.

What Else Countrywide is Doing?

Countrywide is currently developing new innovative products, services and support systems that will allow us to assist more customers and will help us meet the challenges of the changing economic environment.

- GSE and FHA Refinance Programs -- The development of refinance programs in HUD, FNMA and FHLMC will provide an outlet for some of the homeowners facing foreclosure where they meet the criteria. As a leading FHA and GSE lender, Countrywide will be very active in participating in these programs.
- Short Refinance Programs -- The combination of a balance write off and a refinance has been done by many lenders in very small, case by case situations. Further development of this option is possible. Challenges to this product include many of the same challenges in accomplishing a short sale (establishing fair value of the property and working with borrowers and investors to identify win-win solutions).

What Else Countrywide is Doing? (continued)

- Improved Customer Communication:
  - Training: Continuous improvement in our training and scripting for workout counselors to make sure each borrower is offered all the available options appropriate for their circumstances.
  - Creative Brochures: Educational materials that prevent homeowners from falling into default or prey to scams.
  - DVD: An animated version of the brochure.
  - Interactive Website: Providing web based tools to assist borrowers.
- Consumer Advocacy Groups: Establish additional partnerships to coordinate outreach efforts such as joint mailings to delinquent borrowers.
- Branch Campaigns: Expand on existing program to reach out to local communities through prearranged branch counseling visits.
- Technology that Makes us Better Partners: Develop platforms that will further our understanding of our investor's loss position so we can make the right decisions earlier in the process.

What Else Countrywide is Doing?

(continued)

- Vendor Management: Work closely with allied vendors such as Foreclosure and Bankruptcy attorneys to make sure that compensation is based upon the right objectives, such as preventing foreclosure, where appropriate.
- Legislative Changes: Countrywide supports legislative efforts to eliminate any tax burden placed on borrowers who partner with their lenders in Short Sales transactions in order to prevent foreclosure and maintain their credit status.
- Increase in Dedicated Workforce: Countrywide is preparing for increases in demand for one-on-one borrower counseling by adding and training additional staff. Total expenses for the home retention function are expected to increase by 45% between 2006 and 2008.
- Investor Relationships: Influence investors to increase flexibility with products in order to simplify the approval process.

Measurements of Success

In the month of August 2007, Countrywide completed 5,887 workout closings. A closing is defined as a completion of a specific workout program, such as a repayment plan, modification, short sale, etc.

For the month of August 2007, Countrywide had 59,718 loans in some stage of workout inventory, being monitored, processed or evaluated on a specific workout program leading to an eventual closing.

On average, for loans that entered foreclosure over the last several years, better than 2/3's managed to avoid foreclosure completion.

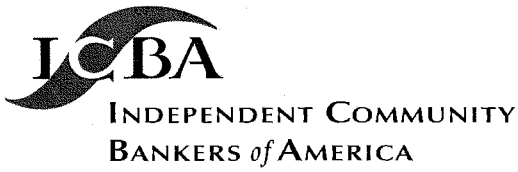
Less than 1% of the loans Countrywide has ever made or bought in the history of CHL, actually went through a foreclosure sale.

Measurements of Success (cont.)

Foreclosure Avoidance Transactions – 2006-07:

Specific Workout Options	2006	2007 (projected)
Modifications	14,040	24,390
Short Sales	3,619	7,908
Long Term Repays	9,750	14,838
Repay to Mod	2,825	3,054
Special Forbearance	2,715	4,788
Partial Claims	3,788	4,208
Deed in Lieu	606	1,122
Total*	50,084	67,806

(*total includes miscellaneous workout options not shown)



Statement on behalf of the

Independent Community Bankers of America
Washington, DC

Legislative and Regulatory Options for Minimizing and Mitigating Mortgage Foreclosures

United States House of Representatives

House Committee on Financial Services

September 20, 2007

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to offer this statement before the House Financial Services Committee concerning recent events in the credit and mortgage markets. Despite uncertainty in the mortgage sector, community banks are stable, well capitalized and prepared to assist their communities' recovery.

The news is filled with talk of a "credit crunch" and the inability to obtain credit to purchase a home or to refinance an existing mortgage. Dozens of mortgage lenders and brokers have gone out of business. Yet our nation's community banks are not cutting back on lending. Community banks have money to lend and want to work with consumers looking for credit solutions.

Community banks are responsible lenders that use commonsense underwriting and thus are not experiencing the skyrocketing delinquencies and foreclosures highlighted in the media. Generally, they underwrite loans conservatively and do not offer nontraditional loan products. Community banks are responsible, highly regulated lenders that provide their customers with affordable loans that enable them, not only the opportunity to buy a home, but to keep it.

Summary of ICBA's position:

- Despite current market conditions, community banks are in solid shape: they have plenty of liquidity and are ready to lend -- factors essential to assisting their communities' recovery from unprecedented numbers of foreclosures and a housing market that has nearly come to a standstill.

- ICBA strongly opposes predatory lending practices and believes that these practices should be stopped. Existing anti-predatory lending laws and regulations should be enforced against all predatory lenders.

- ICBA is not opposed to requiring tax and insurance escrows for subprime loans, although such a requirement would be expensive and may cause some community banks to stop their limited subprime loan offerings.

- ICBA supports appropriate restrictions on prepayment penalties.

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[1] The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever changing marketplace.

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 265,000 Americans, ICBA members hold more than $876 billion in assets, $692 billion in deposits and more than &589 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

- ICBA believes that stated income loans have been used inappropriately and supports clear disclosure to the borrower of the loan type, terms and income claimed.

- ICBA supports the requirement that lenders should underwrite loans to the fully indexed rate and fully amortize payments.

- New proposals to address predatory lending practices should be aimed at high-cost loans.

- As highly regulated financial institutions subject to strict lending and employment standards, it is unnecessary and unduly costly to require community banks to register and license their employees, as some have proposed.

Community Banks are Healthy Despite the Mortgage Industry Crisis

While the latest headlines are filled with questions about the stability of the largest Wall Street firms and dozens of non-bank lenders have gone out of business, community banks and savings associations are continuing to meet the credit needs of borrowers on Main Street. Despite pressure on net interest margins, community banks are well-positioned to continue as responsible lenders in their communities. Community banks have plenty of liquidity due to strong deposit growth and daily access to Federal Home Loan Bank (FHLB) funding. They have sensible underwriting standards, strong capital and healthy reserves. Unaffected by the credit crunch, community banks are stable with ample money to lend.

During the current credit environment, the FHLBs have played an important role in providing daily liquidity to keep the residential mortgage market functioning. Thousands of insured institutions, large and small accessing FHLB advances have experienced no disruptions in their access to the credit markets. Fannie Mae and Freddie Mac too have served the purpose for which they were created, to provide liquidity and stability through the secondary market, allowing mortgage lenders to continue lending. ICBA urges their regulator, the Office of Housing Enterprise Oversight, to be open minded about their portfolio limits to ensure that both Fannie Mae and Freddie Mac have the flexibility needed to assure continued liquidity. This is particularly important should conditions deteriorate further for loans they are authorized to purchase, but that the financial markets may find undesirable.

Community bank mortgage portfolios are stable because of their conservative lending and underwriting practices. Community banks tend to originate standard 30- and 15-year mortgages.[2] According to ICBA's August 2007 data, **community bank mortgage delinquencies are 20 percent to 30 percent lower than the national average** for one-to-four family residential properties.[3] As of June 30, 2007, the percent of past due and non accrual loans on the books of ICBA member banks also were lower than those on the books of all insured depositories.[4]

Unlike some lenders that are avoiding new mortgage loans, community banks continue to put more residential mortgages on their books. By June 30, 2007 ICBA members increased first lien mortgages on their books 2.7 percent over yearend 2006.[5] This is nearly triple the rate of all insured depositories.[6] In addition to these loans, many community banks sold mortgages through secondary market sources.

The Quarterly Banking Profile issued by the Federal Deposit Insurance Corporation (FDIC) based on second quarter 2007 data attests to the health and stability of the regulated financial services sector. The recent FDIC report shows that while insured institutions are facing challenges on the mortgage side of their businesses, commercial lending remains strong.[7] Commercial and industrial (C & I) loans increased $51.3 billion, or 4.1 percent, setting a quarterly record.[8] Lending to small business accelerated during the last 12 months.[9] Loans of less than $1 billion to C&I borrowers grew by $28.5 billion, or 9.6 percent, over last year.[10] This is the largest increase for these loans in the 12 years for which growth data is available.

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[2] *ICBA Mortgage Hits $3 Billion Milestone, Community Banks Have Mortgage Money to Lend.* ICBA Press Release, August 29, 2007 *citing* FDIC Quarterly Banking Profile Second Quarter 2007, vol 1, no. 2 (August 22, 2007). More than 800 community banks originate servicing released mortgages through the partnership of ICBA Mortgage and Taylor Bean Whitaker. Many community banks also sell servicing-retained mortgages directly through the various government sponsored agencies and hold loans in their portfolios making community bank mortgage originations a strong sector in the marketplace,

[3] Id. Volume numbers reflect the period ending August 3, 2007 based on the loan originations of 826 community banks using the ICBA Mortgage/Taylor Bean Whitaker mortgage program. The delinquency rate for these community banks is 3.5 percent. This number does not reflect all loans made by ICBA member banks, merely those placed through ICBA Mortgage. The average number of delinquencies nationally is based on the Mortgage Bankers Association March 2007 quarterly report showing national delinquencies at 4.84 percent.

[4] June 30 2007 *Call Report and Thrift Financial Report.* Federal Financial Institutions Examination Council. www.ffiec.gov as of August 24, 2007.

[5] *Id.*

[6] *See id.*

[7] *Mortgage Hits*, ICBA Press Release, August 29, 2007.

[8] *Id.*

[9] *See id.*

[10] *See id.*

Although the Quarterly Banking Profile reports a rise in charge-offs and non current loans, particularly residential mortgage loans, net interest income positively contributed to earnings and banks were able to increase loss reserves. Insured institutions have ample capital to help them through the current challenges. Slower but steady economic growth and an improving yield curve in the months ahead bode well for continued consumer and small business lending and thus the ongoing strength of community banks.

Community Banks are Responsible Community Lenders

When making mortgage loans, some lenders are concerned with which loan is best for the lender; community banks are concerned with which loan is best for the customer. Community banks generally do not make subprime loans with the characteristics that have led to recent problems, such as "teaser" rates, lack of appropriate documentation, and very high or unlimited limit reset payments and interest rates. As responsible community-based lenders, they require appropriate documentation of borrower income and do not make loans that compel borrowers to refinance or sell in order to remain solvent. Community banks do not have aggressive subprime marketing programs targeting particular low income areas or low income borrowers. However, they do help borrowers with non-traditional credit histories or imperfect credit. Commonly, community bank subprime loans are not sold into the secondary market, but are kept on portfolio. This permits the bank and the borrower to work out a solution if repayment problems arise.

Comments Regarding Lending Practices

ICBA has been generally supportive of efforts by banking regulators to provide additional guidance on nontraditional loan products. These products should have a limited place in the market, and are appropriate in limited circumstances and with clear disclosures in subprime lending. As the mortgage industry develops new finance and securitization methods, federal banking regulators must be vigilant in their introduction of revised regulations guiding the proper application of innovative mortgage products.

An important distinction that must be recognized is the difference between subprime and predatory lending; failure to understand the distinction does a disservice to valid subprime borrowers and lenders. While predatory loans may have some attributes similar to subprime loans, legitimate subprime lending is an important tool to help banks reach less creditworthy borrowers. The failure of the mortgage market and the rise of predatory lending was due to legitimate subprime mortgage products being aggressively marketed to unsuitable borrowers as well as mortgage fraud, misrepresentation and other unlawful lending practices.

The goal of legitimate subprime lending is to provide a loan until the borrower's credit is rehabilitated and the loan can be refinanced into a conventional loan product with better terms. For example, a community bank subprime mortgage would be made on average to a borrower with a FICO score under 620. The loan likely would be a true three-year adjustable rate mortgage with a cap of 6 percent change that can only move by 2 percentage points up or down on any reset date.[11] Made responsibly, these are not problem loans. On the contrary, the borrower has the opportunity to (1) become a homeowner, (2) build equity in the home, (3) improve their credit history and (4) move into a prime loan.

Escrow for Taxes and Insurance on Subprime Loans

Loans to prime borrowers typically include escrow for taxes and insurance. Too often, escrow accounts have not been set up for subprime loans – particularly those with predatory characteristics. Borrowers have been unpleasantly surprised by additional tax and insurance costs not within their budget. If escrow helps prime borrowers meet their mortgage obligations, then it may be a tool that would help those with credit problems to budget for their annual tax and insurance payments. The inclusion of tax and insurance payments in the mortgage payment demonstrates the true monthly cost of a home. More importantly, it may serve as a "reality check" for overenthusiastic homebuyers by encouraging them to reevaluate whether they can afford the full cost of a home before purchase.

ICBA is not opposed to requiring tax and insurance escrows for subprime loans, though we have concerns that this may result in added operating costs for smaller lender. Small lenders without escrow account services would need to establish a program. The additional cost of establishing and maintaining an escrow service may cause some small lenders to exit the subprime market, thus restricting the availability of subprime credit and reducing the number of responsible lenders offering subprime products.

Requiring escrow accounts for all loans, particularly prime loans, is neither necessary nor desirable. Banks need lending flexibility in situations where the timing of a borrower's income makes monthly escrow payments unattractive. For example, a borrower with income that depends on an annual commission may not want the monthly burden of tax and insurance escrow payments. A more sophisticated borrower may prefer to keep their monies in an interest earning account and pay their tax and insurance annually. ICBA believes that escrows for tax and insurance on prime loans should not be required, but dictated by the market and a borrower's needs.

[11] Gamble, Richard H. *Picking Up the Pieces*, Independent Banker. p. 44 (July 2007) *quoting* Larry Lyons, President of Central Bank located in Powhatan, VA.

Prepayment Penalties

Prepayment penalties are not predatory *per se*. These penalties appeal to some customers who do not plan to move from their home for several years and would benefit from the accompanying lower interest rate. Generally, community banks do not write mortgages with prepayment penalties.

ICBA is concerned by large prepayment penalties on subprime loans and supports clear disclosure of the existence of a prepayment penalty and its terms. However, all prepayment penalties should not be prohibited. We would support limitations on prepayment penalties for adjustable rate mortgages to restrict the duration of the prepayment penalties and ensure that the borrower has the opportunity for penalty-free refinancing before the first rate adjustment. Merely banning all prepayment penalties may raise interest rates and limit product options for certain customers.

Stated Income for Low Doc Loans

Stated income loans, commonly referred to as low doc loans, have been used inappropriately by some lenders. Stated income loans should not be used casually, but limited to specific situations for particular borrowers, such as the self employed or borrowers who do not file traditional income tax forms.

ICBA opposes a complete prohibition on stated income loans. The prudent solution is to allow federal banking regulators to provide guidance on the appropriate use of these loans. We support clear disclosure to the borrower specifying the type of loan, the income claimed on the application and informing the borrower that they have the option to fully document their income, which may produce better loan terms.

Commonsense Underwriting and the Ability to Repay

It is ICBA's strong belief that lenders must take particular care to ensure full understanding of a subprime borrower's repayment ability. ICBA supports the requirement that lenders underwrite loans to the fully indexed rate and fully amortize payments. As an industry, community banks generally are conservative underwriters and it is common practice to test a borrower's repayment ability under various repricing scenarios.

Traditionally, a borrower's ability to repay was considered within an analysis of the "Four C's": Capacity,[12] Credit,[13] Capital[14] and Collateral.[15] As part of conservative underwriting, community banks consider the borrower's ability and willingness to repay the loan. The bank will consider sources of income, current debt and loan repayment history. The lender should make a determination that the borrowers can afford the property, have enough income to make monthly payments, can make regular payments and have a history of repaying borrowed money.

Comments on Legislative Proposals

Congress must consider prudent solutions that will assist the country in weathering the immediate crisis safely while transforming mortgage practices in the long term to avoid another foreclosure crisis in the future. Non-bank lenders should not continue to be free from regulatory scrutiny and bank-like supervision. To ensure that restrictions or requirements are effective in combating lending abuses, it is important they be imposed across the industry, including mortgage brokers and non-bank lenders. Without establishment of consistent bank-like supervision, non-bank lenders could easily return to predatory lending practices when the sting of the mortgage crisis passes.

ICBA urges Congress not to increase the regulatory and reporting requirements for lenders that are already subject to effective oversight and supervision. This will merely penalize responsible institutions, like community banks, that are not predatory lenders and have not profited from predatory lending practices.

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[12] Capacity is the borrower's ability to pay an obligation when due, normally determined by verifying salary given on a credit application and considering probability of continued employment. Fitch, Thomas. *Dictionary of Banking Terms*, Barron's Pub. 5th Edition (2006). The traditional guideline is that mortgage principal, interest, taxes and insurance should not exceed 28% of gross monthly income. When combined with recurring monthly debts, such as car loans and revolving credit card payments, total monthly debt should not exceed 36% of gross monthly income.

[13] Credit is the confidence in the borrower's ability or intention to fulfill financial obligations, usually determined by an analysis of the borrower's credit history. Some lenders will also consider alternative credit history, including payments for utilities, car insurance, and past rental or mortgage history. *Id.*

[14] Capital is wealth such as money or property held by an individual indicating the amount of money saved to cover down payments, closing costs and able to serve as an economic buffer during the term of the loan. It may include checking and saving accounts, insurance policies, gifts, retirements accounts, stocks, bonds, and proceeds from sale of existing real or personal property. *See id.*

[15] Collateral is property pledged as security to ensure payment or performance of a loan or obligation. In bank lending it is generally something of value owned by the borrower. If the borrower defaults, the asset pledged may be taken and sold by the lender to fulfill completion of the original contract. *See id.*

Focus on High-Cost Loans, Not Specific Loan Options

Federal bank regulators define high-cost loans as those having interest rates 8 percent higher than the specified Treasury security benchmark rate for first mortgages and 10 percent higher on second mortgage loans.[16] These loans are problematic because a seemly small rate change can make a substantial difference in payments. For example, a $300,000 prime loan at 6 percent costs $1,799 a month. At 9 percent interest rate, a high-cost loan costs $2,414 per month – an increase of $615 per month. When coupled with an adjustable rate, many subprime borrowers have inadequate income to absorb large payments increases common to high-cost adjustable loans.

While not all subprime loans are predatory, predatory practices generally are associated with higher cost loans, not prime products. Efforts to stop abusive lending practices should not prohibit specific loan products created to meet the needs of lower income borrowers or first time homebuyers. Applied responsibly, these products help community banks meet credit needs and support economic development in their communities. Any new regulations intended to prevent predatory practices should focus on the high cost loans while preserving the availability of innovative lending options.

Avoid Burdensome Licensing and Registration

Community banks are among the most highly regulated financial institutions in the country. As regulated institutions they are subject to extensive oversight that dictates their lending and employment practices. It is unnecessary and unduly costly to require community banks to register and license their employees in order to rein in the unconscionable lending practices not found among regulated bank lenders.

Community banks are subject to thorough onsite examination by the federal banking regulators every twelve to eighteen months. The exam focuses on all areas of bank operations, including lending procedures. If the examiners identify problem lending practices or if a bank is found in violation of consumer protection laws, including the Truth in Lending Act (TILA)[17] and Home Ownership and Equity Protection Act (HOEPA), then the bank will be subject to appropriate enforcement action.

[16] FRB Regulation Z, 12 CFR § 226.32 (2007). Regulation Z implements the Home Ownership and Equity Protection Act (HOEPA) which prohibits extending credit on home-equity loans without regard to a borrower's ability to pay. HOEPA restricts certain loan terms for high-cost loans because they are associated with abusive lending practices. These terms include short-term balloon notes, prepayment penalties, non-amortizing payment schedules, and higher interest rates upon default.

[17] The Truth In Lending Act (TILA) requires lenders to disclose key terms in extension of credit, including finance charges, conditions, and the annual percentage rate. Credit terms must be disclosed clearly and conspicuously on all credit applications. TILA grants the right of rescission on all loans that grant the lender a security interest in the home.

Community Banks are Subject to Rigorous Employee Restrictions

Regulated financial institutions are subject to employment and ownership restrictions of Section 19 of the Federal Deposit Insurance Act.[18] This section prohibits any person who has been convicted of any criminal offense involving dishonesty[19], a breach of trust[20], money laundering, or has agreed to enter into a diversion program in connection with a prosecution from owning or controlling, directly or indirectly an insured institution; or affiliating or participating directly or indirectly in the conduct of the affairs of an insured institution without prior written consent of the FDIC. This restriction applies to entry level employees as well as outside consultants. All FDIC-insured institutions must establish a pre-employment background screening that ensures that only applicants that meet this standard are employed at the bank. Upon applying for a job, the name of any potential employee is compared against each federal banking agency's listing of individuals assessed civil monetary penalties or banned from banking. The penalty imposed on banks and individuals for violating Section 19 is a fine of up to $1 million for each day the violation continues or imprisonment for not more than five years or both.

Community banks operate within a regulatory structure that identifies and removes bad actors. In 2006, the four federal bank regulators issued 868 enforcement actions against regulated financial institutions.[21] Of these, at least 110 were permanent bans from banking against bank employees.[22] It may be prudent to extend such a program to non-bank lenders and independent brokers. However, the creation of a new banking registration regime for regulated depository institutions is unnecessary and redundant.

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[18] FDIC Financial Institution letter, FIL-46-2005. June 1, 2005.

[19] "Dishonesty" is defined as "directly or indirectly to cheat or defraud; to cheat or defraud for monetary gain or its equivalent; or wrongly to take property lawfully belonging to another in violation of any criminal statute." FDIC Statement of Policy for Section 19 of the FDIC Act, 63 Fed. Reg. 66, 177, 66,185 (1998).

[20] "Breach of trust" is defined as "a wrongful act, use, misappropriation, or omission with respect to any property or fund which has been committed to a person in a fiduciary or official capacity or the misuse of one's official or fiduciary position to engage in a wrongful act, misappropriation or omission." *Id.*

[21] The enforcement action lists for each federal regulator are publicly available at http://www.ffiec.gov/enforcement.htm. In 2006, the Federal Reserve reported 28 actions; 10 against individuals with 7 permanent prohibitions from banking. The Federal Deposit Insurance Corporation (FDIC) reported 225 actions, including 117 against individuals and 88 permanent prohibitions. The Office of the Comptroller of the Currency (OCC) had 558 enforcement actions in 2006. Unfortunately, their public database does not separate institution versus individual enforcement actions and does not list permanent prohibitions. The Office of Thrift Supervision (OTS) reports 57 actions with 15 permanent prohibitions.

[22] *See id.*

Registration and Licensing of Employees is Costly and May Drive Community Banks Out of Lending

Registration and licensing of all bank employees who have customer contact as part of the mortgage process would create substantial and unnecessary costs. A typical community bank has approximately $122 million in assets, 36 employees and 6.8 branches.[23] In order for a bank of this size to function efficiently, employees must serve in multiple roles requiring customer contact. If the cost of employee registration and licensing is too high, some community banks will stop offering mortgage services. If a substantial number of banks chose to stop mortgage lending due to registration and licensing costs, ultimately the community will suffer from a restriction of available credit and a decline in the number of responsible lenders in the market.

Registration and Licensing Requirements Should be Targeted

Should the committee seek to impose registration and licensing requirements on bank employees, at a minimum the requirements should be sufficiently narrow to permit tellers, customer service representatives and administrative staff to assist customers without having to be registered or licensed. Currently, bank employees who are not dedicated loan officers may respond to a customer's request for information regarding current interest rates and available mortgage services. They may accept mortgage applications either in person, by facsimile, or electronically. In banks without an in-house mortgage program, a non-loan officer employee may refer a customer to an outside lender. If registration and licensing requirements are applied to depository institutions, then the restrictions should be narrowly defined in order to allow small banks to operate efficiently and without impacting the customer-focused service at the heart of community banking.

Conclusion

ICBA supports the efforts of the House Financial Services Committee to investigate the causes that gave rise to the current credit crunch and to seek ways to protect subprime borrowers from unscrupulous brokers and lenders. We urge the committee not to impose additional burdens on those industry participants, such as community banks, that are responsible lenders and are essential to the rehabilitation of their communities in the midst of this crisis.

On behalf of our members, ICBA appreciates the opportunity to offer this statement before the House Financial Services Committee concerning the important role of our nation's community banks.

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[23] *ICBA Annual Demographic Report for 2006.* Asset size and number of employees reflects the national median for all community banks. The number of branches is the national average for all community banks.

STATEMENT OF

THE NATIONAL ASSOCIATION OF HOME BUILDERS

TO THE

HOUSE COMMITTEE ON FINANCIAL SERVICES

HEARING ON

"LEGISLATIVE AND REGULATORY OPTIONS FOR MINIMIZING AND MITIGATING MORTGAGE FORECLOSURES"

September 20, 2007

The National Association of Home Builders (NAHB) appreciates the opportunity to submit a statement on the House Financial Service Committee's hearing on "Legislative and Regulatory Options for Minimizing and Mitigating Mortgage Foreclosures." As the committee continues to advance legislation, and hold hearings to further examine this critical issue, NAHB looks forward to contributing in a positive way to seek solutions to alleviate the mortgage credit crunch, provide stability to the markets and help a rising number of home owners avoid default.

Background on Housing and Mortgage Credit Problems

Turmoil in the subprime mortgage market spilled over into the broader housing and credit markets in August. Although these highly visible and very troubling financial market events have eased a bit, they are likely to continue with negative impacts on housing finance and home sales.

What Happened?

The causes of the current mortgage market turmoil can be found in the lax lending standards, high home price appreciation and strong demand for mortgage securities during the 2004 – 2005 period. During this period, there was a proliferation of adjustable-rate mortgages (ARMs) featuring deeply discounted initial "teaser" interest rates, interest-only payment schedules or payment option contracts allowing monthly payments smaller than accrued interest. These ARM structures were extended to nonprime borrowers, including bona fide "subprime" homeowners and investors/speculators intending to make a profit by flipping properties in markets with high home price appreciation. Many of these loans also included dangerous risk-layering practices such as "no-doc" features that waived verification of borrower income and debt ratios, as well as "piggy-back" second mortgages that often resulted in combined loan-to-value ratios up to 100 percent.

Fueling the growth of such lending was a complex mortgage finance system that widely disbursed credit risk from the lender to the investor who ultimately bore the risk. Risk was finely calibrated through a risk continuum that was distributed geographically and vertically. The system involved mortgage lenders, conduits that packaged mortgages into exotic securities structures, financial rating agencies that rated securities for investment quality (sometimes inaccurately) and investors, both domestic and foreign, lured by above-market yields, particularly on subprime loans.

The system worked well until house price appreciation faltered and mortgage rates began climbing in the latter half of 2006. Subprime borrowers were especially hit hard, jolting many into delinquency or foreclosure as they were unable to meet higher mortgage payments after their loans "reset" to higher rates or could not refinance due to a lack of equity in their homes or a prepayment penalty. As a result, the delinquency rate on subprime ARMs increased to 16.95 percent in the second quarter of this year, compared to 5.12 percent for the overall mortgage market as reported by the Mortgage Bankers Association's *National Delinquency Survey*. The

rise in delinquencies has also spread to other mortgage products, including Alt-A ARMs and prime piggy-back second mortgages.

As investors around the globe suddenly realized that they did not understand the risks of the mortgage securities they were holding, valuation of these securities became difficult or impossible to determine. Investor confusion affected all mortgage products not backed by the federal government (FHA or VA loans) or the government-sponsored enterprises (Fannie Mae and Freddie Mac). First, the subprime market seized up, which then spread to Alt-A ARMs and the jumbo market – loans to credit-worthy borrowers with loan amounts greater than $417,000, the Fannie Mae and Freddie Mac loan purchase limit.

Consequences

There have been some significant shifts in the mortgage and housing landscape as mortgage credit problems continue to work through the market. First, lax underwriting and dangerous risk-layering practices that proliferated during the housing boom are gone due to tighter underwriting standards imposed by federal and state banking regulators. These loans must now be underwritten at the fully indexed rate, which has removed potential buyers from the market who can not qualify under the more stringent standards.

In contrast, there has been a resurgence in the FHA, VA and conforming conventional markets. These markets remain liquid, although spreads to Treasuries have widened a bit due to the world-wide flight-to-quality that has pushed down Treasury yields. As discussed further below, NAHB supports efforts to strengthen the roles of FHA, Fannie Mae and Freddie Mac in addressing the recent mortgage foreclosure problems. The situation in the jumbo market has improved slightly since August – when the market actually shut down – as some large lenders have announced that they are still in the jumbo market, but at rates that are still a good bit higher than the typical spread to conforming loans.

While liquidity conditions have eased a bit recently, this summer's disruptions have caused and will continue to cause problems in sectors of the housing market not immediately affected by the specific events. For instance, if fewer subprime borrowers are in the market, fewer homes will be sold, leaving the large vacant housing inventory little room to contract. If home owners with good credit cannot sell their homes, they will not purchase a new home. In addition, the psychological impact on potential home buyers has caused and will continue to cause them to refrain from entering the market, which will continue to put downward pressure on home prices thereby providing additional reasons to remain on the fence.

Impact on Housing Sector and the Economy

Tighter Mortgage Lending Standards

NAHB's members and their customers have been significantly impacted by the mortgage market upheaval and there is deep concern that the dislocations in the financing markets will increase the depth and length of the housing downturn.

In a national survey conducted this month by NAHB, 62 percent of builders reported that more restrictive mortgage lending standards have adversely impacted their sales. In the western region of the country the proportion affected was 75 percent and 88 percent of builders producing 100 or more units a year cited negative sales impacts. In comparison, in March 2007, only 33 percent of builders were noting sales problems due to financing stresses.

In terms of the degree of impact on sales, builders citing financing troubles reported an average sales decline of 32 percent, more than double the 15 percent slide registered in March. A third of the builders reported sales declines of 10 to 24 percent, 27 percent said their sales were down 25 to 49 percent, and 31 percent experienced a drop in sales of more than 50 percent.

The constriction in mortgage credit also contributed to sales cancellations. Overall, 36 percent of the builders surveyed in September said they had contracts cancelled because buyers were unable to qualify for a mortgage. This was up from 28 percent back in March. Again, builders in the west reported the most negative results, with 49 percent reporting lost sales, and an overwhelming portion, 88 percent, of builders producing 100 or more units annually reported contract cancellations. Regarding the scale of cancellations, 44 percent of the builders surveyed said their sales pipeline shrunk by 10 to 24 percent.

Consistent with most other assessments of mortgage market conditions, builders attributed the highest financing problems to the subprime component of the market, while assigning the fewest difficulties to prime conforming loans.

Availability of Housing Production Credit

The problems experienced in the home mortgage market, along with the widespread slump in housing demand, seem to be emerging as well in markets where builders obtain production financing. In September, the proportion of builders reporting deterioration in the availability of credit increased sharply for all types of housing production loans. Those citing worse (relative to the second quarter) availability of land acquisition loans rose from 19 to 26 percent; builders reporting poorer availability for land development loans increased from 21 to 27 percent; those experiencing tighter availability for single family construction loans jumped from 13 to 27 percent; and, builders having less favorable credit availability for multifamily construction loans moved from 8 to 18 percent.

The Housing Outlook

The forecast for housing activity has undergone a number of downward revisions as the bad news has compounded. NAHB is currently projecting new single family home sales to bottom out in the first quarter of 2008 at an annual rate of 775,000 units and to experience some moderate improvement in the remainder of next year. Under that scenario, new home sales would total 843,000 in 2007 and 820,000 in 2008. That forecast, however, is based on the assumption that, while reduced availability of subprime loans and generally tighter underwriting standards for all mortgage loans will be ongoing issues, the current mortgage market dislocations affecting jumbo mortgages do not persist. If that turbulence continues and spreads to the

conforming markets, then all bets are off and the housing sales slump could extend much longer and deeper, seriously damaging overall economic performance.

In NAHB's forecast, single family housing starts reach a trough in the second quarter of 2008 at an annual rate of 940,000 units and begin registering a modest recovery in the second half of that year. Single family housing starts are expected to total 981,000 in 2008, down 11 percent from the 1.105 million units expected to be started in 2007. Single family starts had topped 1.7 million units in 2005 and approached 1.5 million as recently as 2006.

NAHB Recommendations

Federal Reserve Policy

NAHB applauds the actions the Federal Reserve has taken thus far to quell the mortgage credit crunch. On August 17 the Fed lowered the discount rate by 50 basis points and eased borrowing terms on direct loans to banks from the discount window, including an extension of term financing up to 30 days and an expansion of collateral for discount window borrowings including home mortgages. The move signaled the Fed's willingness to act quickly to restore orderly conditions to financial markets and its growing concern about the impact of financial market disruptions on economic growth. This represented a significant shift in the Fed's outlook, which as recently as the August 7 Federal Open Market Committee (FOMC) meeting had cited inflation as the key risk to the economy.

The Fed's policy shift was reinforced by its aggressive actions at the September 18 FOMC meeting where it slashed both the federal funds and discount rates by 50 basis points. More importantly, in the statement accompanying these actions, the Fed stated "the tightening of credit conditions has the potential to intensify the housing correction and to restrain economic growth. Today's action is intended to help forestall some of the adverse effects on the broader economy that might otherwise arise from the disruptions in financial markets." The statement also stressed the Fed's growing concerns with the impact of financial market turmoil on economic growth. "Developments in financial markets since the [FOMC's] last regular meeting have increased the uncertainty surrounding the economic outlook. The Committee [FOMC] will continue to assess the effects of these and other developments on economic prospects and will act as needed to foster price stability and sustainable economic growth." This is the clearest statement yet that the Fed will not let the housing and mortgage market problems develop into an economic recession.

NAHB heralds the Fed's latest policy move and is heartened by the prospect of further actions if needed. The Fed's rate cuts will help the economy to gain strength and the housing market to recover.

Regulatory Recommendations

Federal Housing Administration

On August 31, President Bush announced the FHASecure initiative, which is designed to help the Federal Housing Administration (FHA) enable homeowners to refinance various types of adjustable rate mortgages (ARMs) that have recently "reset." The President also announced FHA's plan to implement a risk-based mortgage insurance premium structure.

NAHB believes that FHASecure and risk-based mortgage insurance premiums for the FHA's single family mortgage insurance program will help address the needs of thousands of homeowners who currently have conventional adjustable rate mortgage loans and who are facing, or expect to face, financial hardship because of the interest rate reset provisions of their loans.

FHASecure

Under FHASecure, borrowers who are delinquent on their mortgages as a result of interest rate resets will now be able to refinance using an FHA-insured mortgage. In many cases, homeowners may be permitted to include mortgage payment arrearages into the new loan amount, subject to existing mortgage limits and the loan-to-value limit shown below. Previously, only borrowers who were current on their existing loan were allowed to refinance into an FHA-insured mortgage.

The FHA will permit the inclusion of the existing first lien, any purchase money second mortgage, closing costs, prepaid expenses, discount points, prepayment penalties, and late charges. The FHA will also permit arrearages (principal, interest, taxes and insurance) to be added into the new loan amount.

If the new maximum FHA-insured loan is insufficient to pay off the existing first lien, closing costs and arrearages, the lender may execute a second lien at closing to pay the difference. The combined amount of the FHASecure first mortgage and any subordinate lien may exceed the applicable FHA loan-to-value ratio and geographical maximum mortgage amount. If payments on the second are required, they must be included when qualifying the borrower.

As a further indication that FHASecure is intended to address the immediate interest rate reset crisis that many homeowners are facing, mortgage applications must be signed no later than December 31, 2008.

Risk-Based Mortgage Insurance Premiums

As stated previously, the President also announced that HUD would be undertaking a rulemaking process to implement risk-based mortgage insurance premiums for borrowers who receive an FHA-insured mortgage loan.

Under the current structure, in which all borrowers pay the same mortgage insurance premium, the default risk to the Mutual Mortgage Insurance Fund for less creditworthy borrowers is offset by the lower default risk of the program's more creditworthy borrowers. In anticipation of the increased likelihood of default by homeowners who have FHA-insured loans, the Administration's FY2008 budget proposed to increase the up-front MIP to 166 basis points while also increasing the annual MIP to 55 basis points.

NAHB believes that the FHA can effectively serve a broad range of borrowers while acknowledging that the risk of default varies widely. In fact, some delineation in credit risk is necessary if the FHA is going to prudently provide an alternative to subprime borrowers who cannot currently get reasonable loan terms on conventional mortgages.

By setting insurance premiums that are commensurate with credit risk will, the FHA program will be opened to borrowers who have accepted onerous and possibly predatory terms on alternative forms of financing and who are shut out of the mortgage market by a tightening of qualification criteria.

The current statutory framework offers HUD flexibility in setting risk-based MIPs for FHA-insured loans that the agency has never employed. In addition, proposals that are currently before Congress would increase the up-front and annual mortgage insurance premium ceilings under most circumstances, which would provide even more flexibility in this area.

Mortgage Lending Regulation

NAHB supports directing financial institutions to have appropriate and prudent underwriting standards, risk management practices, and consumer disclosures. NAHB further supports the regulators' ability to take remedial action against institutions that fail to adhere to safe and sound standards, exhibit predatory lending practices or violate consumer protection laws. However, NAHB's support is conditioned on the regulators exercising care in the banking supervision/examination process to avoid unnecessarily reducing the flow of mortgage credit, limiting consumer mortgage options, or raising housing credit costs for qualified home buyers. Any regulations developed to reform mortgage lending practices should not include provisions that would inadvertently or unnecessarily disrupt the mortgage lending process, limit consumer financing options, or increase the costs or reduce the availability of mortgage credit.

For example, the banking regulators recently issued the *Statement on Subprime Mortgage Lending* (the Statement). Subprime mortgage products have varying risk profiles, underwriting standards and borrower demographics. A financial institution's risk management protocol may vary on par with its mortgage offerings and we have encouraged the regulators to make accommodations for such circumstances so long as the institution is conducting its mortgage operation in a safe and sound manner and provides adequate financial disclosures to consumers. The rigid application of the Statement would be inconsistent with the flexibility that is essential for certain specialized types of lending activity. Therefore, the Statement, and any other policy statements or regulations going forward should provide sufficient flexibility so that a financial institution could underwrite subprime loans using realistic expectations of interest rate trends and

future borrower income, as long as these factors are supported by appropriate documentation and review.

In addition, it is important that efforts to ensure prudent mortgage lending and risk management practices as well as adequate consumer disclosures are comprehensive and uniform for all institutions and organizations that are involved in providing mortgage credit. Institutions' control systems encompass both institution personnel and applicable third parties, such as mortgage brokers and correspondents. Institution compensation programs should avoid providing incentives that are inconsistent with prudent underwriting or that steer consumers to subprime loans to the exclusion of other products for which the borrower may qualify.

NAHB believes that continued coordinated regulatory efforts among federal and state agencies is necessary to ensure prudent lending practices and effective consumer protections while facilitating efficient operation of the residential mortgage markets.

GSE Regulatory Actions

NAHB strongly supports our nation's housing government-sponsored enterprises (GSEs). The two oldest GSEs, Fannie Mae and the Federal Home Loan Bank System, were created during the Great Depression to address liquidity problems such as those now occurring in the subprime market. Freddie Mac, the youngest GSE, was created for a similar purpose in 1970. Under the present regulatory structure, the Office of Federal Housing Enterprise Oversight (OFHEO), regulates the safety and soundness of Fannie Mae and Freddie Mac, while the Federal Housing Finance Board (FHFB) regulates the Federal Home Loan Banks. NAHB believes there are actions these regulatory bodies can, and must, take that would allow the GSEs to enhance their roles in alleviating the current mortgage crunch.

GSE Portfolio Limits

Fannie Mae and Freddie Mac are presently constrained in meeting their liquidity missions by caps on their investment portfolios that were put in place by OFHEO to address safety and soundness concerns. Fannie Mae's portfolio cap, established by a May 2006 consent order with OFHEO, is fixed at $727.7 billion, however, it can be adjusted to address market dislocations. Freddie Mac's cap, established by a voluntary agreement between Freddie Mac and OFHEO, is presently $728.1 billion. (In contrast to Fannie's cap, Freddie's cap allow for 2 percent annual growth, or 0.5 percent per quarter).

The portfolios are critical to the GSEs' mission of maintaining liquidity in the mortgage markets. In August, Fannie Mae requested a 10 percent increase in its portfolio cap which had swelled to $729.8 billion at the end of July. OFHEO rejected this request, but said it would keep such requests under active consideration.

NAHB, along with the Mortgage Bankers Association and the National Association of Realtors, has urged OFHEO Director James Lockhart to reconsider a temporary increase in these portfolio limits to help stem the current mortgage crisis. In a letter dated August 13, our organizations proposed that an increase in the portfolio caps should be appropriately targeted to

assure that the GSEs use the increased capacity to help meet the most urgent credit needs, including private label MBS market and mortgages for creditworthy families who would otherwise find it difficult or impossible to obtain a mortgage. Further, we believe that the authority should be consistent with safety and soundness and include appropriate conditions concerning how long this new capacity will be available to the GSEs, the specific size of the increase, types of assets eligible for purchase, appropriate reporting and monitoring provisions and a reasonable schedule for returning to the current limits to avoid future disruptions to the mortgage market.

On September 19, OFHEO announced that, while it still believes it is not prudent at this time to allow any major increases in Fannie Mae's or Freddie Mac's portfolios, it will take a series of steps to provide more portfolio flexibility for the enterprises. OFHEO provided a more liberal definition of the portfolio caps, which will add roughly $7 billion to the previous maximums. The regulator also initiated changes that will eliminate the need of the enterprises to maintain their portfolios at levels that provide a cushion below the cap. In addition, Fannie Mae will be allowed the same moderate quarterly cap growth already accorded Freddie Mac.

OFHEO stated that these steps, in conjunction with Fannie Mae's and Freddie Mac's capacity for portfolio management and mortgage securitization, will enable the enterprises to each purchase or securitize $20 billion or more of subprime mortgages, refinanced mortgages for borrowers with lower credit scores, and affordable multifamily housing mortgages. OFHEO will require Fannie Mae and Freddie Mac to file monthly reports detailing impact of the portfolio changes on their purchases of the targeted mortgage types.

NAHB is pleased with OFHEO's action and looks forward to Fannie Mae's and Freddie Mac's development of new and expanded programs for the areas of the mortgage marketplace that are in need of resuscitation. As stated in our letter to OFHEO, NAHB continues to believe even greater portfolio relief is needed and warranted and supports prompt removal of the caps when the enterprises complete their remediation efforts, which should occur in the near future.

Proposed Conforming Loan Limit Guidance

OFHEO has issued Proposed Guidance on the conforming loan limit calculations for Fannie Mae and Freddie Mac that would incorporate declines in the home price index in the annual conforming loan limit calculation. NAHB strongly opposes the Proposed Guidance and urges OFHEO to withdraw it. Given current market conditions, now is not the time to be considering declines in the conforming loan limit.

Under current law, the conforming loan limit is adjusted annually on the basis of the October-to-October percent increase in the average home price index computed by the FHFB. Fannie Mae and Freddie Mac are restricted from purchasing loans above the conforming loan, as provided in their charters. Conforming loans often carry interest rates 25 to 50 basis points lower than rates on nonconforming loans. The conforming loan limit also impact limits for loans insured by the Federal Housing Administration (FHA) or guaranteed by the Department of Veterans Affairs (VA).

OFHEO's proposed guidance would require that a decline in the price index be deferred for a year and then netted out from the following year's increase in the loan limit. If, instead, the index declines in the following year, the limit is adjusted by the previous year's decrease the latter decline is deferred to the next year. Declines of less than one percent would be deferred until the cumulative declines from future year(s) exceeds one percent. Loans that were within the conforming loan limit at the time of origination would be grandfathered over the life of the loan, regardless of whether the loan limit declines below the limit at origination.

OFHEO has stated that the conforming loan limit for 2008 will not be reduced, regardless of what happens to the FHFB October price index. Despite these assurances, NAHB believes that guidance which provides for a possible decline in the conforming loan limit is bad public policy and must be withdrawn. NAHB supports the current method for calculating loan limits based on the annual percent increase in the FHFB housing price index. When the index has declined the loan limit has remained unchanged and the decrease has been netted out of future increases. The current system has worked well for home buyers, builders, lenders and other market participants. Moreover, it is consistent with current statutory requirements.

Federal Home Loan Bank System

NAHB is a strong supporter of the Federal Home Loan Bank (FHLBank) System. NAHB's members are primarily small businesses with limited capital of their own who rely on the FHLBank System for credit to develop land and build homes. For example, more than 90 percent of all loans for residential land acquisition, development and construction (AD&C) come from commercial banks and thrifts, many of which are FHLBank members.

NAHB regards the triple-A rated FHLBank System as a critical element of the housing finance system. The FHLBanks provide a dependable and less expensive source of liquidity during all business cycles, and especially during this difficult juncture. The FHLBanks have shown outstanding responsiveness to credit needs in their districts as evidenced by the increased use of FHLBank advances. Advances for the month of August grew to $769 billion, up $110 billion, or 16.6 percent from July 31 levels. By comparison, the advances for the first half of 2007 grew a total of $2.7 billion.

This news further highlights the very positive role of the FHLBanks in supplying credit during the current mortgage market difficulties. Going forward, NAHB urges that the FHLBanks should not be restricted in expanding their advance business to meet liquidity needs. Furthermore, the limit on their investments in mortgage-backed securities should be increased.

With regard to subprime assistance, the current Federal Housing Finance Board regulations for the FHLBank Affordable Housing Program (AHP) should be revised to allow more flexibility for the use of AHP funds for refinancing loans for subprime borrowers.

Fannie Mae and Freddie Mac Efforts to Ease the Mortgage Crisis

Throughout the current turmoil in the subprime and jumbo mortgage markets, Fannie Mae and Freddie Mac, have continued to provide liquidity for mortgage loans that fall within the

loan limit that constrains these two government sponsored enterprises. Evidence of this is seen in the stability of interest rates and in the terms of the loans being offered to borrowers whose loans are in turn sold by lenders to Fannie Mae and Freddie Mac.

Earlier this year, Fannie Mae announced its HomeStay™ Initiative, which adds flexibility to Fannie Mae's suite of prime mortgage loans that are aimed at serving the needs of borrowers with slightly blemished credit who may have previously received subprime loans or adjustable-rate loans with onerous terms. Through its automated underwriting tools, Fannie Mae has emphasized the range of low- and no-downpayment loans that are available with repayment terms extending as long as 40 years. Well-qualified borrowers can also obtain interest-only loans for limited terms.

Freddie Mac has also continued to emphasize its willingness to purchase fixed- and adjustable-rate Alt-A loans at market rates to borrowers who meet Freddie Mac's credit risk criteria.

All of the mortgage loan products offered by Fannie Mae and Freddie Mac require that lenders carefully evaluate the ability of each applicant to repay the loan based on their current income and, in the case of an adjustable-rate loan, to assure that applicant will be able to continue to meet the repayment obligation at the fully indexed interest rate. It should be noted that these efforts by Fannie Mae and Freddie Mac are clearly aimed at assisting owner occupants and are not intended to bail out investors or real estate speculators.

In those cases where homeowners cannot continue to meet their mortgage loan obligations, both Fannie Mae and Freddie Mac are encouraging loan servicers to pursue workouts, settlements or short sales with these borrowers. Freddie Mac, for example, is providing financial incentives to servicers who successfully work with borrowers to avoid foreclosure.

Legislative Recommendations

Enact Legislation to Revitalize the Federal Housing Administration

NAHB appreciates the significant level of bipartisan support for meaningful FHA reform that was shown in the passage of H.R. 1852, *the Expanding American Homeownership Act of 2007,* in the House of Representatives on September 18 by a vote of 348-72.

In recent years the FHA has been unable to respond fully to borrowers' needs because of statutory constraints, and the ongoing turmoil in the subprime market has greatly increased the urgency for enactment of FHA revitalization legislation. FHA's share of the market fell from 18 percent in 1990 to less than 4 percent in 2006. FHA's descent steepened in the latter stages of that period as competing subprime mortgage loan programs lured many borrowers into less advantageous mortgages.

Passage of H.R. 1852 is an important step forward to address problems in the subprime mortgage market and help creditworthy borrowers to obtain home loans at prices and terms they

can afford. In particular, NAHB is pleased that the House adopted the NAHB-supported amendment offered by Reps. Barney Frank (D-Mass.), Gary Miller (R-Calif.) and Dennis Cardoza (D-Calif.) that will enable more creditworthy borrowers to purchase an FHA-insured home in many high-cost metropolitan markets. Currently, the FHA loan limit is too low to enable many potential home buyers to utilize the FHA program in areas where housing costs run high.

The House-passed bill also contains a number of other important provisions that will give the FHA the tools it needs to deliver the range of mortgage products it needs to meet its mission objectives more effectively. Specific provisions that NAHB supports include:

- Grant the FHA authority to establish greater flexibility in setting downpayment requirements for its single-family programs.
- Revise FHA requirements for condominium loans, which are often burdensome and differ significantly from mortgage loans for detached single-family homes.
- Allow the FHA to establish a risk-based mortgage insurance premium pricing structure that rewards higher-risk borrowers who establish a track record of timely payments.
- Permit the FHA to extend the maximum loan maturity to 40 years to enable borrowers to reduce their monthly mortgage payments.
- Give the HUD secretary increased flexibility to increase the FHA multifamily mortgage loan limits in high cost areas.
- Allow the FHA to insure more "reverse mortgages" and increase the maximum loan amount.

We look forward to working with members of this Committee and the Senate Banking Committee to ensure passage of comprehensive FHA modernization legislation in this Congress.

Enact GSE Regulatory Reform Legislation

Congress must pass GSE regulatory reform legislation as quickly as possible. It is time to remove the cloud of reform that has been hovering over the GSEs for the past 4 years and inhibiting them from doing their important housing missions that are so critical to resolving today's mortgage credit crisis.

NAHB supports H.R. 1427, the *Federal Housing Finance Reform Act of 2007,* which was passed by the House in May with strong bipartisan vote of 313-104. NAHB believes that H.R. 1427 appropriately responds to financial safety and soundness concerns of the GSEs, while protecting and advancing their crucial housing missions. NAHB urges the Senate to pass similar legislation soon.

Importantly, H.R. 1427 provides for an increase for the conforming loan limit in high cost areas which will allow Fannie Mae and Freddie Mac to buy and package loans on properties in areas where they are currently unable to do so because house prices and mortgage amounts exceed the one national limit. This will provide much needed mortgage credit for borrowers in these area where the availability of jumbo loans effectively has dried up.

In addition to this provision, other key areas addressed in H.R. 1427 include:

- Portfolio – Restricts the types of risks that the regulator should consider in regulating the enterprises' portfolios to those based on safety and soundness to the enterprises, rather than broader concerns such as systemic risk.

- Minimum Capital – Directs the regulator to review any increases in minimum capital and to rescind such increases when the factors that led to the temporary increase are successfully resolved or no longer present.

- Affordable Housing Fund – Provides for the creation of an affordable housing fund (AHF) to support affordable housing efforts. The bill ensures that applicants demonstrate both the experience and the capacity to successfully and efficiently employ funds, and that the AHF selection process puts funds to the most effective use.

Tax Code Modifications

Another consequence of the mortgage crisis is the possible tax effect on struggling homeowners. Section 108 of the Internal Revenue Code requires any discharge of indebtedness (credit cards, student loans, mortgages, etc.) to be includable in taxable income. Note that this does not apply if the taxpayer is insolvent or has declared bankruptcy under Title 11. With respect to mortgages, this tax arises in several situations. Most mortgages are held as recourse (personal liability) debt. For such debt, tax liability may be generated as a result of foreclosure. If the fair market value of the homeowner's residence is less than the outstanding mortgage principal, then in most cases the lender will discharge or forgive this difference as part of the foreclosure process. This amount is considered forgiven debt and is taxed at ordinary income tax rates. Similarly, if the homeowner coordinates with the lender a short sale with debt forgiveness or restructures an existing mortgage to ensure reduced future payments (through principal or interest rate reduction), then the discharged debt amount is also taxed at ordinary income tax rates.

For homeowners holding mortgages characterized as non-recourse debt, as is often the case in California and in limited cases in other states, a different tax consequence results from foreclosure. For homes with a fair market value less than the outstanding mortgage principal, the taxable income due to foreclosure is equal to outstanding principal minus the tax basis of the residence, with the net amount taxed as capital gain income. For many homeowners, this will result in no increase in tax liability because the Section 121 principal residence gain exclusion may apply ($250,000 for single taxpayers and $500,000 for married taxpayers). However, if non-recourse debt is forgiven by a lender as part of coordinated short sale, then the discharged

debt is taxed as ordinary income as in the situation with recourse debt. This ordinary income tax treatment applies to workouts with debt forgiveness as well.

Proposals that provide for an exclusion from Section 108 for debt associated with residences have several beneficial effects. First, for holders of non-recourse mortgages, the existing tax rules encourage many struggling homeowners to prefer foreclosure over workout with lenders. This means the existing tax rules create a bias to moving homeowners out of their homes and increasing the inventory of the housing stock on market. Second, for taxpayers who are solvent, the potential increase in tax liability discourages homeowners from seeking restructuring agreements from lenders, a preferred situation for homeowners, lenders and neighborhoods. For these reasons, Congress should provide an exclusion for personal residence debt from Section 108 as a means of encouraging market-based restructuring between lenders and homeowners and discouraging foreclosures.

Avoid Excessive Mortgage System Restraints

The federal banking regulators have taken significant steps to address shortcomings in mortgage underwriting and consumer disclosures through statements on nontraditional and subprime mortgage lending. These guidelines have also been adopted by organizations representing state and local banking and mortgage lending regulatory bodies. In addition, the Federal Reserve is contemplating further changes to mortgage lending requirements related to the Home Ownership and Equity Protection Act (HOEPA) and the Administration has announced plans to release new requirements under the Real Estate Settlements Procedures Act (RESPA). On the legislative side, a number of bills have been introduced in Congress to address concerns with mortgage lending practices and consumer protections and disclosures in the current mortgage finance system.

NAHB has endorsed the banking regulators statements on nontraditional and subprime mortgage lending and supports additional efforts to ensure that mortgage loans are prudently underwritten and managed and that consumers are adequately informed of mortgage borrowing choices, including the benefits and risks of those choices. However, NAHB also cautions against over-reactions that would result in excessive, redundant or conflicting measures in these areas. It would be counter-productive to enact legislation or implement regulations that would unnecessarily reduce the flow of mortgage credit, limit consumer mortgage options, or raise housing credit costs for qualified home buyers.

NAHB appreciates the opportunity to provide this statement to members of the Committee. NAHB looks forward to working further with members of Congress, regulatory agencies and other interested parties to find solutions to alleviate the mortgage credit crunch, provide stability to the housing and financial markets and help a rising number of home owners avoid losing their most important asset – their home.

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STATEMENT OF THE NATIONAL ASSOCIATION OF REALTORS®

TO THE

HOUSE FINANCIAL SERVICES COMMITTEE

ENTITLED

"LEGISLATIVE AND REGULATORY OPTIONS FOR MINIMIZING AND MITIGATING MORTGAGE FORECLOSURES"

SEPTEMBER 20, 2007

REALTOR® is a registered collective membership mark which may be used only by real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.

On behalf of 1.35 million members of the National Association of REALTORS®, we present our views on the federal role in mitigating and minimizing mortgage foreclosures. NAR represents a wide variety of housing industry professionals committed to the development and preservation of the nation's housing stock and making it available to the widest range of potential homebuyers. The Association has a long tradition of support for innovative and effective federal housing programs and we have worked diligently with the Congress to fashion housing policies that ensure federal housing programs meet their mission responsibly and efficiently.

The current crisis in the mortgage market is troubling to all of us. In 2006, 1.2 million families entered into foreclosure, 42 percent more than in 2005[1]. Abusive lending, exotic mortgages and a dramatic rise in subprime lending – coupled with slowing home price appreciation – have all contributed to this crisis.

The National Association of Realtors® supports a number of short-term, intermediate and long-term actions needed to address the current crisis and minimize the likelihood that the nation faces such a situation again.

Remedies for the Current Crisis

Increased FHA Loan Program Flexibility. NAR supports changes to the FHA loan program recently announced by the President to allow homeowners with loans they can no longer afford to refinance into an FHA loan product. *FHASecure* will allow homeowners with good credit to refinance their existing loans with FHA loans, even if they are not current on their existing loans. These borrowers will have to have proven good payment histories prior to the interest rate reset on their current loans, and will have to meet all other FHA underwriting criteria.

FHA products are safe, thanks to appropriate underwriting and loss-mitigation programs, and fairly priced without resorting to teaser rates or negative amortization. It is predicted that *FHASecure* will assist 240,000 households who otherwise would face foreclosure.

In April of this year the National Association of REALTORS® sent a letter to HUD Secretary Alphonso Jackson asking for regulatory action to allow FHA to refinance loans that were in delinquency. We applaud the Administration for making this welcomed change

Mortgage Cancellation Relief. The National Association of REALTORS® has also been a strong advocate for mortgage cancellation relief. NAR believes that Congress should provide tax relief to borrowers in the event a lender excuses some portion of a mortgage debt. Current law provides tax relief for owners of investment real estate when some portion of their mortgage debt is forgiven. No tax relief mechanism has ever been available, however, for owner-occupied residences. Today's market conditions and fundamental fairness make such a mechanism essential.

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[1] A Flood of Foreclosures, But Should You Invest?, Market Watch, February 18, 2007.

The policy considerations that support tax relief arise from questions about taxing phantom income. When a residence is sold, a seller may experience a so-called "short sale" in which the proceeds realized from sale are insufficient to cover the outstanding balance on the mortgage. A lender might forgive the shortfall amount, but, under current law, the individual would still be required to pay tax, even though there is no cash with which to pay it. Similar situations could arise on a foreclosure. As a matter of policy, tax writers have generally tried to assure that there is no tax on phantom income in cases when the individual has generally complied with tax laws. The current phenomenon of short sales and foreclosure generates phantom income that should not be taxed.

Current law provides an asymmetric result for taxation on the sale of a principal residence. There are only two instances in which an individual will pay tax on the sale of a principal residence. The truly fortunate will pay tax only if their *gains* exceed $250,000 ($500,000 on a joint return). The tax on any amount in excess of $250,000/$500,000 is imposed at capital gains rates. The other category of individuals who pay tax on the sale of a principal residence are the truly *un*fortunate who must pay tax on the phantom income generated when they sell for less than they owe or lose their home through foreclosure. To add insult to injury, the phantom income is taxed at ordinary rates.

Fundamental fairness would dictate that those who sell their properties in situations where there is true economic loss should be relieved of any requirement to pay tax, just as most individuals who benefit from a true economic gain are relieved of any requirement to pay tax.

NAR supports H.R. 1876 (and its companion, S. 1394), bipartisan legislation that would provide mortgage cancellation tax relief. The legislation includes many safeguards to prevent abuses, and NAR is working with tax staff to assess the need for any additional anti-abuse rules. Congress has previously provided mortgage cancellation tax relief to individuals affected by hurricane Katrina. Legislation is currently under consideration that would also provide mortgage cancellation relief to individuals in the military. NAR urges Congress to extend this relief to *all* individuals affected by the challenges facing some borrowers in today's housing market.

Foreclosure Forbearance and Mitigation. NAR supports legislative, regulatory, and private-sector foreclosure avoidance and mitigation efforts. We urge lenders, especially lenders that have made loans without considering the ability of the borrower to make payments under the loan, to act promptly to help borrowers resolve the problem. Possible steps could include recasting the mortgage, forbearance, favorable refinancing, waiving of prepayment penalties, and other appropriate tools. Prompt action will almost always be in the best interests of the lender, as well.

NAR also supports increased funding for programs that provide financial assistance, counseling, and consumer education to borrowers to help them avoid foreclosure or minimize its impact. We also believe that Congress and the regulators should examine alleged abuses by mortgage servicers, some of whom are engaging in predatory servicing by imposing unjustified high fees on borrowers. These abusive practices can contribute to, or even cause, delinquencies and foreclosures.

Furthermore, NAR has taken the lead within the industry to partner with the Center for Responsible Lending and NeighborWorks® America to create a brochure that can help financially stressed consumers having problems paying their mortgage understand their options and offer guidance on how to avoid foreclosure. Our foreclosure avoidance brochure is available at www.realtor.org/subprime along with additional consumer education tools, including a brochure on avoiding the trappings of a predatory loan.

Future Prevention

The full impact of this crisis remains to be seen, but with 2.2 million American households projected to lose their homes, the National Association of REALTORS® strongly believes that legislation must be enacted to prevent a similar disaster from happening again. These foreclosures will cost homeowners as much as $164 billion, primarily in lost home equity.[2]

Responsible Lending Principles. NAR supports a detailed list of protections for consumers in the mortgage transaction, which were included in our statement submitted for the July 25, 2007 House Financial Services Committee hearing entitled, "Improving Federal Consumer Protection in Financial Services – Consumer and Industry Perspectives." In short, NAR strongly believes all mortgage originators should:

- Treat all parties in the transaction honestly and fairly, which is consistent with REALTORS®' responsibilities under NAR's Code of Ethics.
- Verify the borrower's ability to repay the loan, based on all terms, including property taxes and insurance, without having to refinance or sell and considering the totality of the borrower's circumstances with some flexibility to accommodate those with unique circumstances.
- Underwrite using a reasonable debt-to-income ratio, making sure borrowers have enough residual income after making their monthly mortgage payment, including property taxes and insurance, to meet their needs for food, utilities, transportation and other essentials;
- Generally require that, for subprime loans, the monthly payment include an amount to be held by the mortgage servicer in an escrow/reserve/impound account for the payment of the borrower's payment of property taxes and insurance;
- Underwrite loans based on verified income and assets, with few exceptions;
- Ensure that any refinanced mortgage provides a significant benefit to the borrower;
- Eliminate prepayment penalties, or at least make them for the shortest time and the lowest amount possible;
- Consider alternative payment history, such as rent, utilities, and telephone and report payment history of borrowers on a monthly basis;
- Offer a choice of mortgages with interest rates and other fees that reflect the borrower's credit risk; and
- Face strong penalties for abusive lending acts.

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[2] Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners, Center for Responsible Lending (December 2006).

FHA Reform Legislation. HR 1852, the "Expanding American Homeownership Act of 2007", sponsored by Chairman Barney Frank (D-MA) and Subcommittee Chairman Maxine Waters (D-CA) passed the House by a vote of 348-72 earlier this week. The Senate bill is making its way to the Floor. We urge you to quickly conference this bill and get it on the President's desk as soon as possible. Without the measure's reforms – increased loan limits, modified downpayment requirements, and streamlined condominium loan program requirements - FHA loans will remain inaccessible to many homebuyers and owners, including those who need to refinance out of problem loans or are unable to find conventional mortgage financing in today's markets.

Conclusion

Today, our nation faces three challenges in dealing with the aftermath of this year's mortgage turmoil. First, we must help those families threatened with the loss of their homes as the result of changing economic conditions and skyrocketing mortgage terms. Second, we must make sure that today's mortgage market turmoil does not spread to the economy as a whole. And, finally, we must make the changes necessary to ensure that American families do not face such a situation again. Both private industry and the federal government have an important role to play in each these challenges. The National Association of REALTORS®stands ready to work with you on implementing these most important measures and thanks you for holding this important hearing and taking a vital first step.