

**Testimony of Julia Gordon**  
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**Before the Financial Crisis Inquiry Commission**

*January 13, 2010*

Good afternoon and thank you for the invitation to participate in this hearing. We appreciate the opportunity to comment on the causes and consequences of the financial crisis.

I am Senior Policy Counsel at the Center for Responsible Lending (CRL), a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices.<sup>1</sup> CRL began monitoring the subprime mortgage market in 2002, one of the few research organizations doing so at that time. At the end of 2006, we published a study projecting that one out of five subprime mortgages would fail. At the time, the Mortgage Bankers Association called us “wildly pessimistic.” Given the devastation resulting from the subprime fiasco, we sincerely wish our projections had been wrong.

The most tragic aspect of the subprime crisis that triggered the larger financial crisis is that it was utterly unnecessary. Compared to standard, traditional loans, toxic loan products offered no financial benefit to American consumers. Subprime lending did not even increase homeownership: through 2006, *only ten percent* of all subprime loans went to first time homebuyers, and as a result of the foreclosure crisis, there has been a *net loss of homeownership* that has set us back a decade. The only reason for these products to have been mass-marketed to consumers was for Wall Street and mortgage companies to make quick money by selling (and flipping) large numbers of loans with minimal underwriting. Never have so many toxic loan products been aggressively marketed on such a large scale with such loose lending rules.

With the constant barrage of statistics and staggering dollar figures that have become commonplace during this financial crisis, it is easy to become numb to the depth and scope of the financial pain American families are experiencing today. However, the hardship experienced by ordinary people across the nation is very real.

Consider the situation of Milton Barreto and his fiancée, Kim Machado, who bought their Florida home in July 2006 for \$270,000, with monthly payments of \$1,900.<sup>2</sup> Milton and Kim knew exactly how much they could afford each month, and they asked their broker for a fixed-rate, 30-year mortgage. The broker assured them that they were getting what they asked for. But less than a year after they bought their house, Milton and Kim saw their monthly payments suddenly shoot up to \$2,353 and then to over \$2,800. The house is now worth only about 60 percent of its original price, so they can't sell or refinance. They don't want to walk away from their obligation, even if that would make financial sense, but they still haven't been able to get a loan modification from their servicer. So instead of starting out their life together in a family home that helps them build wealth for

their future, this young couple instead will experience ruined credit, the loss of all their savings they put into their home, and potentially the loss of their home itself.

Unfortunately, Kim and Milton's story is not a story about one rogue broker. Rather, their story is representative of how hundreds of loan companies and thousands of mortgage brokers did business. Millions of people received mortgage loans with built-in payment shocks that forced borrowers into repeated refinancings, stripping home equity with no benefit to the borrower. This was especially true for people of color like Kim and Milton, whose communities have been targeted by unscrupulous lenders in neighborhoods across the country. And, like many victims of predatory lending, Kim and Milton likely could have qualified for a safe, sustainable, fixed-rate loan.

In my testimony today, I will focus on six key points:

- The current foreclosure picture is extremely grim. Since 2007, 2.1 million homes are reported to have been foreclosed and sold off, and currently more than 6 million homes are in trouble. By 2014, we expect that up to 13 million foreclosures may have taken place. Not only will millions of people lose their home and family wealth, but neighborhoods will be decimated and tens of millions of other homeowners will see their home values decline precipitously.
- The foreclosure crisis – and the resulting economic crisis – was caused by reckless and predatory lending practices and toxic financial products, not by the Community Reinvestment Act, Fannie Mae and Freddie Mac, or any other policy goal aimed at increasing homeownership.
- Predatory lenders targeted racial minorities disproportionately. As a result, African-American and Latino communities have been especially hard-hit by the foreclosure crisis, which has significantly increased the wealth gap between whites and minorities and has wiped out the asset base of entire neighborhoods. What's more, these communities were most likely to have the types of subprime loans that have already failed in large numbers, so many minorities will not receive any benefit at all from more recent government programs aimed at foreclosure prevention.
- Over the past decade, federal bank regulators neglected to act as responsible loans were crowded out of the market by aggressively marketed, tricky financial products carrying hidden costs and fees. These regulators' failure to restrain the abuses that led to today's credit crisis demonstrates the need for a much stronger regulatory emphasis on rigorous consumer protection to ensure that both families and financial institutions can flourish in a sustainable way.
- The current governmental response to foreclosures – the Making Home Affordable program – has not lived up to expectations. Foreclosure prevention efforts must be made mandatory for all servicers and any new or revamped foreclosure prevention program must include principal reduction and result in

permanent, sustainable modifications (or permanent, sustainable refinancings). The response must also be tailored to meet the different waves of the foreclosure crisis and the different foreclosure triggers (loan resets/recasts, unemployment, negative equity, etc.).

- As a result of the credit crisis, efforts to promote homeownership for lower-income and minority homebuyers have been set back considerably. Right now, credit is extremely tight, and people with lower credit scores or less cash available for a down payment are locked out of the market. In many cases, the people who cannot get a new mortgage loan are the very people whose credit scores were ruined by a predatory mortgage loan.

## **I. Foreclosures continue to soar, neighborhoods continue to decline, and the mortgage market continues to suffer.**

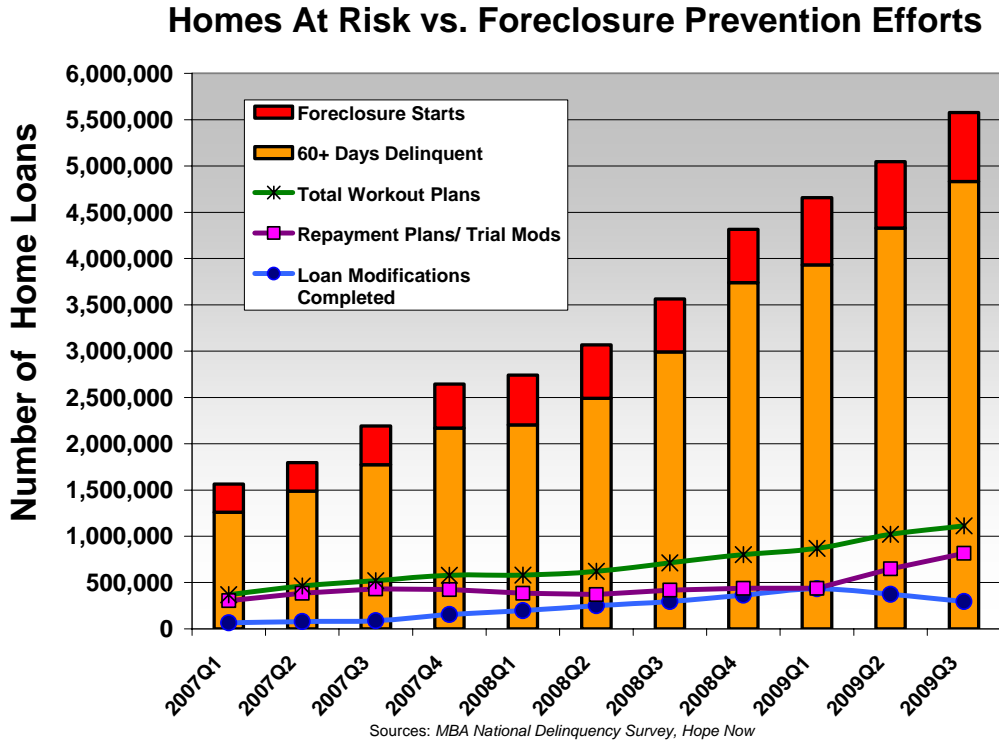
### **A. Foreclosures are at historically high levels and continue to rise.**

Historically, the housing sector has led the way out of economic downturns.<sup>3</sup> Yet with one in seven homeowners behind on their mortgage or in foreclosure<sup>4</sup> and one in four mortgages underwater,<sup>5</sup> continued weakness in the housing sector will likely slow or derail economic recovery and hamper efforts to create jobs and reduce unemployment.

According to industry analysts, the total number of foreclosures by the time this crisis abates could be anywhere between 8 and 13 million.<sup>6</sup> To break down these numbers further, according to statistics from the Mortgage Bankers Association, nearly *six million foreclosures* have already been initiated since 2007.<sup>7</sup> The Hope Now Alliance reports that approximately 2.1 million foreclosure sales have been finalized between 2007 and November 2009.<sup>8</sup> (In addition to the many foreclosure starts still working their way through the process, other foreclosure starts have not resulted in a foreclosure sale for various reasons: sometimes a family will pay the arrearages and reinstate their mortgage; sometimes the home will be sold short; sometimes the homeowner will give up the home in a deed-in-lieu of foreclosure transaction; and especially in recent years, sometimes the family will move but the bank will not finalize the foreclosure.<sup>9</sup>)

Currently, approximately one in ten home loans (4.3 million) are delinquent by more than 30 days but are not yet in foreclosure.<sup>10</sup> Adding these loans to the 4.5 percent of loans currently in foreclosure shows that an astonishing 14.5 percent of all loans (close to 6.5 million) are not current. Figure 1 shows the total number of homes seriously delinquent (60+ days) and consequently at substantial risk. So far, foreclosure prevention efforts have been woefully unable to keep pace with failing mortgages (see Figure 1 and see Section V for more analysis of foreclosure prevention efforts).

Figure 1



Although many consider this crisis to be primarily contained in the sunbelt states, it is worth noting that, during the third quarter of 2009, approximately half of all the states had more than one out of ten borrowers at risk of losing their homes (60+ days delinquent). While Florida, Nevada, Arizona and California topped the list, other states in deep trouble include Illinois, Michigan, Mississippi, New Jersey, Ohio, Maryland, and New York.<sup>11</sup>

**B. While subprime and Alt-A mortgages show the highest rates of delinquencies, prime delinquencies are now increasing at the most rapid rate.**

Delinquencies of subprime loans escalated quickly during 2007 and 2008. Although the rate of increase has begun to level off, about half of subprime loans originated during 2006 and 2007 are delinquent (see Figure 2). The picture looks similar for Alt-A loans, which are largely nontraditional loans aimed at people with better credit profiles than subprime loans but that contain risky features or minimal underwriting. By the first quarter of 2009, approximately one-third of Alt-A loans originated in 2006 and 2007 were delinquent, and that rate continues to climb (see Figure 3).

Figure 2

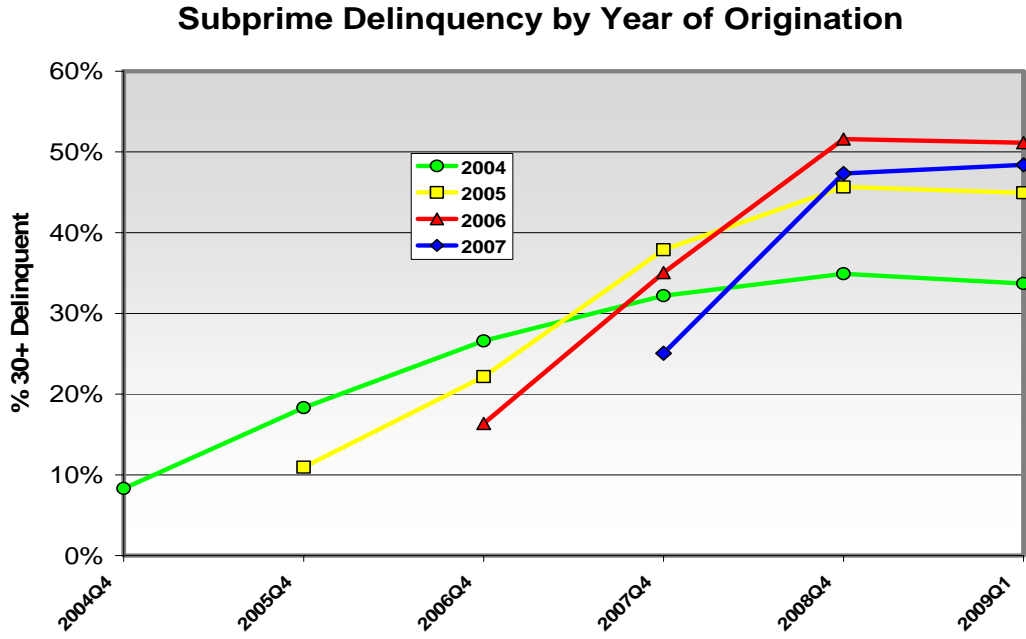
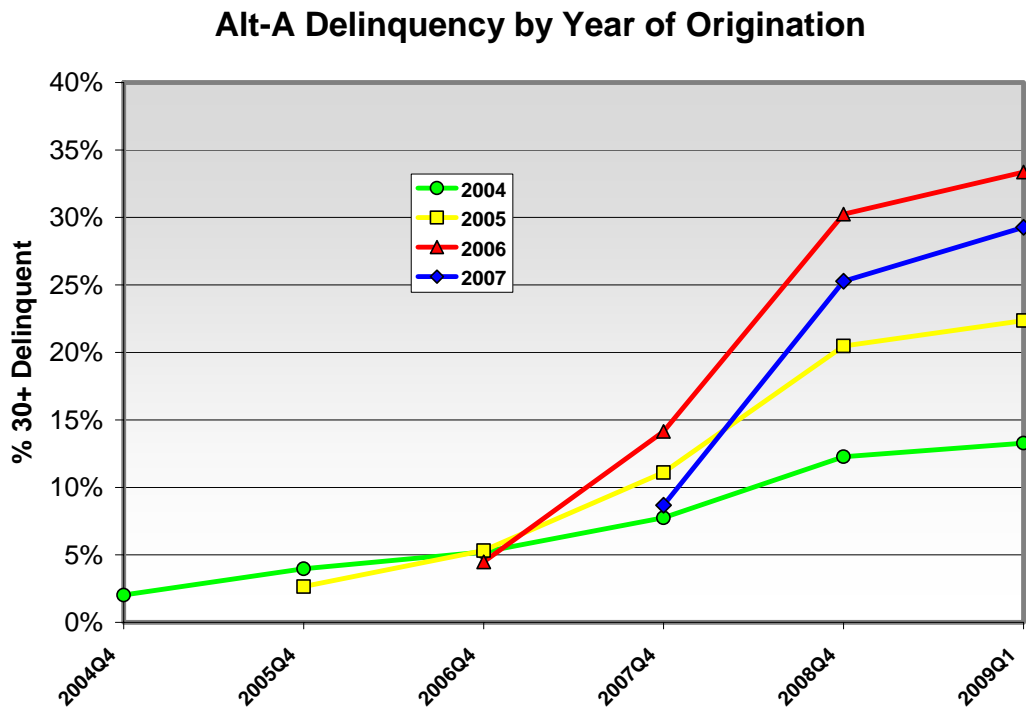


Figure 3



Source for Figures 2 and 3: *Characteristics and Performance of Nonprime Mortgages*, Government Accountability Office, (July 28, 2009)

According to a report by the OCC and OT on the subset of mortgages serviced by their regulated institutions, during the second quarter of 2009, 15 percent of payment option ARMs (POARMs) were seriously delinquent and 10 percent were in the process of foreclosure.<sup>12</sup> These rates are approximately three times higher than the overall rates of delinquency and foreclosure experienced by the mortgages covered by the report.<sup>13</sup>

The long-term projections offer little consolation: Examining the performance of privately secured loans made in 2006 and 2007, Fitch Ratings projects that more than 70 percent of POARM loans and between 40 and 54 percent of 30-year Alt-A loans will default.<sup>14</sup>

Although delinquencies among subprime and Alt-A loans have rightfully received much attention to date, the more traditional prime market has also been deeply affected. Over the last year, interest-only prime adjustable rate mortgages have become an increasing concern. For example, 60+ day delinquencies among such loans serving as collateral in private-label residential mortgage-backed securities and originated in 2007 have doubled, growing from 9.1 percent to 18.6 percent.<sup>15</sup> For all prime loans, the average 60-day delinquency rate reported between 1979 and 2006 was 1.98 percent.<sup>16</sup> According to the MBA, in 3Q2009, at 7.5 percent, the 60-day prime delinquency rate for prime borrowers (5.3 percent for those in fixed rate loans and 18.8 percent for those with adjustable rates) was almost four times higher than historical standards.<sup>17</sup>

### **C. Foreclosures impact the entire community through loss of home value and increased demand for city servicers.**

In addition to the costs to homeowners and communities from the foreclosures described above, the “spillover” costs of the foreclosure crisis are massive. Tens of millions of other homes – households where the owners have paid their mortgages on time every month – are suffering a decrease in their property values that amounts to hundreds of billions of dollars in lost wealth just because they are located close to a property in foreclosure. Depending upon the geography and time period, the estimated impact of each foreclosure on nearby property values ranged from 0.6 percent to 1.6 percent. CRL has estimated that the foreclosures projected to occur between 2009 and 2012 will result in \$1.86 trillion in lost wealth, which represents an average loss of over \$20,000 for each of the 91.5 million households affected.<sup>18</sup> These losses are on top of the overall loss in property value due to overall housing price declines.<sup>19</sup>

What’s more, foreclosures cost states and localities enormous sums of money in lost tax revenue and increased costs for fire, police, and other services because vacant homes attract crime, arson, and squatters. As property values decline further, more foreclosures occur, which only drives the values down still more. The Urban Institute estimates that a single foreclosure results in an average of \$19,229 in direct costs to the local government.<sup>20</sup>

**D. The foreclosure crisis has also had a major impact on renters, many of whom have lost their home after their landlord goes through foreclosure.**

According to the National Low-Income Housing Coalition, a fifth of single-family (1-4 unit) properties undergoing foreclosure were rental properties and as many as 40 percent of families being affected by foreclosure are tenants.<sup>21</sup> While tenants now have some legal protection against immediate eviction,<sup>22</sup> most of them will ultimately be forced to leave their homes.<sup>23</sup> Furthermore, a great deal of housing stock is now owned by the banks rather than by new owners. Banks are not in the business of renting homes and are not well suited to carry out the duties required of a landlord.

Compounding the problem of renters losing homes due to foreclosures is the impact that the crisis is having on other sources of affordable housing. A policy brief from the Joint Center for Housing Studies reports that dramatic changes at Freddie Mac and Fannie Mae and coincident changes in credit markets have disrupted and increased the cost of funds for the continued development of multi-family (5+ units) properties, despite the fact that underwriting and performance has fared better in this segment than in single-family housing.<sup>24</sup> As a result, even though a general over-supply of single-family housing persists, the deficit in the long-term supply of affordable rental housing is at risk of increasing.<sup>25</sup>

**II. The foreclosure crisis – and the resulting economic crisis – was caused by reckless and predatory lending practices and toxic financial products, not by risky borrowers, the Community Reinvestment Act, or Fannie Mae and Freddie Mac.**

The predatory lending practices and toxic products characteristic of the past decade occurred for one reason and one reason only: for mortgage brokers, lenders and investors to make money. These were not “availability” products designed to help renters become homeowners: the overwhelming majority of subprime mortgages made from 1998 through 2006 went to borrowers who already owned their own homes – 60 percent were refinances, and 30 percent were for families who were moving from one home to another.<sup>26</sup> In fact, far from expanding homeownership to people who otherwise could not afford it, subprime lending actually resulted in a net *reduction* in homeownership.<sup>27</sup> Rather, these mortgages existed to make money for originators, who benefited from the repeated refinancings required by these products, and for Wall Street, which wanted ever-increasing numbers of mortgages – the riskier the better – to bundle into “risk-free” securities.

**A. Misaligned incentives lie at the heart of the crisis.**

Buying or refinancing a home is the biggest investment that most families ever make. For the vast majority of Americans, this transaction is often decisive in determining a family’s future financial security. For this reason alone, prospective homeowners cannot be treated with a hands-off, caveat-emptor approach. But recent events have shown us the macroeconomic importance of affordable mortgages for homeowners. Rules of the

road for mortgage lending are not just for the benefit of individual families, but for the benefit of the entire housing market and national economy.

A misalignment of incentives lies at the heart of today's foreclosure crisis.<sup>28</sup> Back in the days when families went to their local savings and loan to get a mortgage and the thrift held that loan among its own investments, the interests of borrowers and lenders were aligned: If the borrower did not pay the mortgage, the lender did not make money. But the proliferation of independent brokers and the growth of the secondary market upset that core alignment of interests between lender and borrower by creating a system where each actor was compensated early in the loan transaction, often within the first month of the loan term, thereby reducing or even eliminating the incentive to worry about how the borrower would fare later on.<sup>29</sup>

At the height of the housing bubble, independent mortgage brokers originated the vast majority of subprime loans, receiving their compensation from lenders immediately upon brokering the loan. Those lenders then sold the loan into the secondary market within weeks, where it was bundled together with other mortgages and sliced and diced into mortgage-backed securities (MBS). The facilitators of this process – the investment bankers, lawyers, and ratings agencies involved – were all paid their fees regardless of the performance of the MBS. Those securities were then sold to investors. At the same time, even more derivative products were layered on top of them, with credit default swaps at the top of the pyramid – what Warren Buffet identified as early as six years ago as “financial weapons of mass destruction.”<sup>30</sup>

Now, the entire economy is paying the price of this untenable structure, as lenders have gone out of business, and those remaining are limiting their lending. The investors in these sliced and diced loans can't put them back together again to help prevent massive foreclosures that are a direct result of their original facilitation of bad acts in the marketplace. To prevent this situation from happening again in the future, a legislative effort to help create a safer, more sustainable mortgage market should have the guiding principle of realigning both the market incentives and the legal incentives all the way up the chain, from brokers through investors.

### **B. Toxic mortgage products stripped equity and led inevitably to foreclosure when home prices stopped rising.**

The most common loan made in the subprime mortgage market was a so-called “hybrid adjustable rate mortgage” that featured a teaser rate mortgage for a short period of time, after which the interest rate would increase sharply, generally without regard to whether interest rates in the economy stayed flat or even fell. The loans were colloquially known as a “2/28” or “3/27” because the interest rate was fixed for two or three years out of a 30-year term.

A typical loan originated in 2006, for example, would start at the rate of roughly 8 percent, would rise to 10 percent two years later, and, depending upon the movement of interest rates generally, would continue to rise every six months up to a cap of roughly 13 percent.<sup>31</sup> To avoid this rate increase, a borrower would have to sell or refinance before



the rate reset. In most cases, a subprime borrower would pay a steep “prepayment penalty,” typically 3.5 percent to 4 percent of the loan balance, for doing so.

Because the typical borrower did not have cash on hand sufficient to cover the prepayment penalties and refinancing fees, these would be paid from the proceeds of the new loan. Accordingly, the loan balance would grow with each refinancing. Of course, this stripped away much of the economic benefit of homeownership, but it was at least possible – and extremely lucrative for brokers, lenders and investors – to continue refinancing as long as home prices kept rising. Once home prices declined, foreclosure was virtually inevitable.

Another complex product that has put many low-income families at risk is the payment option adjustable-rate mortgage (POARM). This product allows people to make monthly payments that do not cover principal and interest, which means that the mortgage experiences “negative amortization” – that is, the principal balance of the loan grows larger – during the period that the minimum payment is being made. Unfortunately, most POARM lenders offered these loans to borrowers for whom they were not suited, structured the products so that the payments substantially increase in five years or less when they hit their negative amortization cap (the loan terms would provide that at a certain level of negative amortization, the loan would recast to a fully amortizing payment), underwrote the loans only to the very low teaser rate, and failed to document income. Also, the majority of POARMs are Alt-A mortgages rather than subprime, so they continued to be written even as the subprime market was beginning to collapse.

In addition to the exploding rates, most subprime loans and many Alt-A contained a number of other risky features as well. These risk layers included steep prepayment penalties, no escrow for taxes and insurance, little or no documentation of income, and underwriting to very low teaser rates. In most cases, mortgage brokers were paid more to steer borrowers into higher-rate loans with riskier features through lender-paid yield-spread premiums. In a particularly toxic combination, mortgage brokers generally received the highest lender payment when an increased rate was combined with a prepayment penalty to lock in the higher rate.<sup>32</sup>

An example of many of these problems is provided by the McGowan family in Gastonia, North Carolina, who lost their home to foreclosure in spite of all their best efforts to make payments on a loan they never should have received.<sup>33</sup> Butch McGowan worked as a fire fighter for many years and his wife, Cynthia, was a police dispatcher. They have two children, including a daughter who has had multiple brain surgeries. They have no credit card debt, but because of their health issues, they have carried debts related to medical expenses. The McGowan family desperately wanted a home of their own, and in 2006, they were very excited when they were told they qualified for financing. When they went to close on the loan, they were expecting to receive a fixed-rate mortgage with an interest rate of 6.75 percent. Instead, the lender rushed in late and said, “9.75 percent is the best we can do. Oh, and by the way, the rate will go up even higher in six months – but don’t worry, you can refinance.”

To make matters worse for the McGowans, they were told their mortgage payment included property taxes and hazard insurance, but it did not. The McGowans closed on their mortgage thinking they could somehow find a way to manage a loan at 9.75 percent until the promised refinance came through. But adding taxes and insurance on top of an expensive loan tipped them over the edge, and even though Mr. and Mrs. McGowan tried their best, they simply couldn't make the payments. Ultimately, they lost their home. The McGowans have used up all their retirement funds, and they are never sure from one week to the next they will have enough money for groceries.

Mrs. McGowan sums up the situation when she says this: "The only thing I wanted to do is to try to fix something for my children to have after we are gone. And now that we've used all of our 401Ks and 457s, there is not much left if we can't hold on to something."

### **C. What didn't cause the crisis: risky borrowers, the Community Reinvestment Act, or Fannie Mae and Freddie Mac.**

#### **1. The housing crisis was precipitated by risky loans, not risky borrowers.**

Since the problems in the subprime market became evident in early 2007, many in the mortgage industry evaded responsibility and fended off government efforts to intervene by blaming the borrowers themselves, saying that they were not ready for homeownership or were overreaching in an attempt to buy more house than they could afford.<sup>34</sup>

However, the stereotypes of the risky borrower or the borrower overreaching to purchase a McMansion turn out to be empirically false. Research shows that the elevated risk of foreclosure was an inherent feature of the defective nonprime and exotic loan products that produced this crisis. Loan originators – particularly mortgage brokers – frequently specialized in steering customers to higher-rate loans than those for which they qualified and loans loaded with risky features. What's more, the average subprime loan amount (which includes loans made in high-priced housing markets like California) was \$205,700 – hardly the money with which McMansions are purchased.<sup>35</sup>

Tragically, most borrowers who received predatory loans qualified for better, more sustainable loans. A study for the Wall Street Journal found that of the subprime loans originated in 2006 that were packaged into securities and sold to investors, 61 percent "went to people with credit scores high enough to often qualify for conventional [i.e., prime] loans with far better terms."<sup>36</sup> And even those borrowers who did not qualify for prime loans could have received sustainable, thirty-year fixed-rate loans, for at most 50 to 80 basis points above the introductory rate on the unsustainable exploding ARM loans they were given.<sup>37</sup>

CRL's research has demonstrated that common subprime loan terms such as adjustable rates with steep built-in payment increases and lengthy and expensive prepayment penalties presented an elevated risk of foreclosure *even after accounting for differences in*

*borrowers' credit scores.* It has also shown how the risk entailed in these loans had been obscured by rapid increases in home prices that had enabled many borrowers to refinance or sell as needed. The latent risk in subprime lending has been confirmed by other researchers from the public and private sectors.<sup>38</sup>

A complementary 2008 study that CRL undertook with academic researchers from the University of North Carolina at Chapel Hill supports the conclusion that risk was inherent in the loans themselves.<sup>39</sup> In this study, the authors found a cumulative default rate for recent borrowers with subprime loans to be more than three times that of comparable borrowers with lower-rate loans. Furthermore, the authors were able to identify the particular features of subprime loans that led to a greater default risk. Specifically, they found that adjustable interest rates, prepayment penalties, and broker originations were all associated with higher loan defaults. In fact, when risky features were layered into the same loan, the resulting risk of default for a subprime borrower was four to five times higher than for a comparable borrower with the lower-rate fixed-rate mortgage from a retail lender.

Finally, CRL conducted a more targeted study to focus on the cost differences between loans originated by independent mortgage brokers and those originated by retail lenders. In that study, we found that for subprime borrowers, broker-originated loans were consistently far more expensive than retail-originated loans, with additional interest payments ranging from \$17,000 to \$43,000 per \$100,000 borrowed over the scheduled life of the loan.<sup>40</sup> Even in the first four years of a mortgage, a typical subprime borrower who used a broker paid \$5,222 more than a borrower with similar creditworthiness who received their loan directly from a lender.<sup>41</sup>

## **2. The Community Reinvestment Act did not lead to the foreclosure crisis**

Another scapegoat often blamed is the Community Reinvestment Act (“CRA”), which is alleged to have produced the crisis by allegedly forcing lenders to make risky loans to low- and moderate-income families and to communities of color. Yet most subprime lending was done by financial institutions that are not even subject to CRA requirements.<sup>42</sup> A recent study of 2006 Home Mortgage Disclosure Act data showed that banks subject to CRA requirements originated or purchased only six percent of the reported high-cost loans made to lower-income borrowers within their CRA assessment areas.<sup>43</sup> Moreover, the CRA was passed in 1977, and was in effect for more than two decades before subprime lending appeared.<sup>44</sup>

## **3. Although Fannie Mae and Freddie Mac should not have purchased subprime MBS, their purchases did not cause the crisis.**

Given the long-standing political dispute over the very existence of the Federal National Mortgage Association (“Fannie Mae”) and the Federal Home Loan Mortgage Corporation (“Freddie Mac”), it is not surprising that these government-sponsored

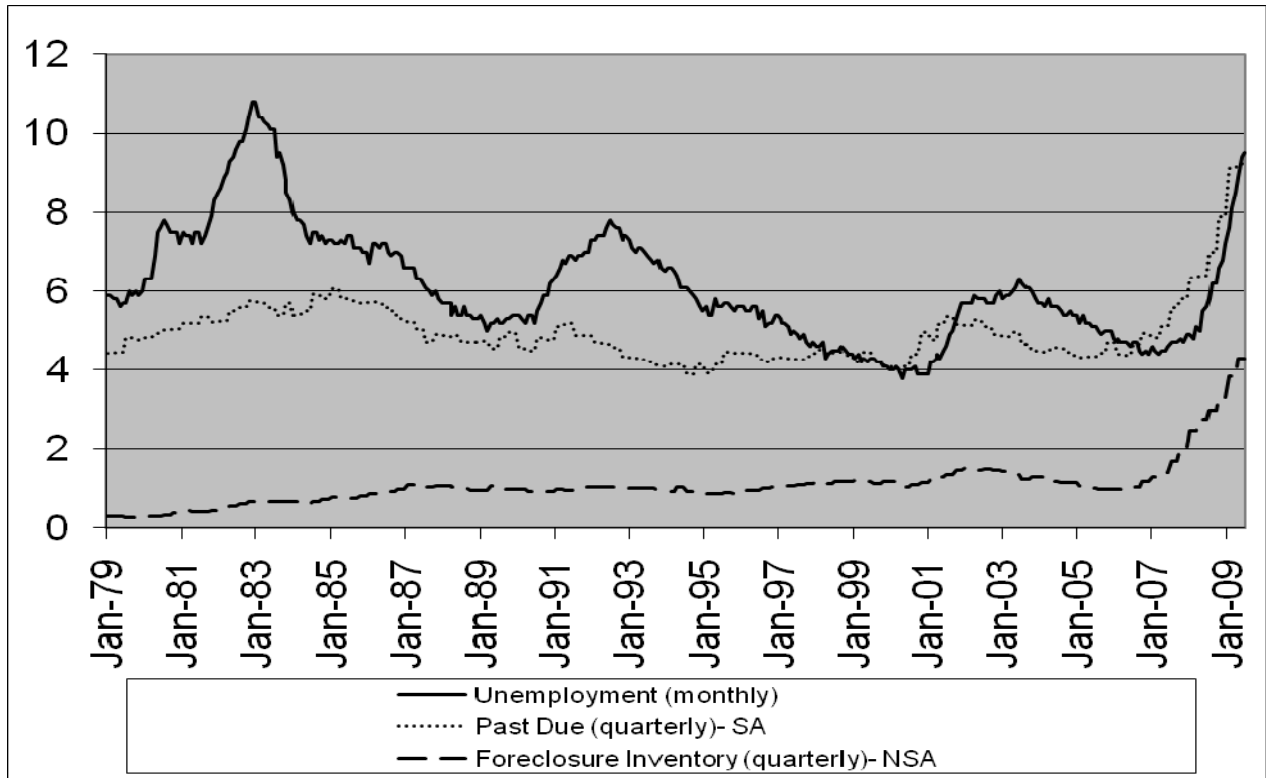
entities (GSEs) are often blamed for the crisis. Those blaming the GSEs point to their decision to purchase subprime securities from Wall Street.

The fact is, while we agree that Fannie Mae and Freddie Mac should not have purchased subprime mortgage-backed securities, their role in purchasing and securitizing problem loans was small in comparison with that of private industry. *All subprime mortgage backed securities were created by Wall Street.* Fannie Mae and Freddie Mac did not securitize any of these loans because the loans did not meet their standards.<sup>45</sup> And, when they finally began to purchase the MBS, they were relative late-comers to a market that had been created by private sector firms and they purchased the least risky, most easily sellable tranches of these securities.<sup>46</sup>

In fact, the GSEs' role in the overall mortgage market diminished substantially as subprime lending rose. As of 2001, Fannie Mae and Freddie Mac funded almost two-thirds of home mortgage loans across the United States. These were loans that Fannie Mae and Freddie Mac purchased directly from originators who met the GSE guidelines and either held on their balance sheets or securitized and sold to investors. Subprime loans accounted for just 7 percent of the market. Around 2003, private issuers were beginning to introduce new, riskier loan products into the market, and began to displace the GSEs. In early 2004, private-issue MBS surpassed the GSE issuances of all loans, and by early 2006, Fannie and Freddie's market share of new issuances had dropped to one-third of the total. As the role of the GSEs was declining, the percentage of subprime loans in the mortgage market almost tripled.<sup>47</sup>

#### **4. While high unemployment makes a bad situation worse, unemployment itself is not the reason for the soaring foreclosure rate.**

In light of the high unemployment rates now prevailing across the country, it is useful to examine the relationship between unemployment, mortgage delinquency, and foreclosures.<sup>48</sup> The chart below shows that during previous periods of very high unemployment, delinquency levels did rise somewhat, but they rose far less than they've risen during the recent crisis. Even more telling, during those previous periods of high unemployment, foreclosure numbers remained essentially flat.<sup>49</sup>



Sources: MBA National Delinquency Survey, Bureau of Labor Statistics.

In short, the current recession has featured unprecedented levels of delinquency and foreclosure due to the shift in the past decade from relatively safe, fully underwritten, fixed-rate, amortizing mortgages to unsustainable, dangerous, and confusing mortgage products with adjustable rates. The lack of appropriate underwriting for ability to repay has led to mortgage debt consuming far more of a family's total income, which makes it harder to survive a period of unemployment without defaulting (other debt, such as credit card debt, is also at much higher default levels than have been the case historically).

Also, in past recessions, homeownership served as a buffer against income interruptions. Homeowners facing unemployment could sell their homes or tap into their home equity to tide them over. Yet today, vast numbers of homeowners have little or no equity at all. Selling homes is difficult to impossible in many markets, and even when sales take place, the former homeowner sees no net proceeds from the sale. This problem exists because the glut of toxic mortgages first inflated the housing bubble and then led to the bursting of the bubble, followed by a self-reinforcing downward spiral of home prices.

As the nation's unemployment numbers continue to rise, some have questioned whether focusing on job creation strategies would be preferable to restructuring mortgages or reforming the way home loans are made. Certainly unemployment and underemployment contribute significantly to the dire economic straits in which many families find themselves, impacting their ability to pay mortgages as well as other debts and living expenses. But the assertion that unemployment is the cause of the current

foreclosure crisis is incorrect, and to make a difference in the foreclosure rate, we must directly address failing mortgages.

**D. Prohibit predatory lending in the future, particularly unsustainable loans, yield spread premiums and prepayment penalties.**

It would be stunning if this crisis were to pass without engendering some fundamental changes in mortgage underwriting practices. Yet industry interests object to virtually any new rules governing lending, threatening that they won't make loans if the rules are too strong from their perspective. Yet as explained above, it is the *absence* of substantive and effective regulation that has managed to lock down the flow of credit beyond anyone's wildest dreams. For years, mortgage bankers told Congress that their subprime and exotic mortgages were not dangerous and regulators not only turned a blind eye, but aggressively preempted state laws that sought to rein in some of the worst subprime lending.<sup>50</sup> Then, after the mortgages started to go bad, lenders advised that the damage would be easily contained.<sup>51</sup> As the global economy lies battered today with credit markets flagging, any new request to operate without basic rules of the road is more than indefensible; it's appalling.

For this reason, we believe strong legislation or regulation governing mortgages is crucial. To most people, requiring mortgage lenders to evaluate whether borrowers can afford their mortgage seems unarguable, because most people cannot imagine how a business could thrive if it made loans that people could not repay. But it was this basic, common-sense principle that was abandoned in the run-up to this crisis. If market incentives have been dis-aligned to the point where it no longer matters to the seller whether the customer can afford the product, government must require that lenders only sell mortgages that borrowers can pay.

Earlier this year, the House of Representatives passed the Mortgage Reform and Anti-Predatory Lending Act (H.R. 1728) with a vote of 300-114. While there are some ways in which this bill should be strengthened, it represents a critical step forward in requiring mortgage originators to consider the consumer's ability to repay the loan and to refinance mortgages only when the homeowner receives a net tangible benefit from the transaction. Most important, H.R. 1728 establishes bright line standards that will result in safer loans and in more certainty for originators of those loans. The bill's safe harbor construct would grant preferred treatment to loans made without risky features such as prepayment penalties, excessive points and fees, inadequate underwriting, and negative amortization. It would also ban yield spread premiums – which, as we explained earlier, were key drivers of the crisis – and it would permit states to continue to set higher standards if necessary to protect their own residents.

On the regulatory front, we strongly support the Federal Reserve Board's initiative to ban yield spread premiums for all loan originators and prohibit steering consumers to unnecessarily expensive loans.<sup>52</sup> The Board's proposed rule represents an important step forward in the recognition that disclosure alone is not enough to protect consumers and that certain practices themselves give rise to unfairness and unnecessary risk.

### **III. Minority families and communities of color received a disproportionate share of subprime loans and are now bearing a disproportionate burden of the foreclosure crisis.**

It is well documented that African-American and Latino families disproportionately received the most expensive and dangerous types of loans during the heyday of the subprime market. Federal Reserve researchers, using data from 2004 through 2008, have reported that higher-rate conventional mortgages were disproportionately distributed to borrowers of color, including African-American, Latino, American Indians, Alaskan Natives, Native Hawaiians, Pacific Islanders, and Hispanic borrowers.<sup>53</sup> For example, in 2006, among consumers who received conventional mortgages for single-family homes, roughly half of African-American (53.7 percent) and Hispanic borrowers (46.5 percent) received a higher-rate mortgage compared to about one-fifth of non-Hispanic white borrowers (17.7 percent).<sup>54</sup>

In addition, a CRL study showed that African-American and Latino borrowers were more likely to receive higher-rate subprime loans than white borrowers with similar risk profiles, while another study provided evidence that loans in minority communities were more likely to carry prepayment penalties than loans in white communities, even after controlling for other factors.<sup>55</sup>

Unfortunately, little concrete data is available on the actual demographic distribution of foreclosures because this data is not collected by any public agency. However, it is widely believed that African-American and Latino families and communities have been disproportionately impacted by the current foreclosure crisis. In addition to much anecdotal evidence of minority neighborhoods being devastated by foreclosures, these beliefs are rooted in solid facts about the origins of the foreclosure crisis. Risky loan products – especially subprime products – have been shown to be more likely to default, which implies that minorities, who were disproportionately sold those products, are disproportionately bearing the brunt of this foreclosure crisis.<sup>56</sup> Based on industry projections, CRL has estimated that of the projected foreclosures between 2009 and 2012, African-Americans will experience 1,115,189 foreclosures and Latinos will experience 1,480,285.<sup>57</sup>

The impact of this crisis on families and communities of color is devastating. Homeownership is the primary source of family wealth in this country, and people often tap home equity to start a new business, pay for higher education and secure a comfortable retirement. In addition, home equity provides a financial cushion against unexpected financial hardships, such as job loss, divorce or medical expenses. Perhaps most important, homeownership is the primary means by which wealth is transferred from one generation to the next, which enables the younger generation to advance further than the previous one. Minority families already have much lower levels of wealth than white families, and therefore this crisis is not only threatening the financial stability and mobility of individual families, but it is also exacerbating an already enormous wealth gap between whites and communities of color.<sup>58</sup>

**IV. Federal bank regulators could have prevented this crisis, but they looked the other way as responsible loans were crowded out of the market by aggressively marketed, tricky financial products carrying hidden costs and fees. It is vital to establish a federal regulator whose primary mission is consumer protection.**

While the market participants from mortgage brokers through Wall Street are responsible for making the toxic loans that crashed the mortgage market, the bank regulators are responsible for failing to stop the problem before it got out of hand.<sup>59</sup> Although regulators received warning from all parts of the country, over a number of years, about many different providers in the subprime and non-traditional market, these warnings were shrugged off.<sup>60</sup>

Shortly after trade press began reporting data on subprime originations separately in 1996, alert regulators could have noticed an inordinate number of business failures from the list of originators. By 2005, a cursory look at the year-by-year list of top subprime originators would have shown an unsettling number of them had collapsed of their own weight or had been the targets of major law enforcement actions. For example, two of the three top subprime originators in the five years between 1998 and 2002 were the subject of state and FTC actions by the end of 2002, each ending in record settlements in the hundreds of millions of dollars. After the crackdown on Household and Associates, Ameriquest jumped to the top spot for 2003-2005 using similar unfair, deceptive, and illegal practices. Together, these three entities perched at the top of the subprime market over an eight year period, and together, they were hit with over a billion dollars in liability as a result of enforcement actions. That should have been a clue that there were fundamental problems in the subprime market.

In 2006, when CRL looked at the longitudinal performance of about 6 million subprime loans, our study found that subprime loans had a very high failure rate from the earliest vintages we studied. Subprime loans originated in years 1998 to 2001 had already failed at a rate of one in four or one in five by spring of 2005, and 2003 originations were already on that same trajectory by spring of 2005.<sup>61</sup> Yet most of the Washington regulators continued to oppose regulation, asserting that it would have the “unintended consequence” of impeding access to credit.

A good regulatory system could have and should have followed through on these warnings. But both the OTS and the OCC looked the other way. For example, even as Washington Mutual had OTS examiners permanently on-site from 2004 to 2006, risky products constituted half of its real estate loans. By mid-2008, over a quarter of its 2006-07 vintage subprime loans were delinquent.<sup>62</sup> Similarly, while the OCC consistently denies that national banks originated toxic subprime loans, some OCC entities, such as Wells Fargo, did indeed make harmful subprime loans, and evidence is now becoming public that Wells steered minority borrowers to those loans.<sup>63</sup> (The OCC has been careful not to deny that national banks made many risky Alt-A loans, which have aged as badly as subprime loans.)



The OTS and OCC also failed in their responsibility to enforce the Equal Credit Opportunity Act (ECOA) and its implementing regulations.<sup>64</sup> From 2000 to 2008, the OTS made only two referrals under ECOA to the U.S. Department of Justice of matters involving race or national discrimination in mortgage lending, and the OCC made zero.<sup>65</sup>

The inaction on the part of the OTS and OCC is not surprising in light of the regulatory capture and charter arbitrage the current system enabled. Both regulators are funded in significant part by assessments levied on the institutions they regulate. As a result, the agencies came to view the institutions they regulated as their paying customers, and they were reluctant to take action that could cause their customers to switch their charter to another regulator. Ultimately, these agencies spent years defending practices that hurt consumers and that contributed in no small part to the housing meltdown.

Similarly, in 1994, the Federal Reserve Board was given authority by Congress to regulate mortgage origination, but it did not exercise its authority for well over a decade. When it finally did issue such rules in the summer of 2008, these rules applied only to the already-defunct subprime market, thereby providing a classic example of closing the barn door after the horses are gone. Far earlier, the Federal Reserve should have banned the most egregious mortgage lending practices pervasive throughout the subprime market, including teaser rate loans made with no regard for the ability to repay; lender-paid incentives to brokers to steer borrowers into more expensive loans than they qualified for; and large prepayment penalties that either trapped borrowers into high-cost loans or stripped them of home equity upon refinancing.

In light of these regulatory failures, CRL considers it crucial to create a single agency to protect consumer interests, such as the Consumer Financial Protection Agency embodied in legislation that passed the House of Representatives last month.<sup>66</sup> The Consumer Financial Protection Agency would gather in one place the consumer protection authorities currently scattered across several different agencies, and would create a federal agency whose single mission is to protect our families and our economy from consumer abuse.

The design of the Agency is appropriately balanced to enhance safety and soundness and allow appropriate freedom and flexibility for innovation while providing effective consumer protection. Highlights include the following:

- The Agency would have essential rule-making authority to prevent abusive, unfair, deceptive and harmful acts and practices and to ensure fair and equal access to products and services that promote financial stability and asset-building on a market-wide basis.
- The Agency would have strong enforcement tools, along with concurrent authority for the States to enforce the rules against violators in their jurisdictions.

- The Agency would preserve the ability of states to act to prevent future abuses so that States would not be hamstrung in their efforts to react to local conditions as they arise.
- The Agency would have access to the real-world, real-time information that will best enable it to make evidence-based decisions efficiently.

In other areas of the economy, from automobiles and toys to food and pharmaceuticals, America's consumer markets have been distinguished by standards of fairness, safety and transparency. Financial products should not be the exception – particularly since we have demonstrated that it is the subprime mortgage products themselves that raised the risk of foreclosure. A strong, independent consumer protection agency will keep markets free of abusive financial products and conflicts of interest. Dedicating a single agency to this mission will restore consumer confidence, stabilize the markets and put us back on the road to economic growth.

**V. It is crucial to stop as many foreclosures as possible and interrupt the downward cycle of housing price declines and continued economic weakness.**

As goes the housing sector, so goes the economy. Not only does it reflect badly on us as a society that we would permit so many people to lose their homes, but the enormous costs both to homeowners and to state and local governments will continue to drag the economy down (it is worth noting that these external costs are not accounted for by the HAMP program's net present value analysis). A continued increase in foreclosures could lead to a double-dip recession or a slower and less robust recovery. For this reason, it is imperative that we continue to try to stop foreclosures and restore health to the housing market, even as it becomes clear that this task is much more daunting than some may have imagined. With no easy solution to this problem, all stakeholders must work together to come up with innovative, workable strategies that can adapt as circumstances change.

**A. Ensure that homeowners have adequate equity in their homes to continue with successful homeownership by reducing principal balances on troubled loans.**

Either within the HAMP program or through another mechanism, it is crucial to ensure that homeowners have equity in their homes. Many analysts believe that principal reduction is ultimately the only way to help the housing market reach equilibrium and begin to recover.<sup>67</sup>

While the overall percentage of American mortgages that are underwater is estimated to be 23 percent,<sup>68</sup> we can assume that percentage is far higher for homeowners who are having trouble affording their mortgage.<sup>69</sup> It is also higher in certain geographic areas, such as California, Nevada, Florida, and Arizona. This problem was caused by the extreme housing price declines triggered by risky lending, and in some cases is exacerbated by the mortgage product itself, such as POARMs.

Recent research has shown a strong correlation between negative equity and mortgage delinquency.<sup>70</sup> Homeowners who are underwater have no cushion to absorb financial difficulties. Furthermore, in some cases, homeowners who are unlikely to move into a positive equity position have fewer incentives to stay in the home or make the necessary ongoing investments in maintenance.<sup>71</sup> For these homeowners, even the reduction of monthly payments to an affordable level does not fully solve the problem. As a result, homeowner equity position has emerged as a key predictor of loan modification redefault, more so than unemployment or other factors.<sup>72</sup>

Negative equity is of particular concern in the case of POARMs. Because of the negative amortization feature and because their origination was concentrated in high-cost areas, many POARMs are very deeply underwater. (The vast majority of POARM borrowers chose to make the minimum payment permitted, at least while they were still paying on their loan, meaning most of these loans were negatively amortizing even as housing prices declined.) As noted in Section I, POARMs are failing at a stunning rate. Unfortunately, because of the way these loans were structured, the current design of HAMP is not able to help many POARM borrowers get their payments to an affordable level. Minimum payments on these loans are so low that it is hard to restructure the loans without raising the monthly payments. What's more, many POARMs already have a 40-year term, so a term extension cannot help either. The only way to help POARM borrowers in a sustainable way is to reduce principal.<sup>73</sup>

The OCC's Mortgage Metrics report indicates that even as loan modification activity ramps up, principal reduction is still relatively rare. One context in which it occurs is in portfolio loans with no second liens,<sup>74</sup> which suggests that banks understand the usefulness of principal reduction but that in situations where there is a conflict of interest between the investor and the bank that owns the servicer, or where the reduction requires investor permission or a mortgage buyback, servicers are not willing to do what it takes to get to the same result. Or, in some cases there may be a basic conflict of interest between the servicer and any loan owner, bank, or investor, because servicers derive the bulk of their income from the monthly servicing fee, which is set as a percentage of the outstanding loan principal balance in the pool.

Ultimately, it is likely that the only way principal reduction is ever going to happen is if it is required as part of HAMP or a program like HAMP, and if there are financial incentives for taking the writedown. Alternatively, loans could be removed from the control of the servicers in some way, such as by requiring servicers to pass the account to a specialty servicer at a certain level of delinquency.<sup>75</sup> It also may be useful to consider policies that will make it easier for investors to buy loans out of pools, or consider whether the government should exercise its eminent domain authority to buy loans out of pools.<sup>76</sup> We do not have a detailed proposal, but we believe it is crucial to explore all avenues.

So far, the only policy reason advanced for the Treasury's failure to incorporate a principal reduction into HAMP is the fear of moral hazard. While this fear is certainly

understandable, given the relatively small numbers of homeowners strategically defaulting at present,<sup>77</sup> we think it is not anywhere near the problem that it has been made out to be. It should be possible to build numerous safeguards into the application process, narrowly tailoring eligibility and either phasing in the reduction over time or creating a shared equity component that would kick in upon sale of the home. If principal reduction is indeed a crucial component of stopping foreclosures, a fear of moral hazard should not stand in the way of additional experiments in this area. Finally, if principal reduction is pursued, it is crucial to ensure that homeowners are not hit with a steep tax bill.<sup>78</sup> Although Congress attempted in 2007 to exempt mortgage loan forgiveness from income tax, the legislation does not cover all mortgage debt and due to complex tax filing requirements, the IRS estimates that only 1 percent of all eligible taxpayers have actually claimed their exemption. Additional legislation will be required to ensure that millions of homeowners don't have their mortgage modified only to be knocked back down either by a tax bill or by a tax lien that they may not even know about.

### **B. Pass legislation mandating loss mitigation prior to foreclosure.**

Ultimately, we have seen that voluntary foreclosure prevention programs simply do not work. Thus, we believe that foreclosure prevention programs will only work if mortgage loan servicers are required by law to conduct loss mitigation prior to instituting foreclosure proceedings. For government loan programs such as FHA and VA, this requirement is already in place. The most effective way to reach this goal is for Congress to pass legislation requiring loss mitigation and including a private right of action.<sup>79</sup>

### **C. Lift the ban on judicial modifications of mortgages on primary residences**

Judicial modification of loans is available for owners of commercial real estate and yachts, as well as subprime lenders like New Century or investment banks like Lehman Bros., but is denied to families whose most important asset is the home they live in. In fact, current law makes a mortgage on a primary residence the only debt that bankruptcy courts are not permitted to modify in chapter 13 payment plans.

Permitting judges to modify mortgages on principal residences, which carries *zero cost to the U.S. taxpayer*, has been estimated to potentially help more than a million families stuck in bad loans keep their homes.<sup>80</sup> It would also help maintain property values for families who live near homes at risk of foreclosure. It would address the “moral hazard” objections to other modification proposals current under consideration, as the relief it provides would come at a substantial cost to the homeowner—including marring the homeowner's credit report for years to come and subjecting the homeowner's personal finances to strict court scrutiny. And it would complement the various programs that rely on voluntary loan modifications or servicer agreement to refinance for less than the full outstanding loan balance.

Proposals to lift this ban have set strict limits on how it must be done. Such proposals would require that interest rates be set at commercially reasonable, market rates; that the

loan term not exceed 40 years; and that the principal balance not be reduced below the value of the property. And if the servicer agrees to a sustainable modification, the borrower will not qualify for bankruptcy relief because they will fail the eligibility means test. As Lewis Ranieri, founder of Hyperion Equity Funds and the person who popularized mortgage securitization, has been arguing for more than a year, such relief is the only way to break through the problem posed by second mortgages.<sup>81</sup>

#### **D. Fix some of the major problems with the HAMP program.**

Finally, it is crucial that we fix some of the major problems with the HAMP program to achieve the necessary and desired results.<sup>82</sup> This program, initially projected to help three to four million borrowers, works by reducing homeowner payments to an affordable level, defined as a 31 percent debt-to-income ratio. After nine months of operation, approximately 697,000 homeowners are now in a trial modification, yet only about 31,000 of those have received a permanent loan modification.<sup>83</sup> What's more, early indications are that close to a quarter of these trial modifications have failed prior to the end of the three-month trial period, some failing in the first month.<sup>84</sup> Homeowners and their advocates report that the program is hard to access, and the program itself still presents serious barriers to mass loan modifications.<sup>85</sup> The program's effectiveness has been hampered by a severe problem with servicer capacity, by a piece-by-piece rollout of complementary programs addressing second liens and short sales, and by lagging compliance procedures or other responses to widespread failures to comply with program guidelines.

In addition to providing for principal reduction, as discussed above, several relatively simple but important improvements could help extend the reach and improve the effectiveness of the HAMP program:

- **Do not permit foreclosures to be initiated or, if already initiated, to proceed while servicers evaluate eligibility for loan modifications or other non-foreclosure options.** Because servicers are not barred from proceeding on a parallel track toward foreclosure while a HAMP evaluation is pending, homeowners are receiving a confusing mix of communications from their lender, some of which tell the borrowers they are being considered for HAMP, but others of which warn of an impending foreclosure sale. This mixed message may well lie at the heart of several vexing problems, including the failure of some borrowers to send in all their documentation, the early redefault of many trial modifications, and the difficulty servicers have reaching certain borrowers. In addition, the continuation of the foreclosure process often means that the servicers' lawyers bill thousands of dollars in attorneys fees that the homeowners are then expected to pay. Finally, although HAMP guidelines prohibit the actual foreclosure sale from taking place prior to a HAMP evaluation, some sales are taking place anyway due to poor communications between servicers and their outside foreclosure attorneys regarding HAMP are minimal.<sup>86</sup>

- **Create a program to assist homeowners who have lost their jobs and do not have nine months of guaranteed unemployment income.** There are at least two potential solutions to this problem. The first is to add a payment forbearance component to HAMP that would give unemployed homeowners a period of time during which they do not need to pay their mortgage, without any additional fees or charges accruing. While we are not certain of the right length, it is clear that the typical three-month or even six-month forbearance will be inadequate for many homeowners. Another proposal is to create a low-cost loan fund similar to a program created by the state of Pennsylvania to provide loans to unemployed homeowners to help them pay their mortgage.<sup>87</sup>
- **Make individual NPV analyses available to homeowners and their representatives.** Servicers should be required to provide borrowers with the numerical results of the NPV calculations, rather than the mere result that modifying their loan would pass or fail the test, as well as with the values used in the analysis. Although disclosure of some of these values is required now, the most important value – the property valuation – is not yet available, yet it is one of the inputs with the greatest impact on the results.
- **Provide an independent appeals process easily accessible by homeowners.** Freddie Mac’s compliance program aims to ensure that servicers abide by the program’s guidelines, but it is not a process accessible by an individual homeowner. Homeowners may now contact the HOPE hotline for help in reconnecting with their servicer, but the HOPE hotline does not have any authority to enforce or monitor compliance with program requirements. Homeowners need access to an independent appeals process in addition to any internal review process they can access within the servicer.
- **Permit homeowners who experience additional adverse life events to be eligible for additional HAMP modifications.** Even after a homeowner is paying their monthly payments due under a HAMP loan modification, life events may occur that would further alter their ability to repay the loan, such as job loss, disability, or the death of a spouse. Some servicers provide some modifications upon re-default as part of their loss mitigation program; this approach should be standard and mandated, and should include continued eligibility for HAMP modifications rather than only specific servicer or investor programs.
- **Clarify that homeowners in bankruptcy are eligible for the HAMP program.** As a result of the HAMP guidelines providing servicer discretion on whether to provide homeowners in bankruptcy access to loan modifications under the program, homeowners generally are being denied such loan modifications. The HAMP guidelines should explicitly provide that servicers must consider a homeowner seeking a modification for HAMP even if the homeowner is a debtor in a pending bankruptcy proceeding.

## **VI. As a result of the foreclosure crisis, efforts to promote homeownership for lower-income or minority homebuyers have been set back considerably.**

The mortgage foreclosure crisis and resulting dramatic scaling back of mortgage lending has had grave consequences for those lower-income and minority households desiring to become homeowners. The consequences of predatory lending have effectively set the clock back to the mid-1990s, when underserved borrowers with less than perfect credit struggled to access any mortgage credit.

From the subprime boom years of the early 2000s, where irresponsible and unsustainable mortgage credit was all too easily available, the pendulum has swung to the other extreme, leading to overly tight lending standards. Fannie Mae, Freddie Mac, mortgage insurers and most lenders today have credit score floors of 620 and in some instances substantially higher. Most lenders are requiring substantial down payments, and even FHA will soon be raising down payments or other upfront closing costs and establishing new credit score minimums.

Further evidence of the consequences of the tightening of credit eligibility comes from recently released 2008 HMDA data. These data show that that mortgage application denial rates for minorities exceeded those for whites and that minorities were increasingly reliant on FHA and VA for access to any mortgage credit.<sup>88</sup> More than a third of African-American purchase applicants were denied financing in 2008, compared to 30 percent for Hispanics and just 13.2 percent for whites.<sup>89</sup> Minority borrowers relied particularly heavily on FHA and VA for new purchase loans: More than 60 percent of African-American purchase loans were backed by FHA or VA, as were 50 percent of Hispanic borrowers.<sup>90</sup>

Moreover, many borrowers have suffered damage to their credit scores due to no wrongdoing of their own, which might nevertheless hinder their ability to qualify for mortgages or other forms of credit going forward. There are many examples: borrowers who experienced foreclosures from irresponsible loans with no meaningful underwriting, verification of income or other evaluation of the borrower's ability to repay. Similarly, the New York Times recently reported that borrowers who have received loan modification programs but without ever missing or being late on mortgage payments can suffer credit score impairments, based only on the servicers use of outdated credit scoring designations.<sup>91</sup> In addition, many credit card companies have executed across the board reductions in credit balances without regard to the cardholder payment history, resulting in negative credit scoring consequences tens of thousands of cardholders.

### **Conclusion**

Today's foreclosure crisis is arguably the most significant economic challenge this country has faced since the Great Depression, and the stakes are high. Not only have millions of families lost their homes, but the crisis is responsible for more than \$1.86 trillion in additional lost wealth.<sup>92</sup> As foreclosures mount, these related costs will only grow worse.

Even under a best-case scenario, the current crisis will continue and fester if interventions remain on the current narrow course. To make a real difference in preventing foreclosures and reducing associated losses, we need a multi-pronged strategy that strengthens the way current foreclosure prevention programs are implemented and also invests in new approaches. We also need better regulatory protection through a dedicated consumer protection agency.

As policymakers take actions to address the immediate crisis, it is our hope that they also will be mindful of policy failures that enabled the situation. Economic cycles and housing bubbles may always be with us, but the experience of recent years vividly shows the value of sensible lending rules and basic consumer protections, even during economic booms. It is critically important that policymakers translate the lessons of this crisis into sensible rules to prevent another disaster in the future.

We stand ready to assist the Commission as you continue to investigate this crisis over the coming year, and we look forward to your findings on these matters of utmost importance to America.

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<sup>1</sup> CRL is an affiliate of Self-Help, a nonprofit community development financial institution that consists of a credit union and a non-profit loan fund. For close to thirty years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to get affordable home loans. In total, Self-Help has provided over \$5 billion of financing to 55,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America. Self-Help's lending record includes an extensive secondary market program, which encourages other lenders to make sustainable loans to borrowers with blemished credit.

<sup>2</sup> Pico National Network and Center for Responsible Lending, *Common-Sense Solutions for Saving Homes and Communities* (Jan. 30, 2009), at 5, available at <http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/common-sense-solutions-for-saving-homes-and-communities.pdf>.

<sup>3</sup> See, e.g., "Housing Starts and Vacant Units: No 'V'-Shaped Recovery, Calculated Risk (Nov. 15, 2009), available at <http://www.calculatedriskblog.com/2009/11/housing-starts-and-vacant-units-no-v.html>; Dean Baker, testimony before the Congressional Oversight Panel "The Failures of TARP" (Nov. 19, 2009).

<sup>4</sup> MBA National Delinquency Survey, Nov. 19, 2009 [hereinafter "MBA National Delinquency Survey"].

<sup>5</sup> First American Core Logic Negative Equity Report Q32009, available at <http://www.facorelogic.com/newsroom/marketstudies/negative-equity-report.jsp>.

<sup>6</sup> Rod Dubitsky, Larry Yang, Stevan Stevanovic and Thomas Suehr, *Foreclosure Update: over 8 million foreclosures expected*, Credit Suisse (December 4, 2008) (projecting 10 million foreclosures by 2012 at current unemployment rates) [hereinafter "Credit Suisse Projections"]; Jan Hatzius and Michael A. Marschoun, *Home Prices and Credit Losses: Projections and Policy Options*, Goldman Sachs Global Economics Paper (Jan 13, 2009) (projecting 13 million foreclosures by 2014) at 16.

<sup>7</sup> MBA National Delinquency Survey.

<sup>8</sup> Hope Now Phase I National Data (November 2009), available at <https://www.hopenow.com/industry-data/Summary%20Charts%20Nov%202009%2020100104%20v2.pdf>.



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<sup>9</sup> Susan Saulny, Banks Starting to Walk Away on Foreclosures, New York Times (March 29, 2009), available at <http://www.nytimes.com/2009/03/30/us/30walkaway.html>.

<sup>10</sup> Id.

<sup>11</sup> MBA National Delinquency Survey. Other states with exceedingly high rates include Maine, Rhode Island, Delaware, Georgia, Louisiana, Massachusetts, Hawaii, South Carolina, Connecticut, Wisconsin, Kentucky, and Minnesota.

<sup>12</sup> OCC and OTS Mortgage Metrics Report (Q2 2009), available at <http://www.occ.treas.gov/ftp/release/2009-118a.pdf>.

<sup>13</sup> Id.

<sup>14</sup> “Fitch RMBS Loss Metrics,” Fitch Ratings, Residential Mortgage Backed Securities Group (Jan. 2010).

<sup>15</sup> A. Frank, A. Rothschild, Y. Shen, “Monthly Review of Prime and Near-Prime Non-Agency,” RMBS Observer, Global Markets Research, Deutsche Bank Securities, Inc. (Jan. 4, 2010).

<sup>16</sup> MBA National Delinquency Survey.

<sup>17</sup> MBA National Delinquency Survey. Please note that the MBA survey did not report prime and subprime loans as separate categories until Q11998. For the years 1979-1997, the reported delinquency rates for all conventional loans was used. In addition, it is likely that the prime delinquency rate reported in the MBA survey includes some portion alt-a loans.

<sup>18</sup> For methodology, *see* Center for Responsible Lending, “Soaring Spillover: Accelerating Foreclosures to Cost Neighbors \$502 Billion in 2009 Alone; 69.5 Million Homes Lose \$7,200 on Average; Over Next Four Years, 91.5 Million Families to Lose \$1.9 Trillion in Home Value; \$20,300 on Average” (May 2009), available at <http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-09.pdf>.

<sup>19</sup> Center for Responsible Lending, *Continued Decay and Shaky Repairs: The State of Subprime Loans Today*, (Jan. 8, 2009), available at <http://www.responsiblelending.org/issues/mortgage/research/continued-decay-and-shaky-repairs-the-state-of-subprime-loans-today.html>.

<sup>20</sup> G. Thomas Kingsley, Robin Smith, & David Price, *The Impact of Foreclosures on Families and Communities*, The Urban Institute, (May, 2009), at 21, Figure 3.

<sup>21</sup> D. Pelletiere, “Renters in Foreclosure: Defining the Problem, Identifying Solutions,” National Low-Income Housing Coalition (Jan 2010), available at <http://dsl-router.nlihc.org/doc/renters-in-foreclosure.pdf>.

<sup>22</sup> The “Helping Families Save Their Home Act of 2000,” signed into law by President Obama in May 2009, provided that month-to-month tenants must receive 90 days’ notice before having to move out and that tenants with leases may stay until the end of their lease (unless the owner plans to occupy the property, in which case they also get 90 days’ notice).

<sup>23</sup> Also, many tenants are not aware of their right to stay in their homes, and when they receive a notice from a bank lawyer naming their landlord and seeking eviction, they leave regardless of their legal rights. *See, e.g.*, Testimony of Deborah Cuevas Hill, The Legal Aid Society of the District of Columbia, before the Committee on Public Services and Consumer Affairs, Council of the District of Columbia (May 28, 2009), available at <http://www.legalaiddc.org/issues/documents/TestimonyreTOPALegislation.pdf>

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<sup>24</sup> “Meeting Multifamily Finance Housing Needs During and After the Crisis: A Policy Brief”, Joint Center for Housing Studies, Harvard University (Jan. 2009), available at [http://www.jchs.harvard.edu/publications/finance/multifamily\\_housing\\_finance\\_needs.pdf](http://www.jchs.harvard.edu/publications/finance/multifamily_housing_finance_needs.pdf).

<sup>25</sup> Id.

<sup>26</sup> See Center for Responsible Lending, “Subprime Lending: A Net Drain on Homeownership” (Mar. 27, 2007), at 3, available at <http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/Net-Drain-in-Home-Ownership.pdf>

<sup>27</sup> Id.

<sup>28</sup> For a much longer discussion of the roots of today’s crisis, see Testimony of Eric Stein, Center for Responsible Lending, before the Senate Committee on Banking (Oct. 16, 2008), available at <http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/senate-testimony-10-16-08-hearing-stein-final.pdf>.

<sup>29</sup> Chairman Bernanke made this point in a recent presentation. See “Housing, Housing Finance, and Monetary Policy,” remarks by Ben Bernanke, Chairman, Board of Governors of the Federal Reserve System, Federal Reserve Bank of Kansas City’s Economic Symposium (August 31, 2007), at 16-17.

<sup>30</sup> Berkshire Hathaway Annual Report (2002).

<sup>31</sup> See Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); Office of Thrift Supervision, Treasury (OTS); and National Credit Union Administration (NCUA), “Illustrations of Consumer Information for Hybrid Adjustable Rate Mortgage Products,” (Docket No. OTS-2008-0003) (Apr. 25, 2008), at note 7 and text; Inside B&C Lending (Dec. 8, 2006).

<sup>32</sup> For more details on yield-spread premiums and other originator compensation, see Comments of the Center for Responsible Lending, Consumer Federation of America, and the National Consumer Law Center, Comment on Proposed Rules Regarding Reg Z (Dec. 24, 2009), available at <http://www.responsiblelending.org/mortgage-lending/policy-legislation/regulators/CRL-et-al-Comment-YSP-Steering.pdf>.

<sup>33</sup> See Testimony of Martin Eakes before the Joint Economic Committee (Sept. 19, 2007), at 9-10, available at <http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/senate-sept-07-final.pdf>.

<sup>34</sup> It is popular, although incorrect, to blame the Community Reinvestment Act (CRA) and Fannie Mae and Freddie Mac (the GSEs) for the foreclosure crisis. For a complete discussion of why CRA and the GSEs did not cause the crisis, see Testimony of Eric Stein, Center for Responsible Lending, before the Senate Committee on Banking (Oct. 16, 2008), available at <http://www.responsiblelending.org/pdfs/senate-testimony-10-16-08-hearing-stein-final.pdf>.

<sup>35</sup> Based on data collected under the Home Mortgage Disclosure Act for loans made in 2006, the average subprime loan amount for all owner-occupied, first lien, single-family homes was \$205,700. The median price for purchase loans was \$159,000.

<sup>36</sup> Rick Brooks and Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy As Housing Boomed, Industry Pushed Loans To a Broader Market*, The Wall Street Journal (Dec. 3, 2007) at A1.

<sup>37</sup> Letter from the Coalition for Fair and Affordable Lending (“CFAL”) to Ben S. Bernanke, Sheila C. Bair, John C. Dugan, John M. Reich, JoAnn Johnson, and Neil Milner (January 25, 2007), at 3, on file with CRL. CFAL is an industry group that represents subprime lenders.

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<sup>38</sup> See e.g., Yuliya Demyanyk, “Ten Myths About Subprime Mortgages”, Economic Commentary, Federal Reserve Bank of Cleveland (May 2009) (available at <http://www.clevelandfed.org/research/commentary/2009/0509.pdf>); Karen Weaver, “The Sub-Prime Mortgage Crisis: A Synopsis” Deutsch Bank (2008) (available at [http://www.globalsecuritisation.com/08\\_GBP/GBP\\_GSSF08\\_022\\_031\\_DB\\_US\\_SubPrm.pdf](http://www.globalsecuritisation.com/08_GBP/GBP_GSSF08_022_031_DB_US_SubPrm.pdf)) (concluding that subprime mortgages “could only perform in an environment of continued easy credit and rising home prices).

<sup>39</sup> Lei Ding, Roberto G. Quercia, Janneke Ratcliff, and Wei Li, “Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models,” Center for Community Capital, University of North Carolina at Chapel Hill (September 13, 2008), available at [http://www.ccc.unc.edu/abstracts/091308\\_Risky.php](http://www.ccc.unc.edu/abstracts/091308_Risky.php) [hereinafter “Risky Borrowers”].

<sup>40</sup> Center for Responsible Lending, *Steered Wrong: Brokers, Borrowers and Subprime Loans* (April 8, 2008), available at <http://www.responsiblelending.org/mortgage-lending/research-analysis/steered-wrong-brokers-borrowers-and-subprime-loans.pdf>.

<sup>41</sup> Id.

<sup>42</sup> Approximately 80 percent of subprime loans were made by players not covered under CRA. See Testimony of Professor Michael Barr of University of Michigan Law School, before the House Committee on Financial Services, February 13, 2008, (“More than half of subprime loans were made by independent mortgage companies not subject to comprehensive federal supervision; another 30 percent of such originations were made by affiliates of banks or thrifts, which are not subject to routine examination or supervision, and the remaining 20 percent were made by banks and thrifts [covered by CRA].”), available at [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/barr021308.pdf](http://www.house.gov/apps/list/hearing/financialsvcs_dem/barr021308.pdf).

<sup>43</sup> OCC News Release: Comptroller Dugan Says CRA Not Responsible for Subprime Lending Abuses, NR 2008-136. Indeed, the CRA seems to have had the opposite of the impact its critics claim. A recent study found that CRA-covered banks were less likely than other lenders to make risky, high-cost loans and were more likely to retain keep originated loans in their portfolio rather than sell them to investors. See Traiger & Hinckley LLP, *The Community Reinvestment Act: A Welcome Anomaly in the Foreclosure Crisis: Indications that the CRA Deterred Irresponsible Lending in the 15 Most Populous U.S. Metropolitan Areas*, Jan. 8, 2008, available at [http://www.traigerlaw.com/publications/traiger\\_hinckley\\_llp\\_cra\\_foreclosure\\_study\\_1-7-08.pdf](http://www.traigerlaw.com/publications/traiger_hinckley_llp_cra_foreclosure_study_1-7-08.pdf); [http://www.traigerlaw.com/publications/addendum\\_to\\_traiger\\_hinckley\\_llp\\_cra\\_foreclosure\\_study\\_1-14-08.pdf](http://www.traigerlaw.com/publications/addendum_to_traiger_hinckley_llp_cra_foreclosure_study_1-14-08.pdf).

<sup>44</sup> For further discussions of how CRA has aided rather than harmed communities, see Janet L. Yellen, Opening Remarks to the 2008 National Interagency Community Reinvestment Conference, San Francisco, California (March 31, 2008) (noting that studies have shown that the CRA has increased the volume of responsible lending to low- and moderate-income households); Ann F. Jaedicke, Testimony Before the Committee on Financial Services, US House of Representatives (February 13, 2008) (“over half of subprime mortgages of the last several years—and the ones with the most questionable underwriting standards—were originated through mortgage brokers for securitization by nonbanks, including major investment banks”); Michael S. Barr, *Credit Where It Counts: Maintaining a Strong Community Reinvestment Act*, Brookings Institution Research Brief (May 2005) (“encouraged by the law, banks and thrifts have developed expertise in serving low-income communities.”).

<sup>45</sup> See Fannie Mae Single Family Selling Guide, available at [http://www.allregs.com/efnma/index.asp?dv=0&id=a&ii=0&im=0&io=fnma&ip=/&iq=0&iv=0&iw=0&iy=0&iz=0&fc=0&fk=\\_&fm=0&fs=0&fv=0&sd=/&sm=1&sp=fnma&sq=\\_&st=\\_&sv=0&sx=/&sy=0&sz=0&t=0&tc=fnma&tp=/&td=0&ti=0&tm=0&to=fnma&tw=0&tv=0&tq=0&tx=/](http://www.allregs.com/efnma/index.asp?dv=0&id=a&ii=0&im=0&io=fnma&ip=/&iq=0&iv=0&iw=0&iy=0&iz=0&fc=0&fk=_&fm=0&fs=0&fv=0&sd=/&sm=1&sp=fnma&sq=_&st=_&sv=0&sx=/&sy=0&sz=0&t=0&tc=fnma&tp=/&td=0&ti=0&tm=0&to=fnma&tw=0&tv=0&tq=0&tx=/); Freddie Mac Seller/Service Guide, available at <http://www.freddiemac.com/sell/guide/#>.

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<sup>46</sup> *Inside the GSEs*, January 3, 2007, p. 4. These securities are divided into tranches, with the AAA tranches being the least risky, and for this reason the easiest to sell to investors. Fannie Mae and Freddie Mac purchased only AAA tranches. The harder securities to sell are those from the subordinate tranches. These were made palatable to investors through the creation of collateralized debt obligations, which repackaged BBB tranches into, in part, a new set of AAA tranches, which help to further market the securities; to my knowledge the GSEs did not invest in CDOs. It was the ability to fund the riskiest portion of subprime mortgage loans that made possible the explosive growth of subprime lending. See Pershing Square Capital Management, L.P., “Who’s Holding the Bag,” presentation, May 2007, available at <http://www.designs.valueinvestorinsight.com/bonus/pdf/TraSohnFinal.pdf>.

<sup>47</sup> See David Goldstein and Kevin G. Hall, “Private sector loans, not Fannie or Freddie, triggered crisis,” *McClatchy Newspapers* (Oct. 11, 2008) (“Between 2004 and 2006, when subprime lending was exploding, Fannie and Freddie went from holding a high of 48 percent of the subprime loans that were sold into the secondary market to holding about 24 percent, according to data from *Inside Mortgage Finance*, a specialty publication. One reason is that Fannie and Freddie were subject to tougher standards than many of the unregulated players in the private sector who weakened lending standards, most of whom have gone bankrupt or are now in deep trouble. During those same explosive three years, private investment banks—not Fannie and Freddie—dominated the mortgage loans that were packaged and sold into the secondary mortgage market. In 2005 and 2006, the private sector securitized almost two thirds of all U.S. mortgages, supplanting Fannie and Freddie, according to a number of specialty publications that track this data.”) available at <http://www.mcclatchydc.com/251/story/53802.html>.

<sup>48</sup> The first two lines on this graph (unemployment and mortgage delinquency) were circulated by the Mortgage Bankers Association as an advocacy tool to demonstrate that unemployment rather than bad practices was responsible for the current foreclosure crisis. However, once foreclosure data was added to the chart, it is clear that the relationship did not exist during previous downturns.

<sup>49</sup> Similarly, the “cure” rate – the rate at which homeowners who are behind on their mortgages catch up rather than default – has plummeted from an average of 45 percent from 2000-2006 (and even higher in earlier decades) to an astonishingly low 6.6 percent. See Fitch Ratings, *Delinquency Cure Rates Worsening for U.S. Prime RMBS* (Aug. 24, 2009).

<sup>50</sup> *Id.*

<sup>51</sup> For example, in September 2006, Robert Broeksmit of the Mortgage Bankers Association told Congress, “Our simple message is that the mortgage market works and the data demonstrate that fact,” and “I strongly believe that the market’s success in making these “nontraditional” products available is a positive development, not cause for alarm.” Statement of Robert D. Broeksmit, CMB Chairman, Residential Board of Governors, Mortgage Bankers Association, Before a Joint Hearing of the Subcommittee on Housing and Transportation and the Subcommittee on Economic Policy, U.S. Senate Committee on Banking, Housing and Urban Affairs, *Calculated Risk: Assessing Non-Traditional Mortgage Products*, available at [http://banking.senate.gov/public/\\_files/broeksmit.pdf/](http://banking.senate.gov/public/_files/broeksmit.pdf/). In May 2007, John Robbins of the Mortgage Bankers Association said, “As we can clearly see, this is not a macro-economic event. No seismic financial occurrence is about to overwhelm the U.S. economy. And we’re not the only ones who think so.” John M. Robbins, CMB, Chairman of the Mortgage Bankers Association at the National Press Club’s Newsmakers Lunch – Washington, D.C., available at [http://www.mortgagebankers.org/files/News/InternalResource/54451\\_NewsRelease.doc](http://www.mortgagebankers.org/files/News/InternalResource/54451_NewsRelease.doc).

<sup>52</sup> See Federal Reserve Board of Governors Proposed Reg. Z § 226.36 (d) and § 226.36(e).

<sup>53</sup> R.B. Avery, G.B. Canner, and R.E. Cook, Summer 2005. “New Information Reported under HMDA and Its Application in Fair Lending Enforcement,” *Federal Reserve Bulletin* (available at [http://www.federalreserve.gov/pubs/bulletin/2005/summer05\\_hmda.pdf](http://www.federalreserve.gov/pubs/bulletin/2005/summer05_hmda.pdf)); R.B. Avery, K.P. Brevoort, and G.B. Canner, September 2006. “Higher-Priced Home Lending and the 2005 HMDA Data,” *Federal Reserve Bulletin* (available at

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<http://www.federalreserve.gov/pubs/bulletin/2006/hmda/bull06hmda.pdf>); R.B. Avery, K.P. Brevoort, and G.B. Canner, December 2007. “The 2006 HMDA Data” Federal Reserve Bulletin (available at <http://www.federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf>); R.B. Avery, K.P. Brevoort, G.B. Canner, December 2008. “The 2007 HMDA Data”, Federal Reserve Bulletin (available at <http://www.federalreserve.gov/pubs/bulletin/2008/pdf/hmda07final.pdf>); R.B. Avery, K.P. Brevoort, G.B. Canner, September 2009, “The 2008 HMDA Data”, forthcoming in Federal Reserve Bulletin (available at <http://www.federalreserve.gov/pubs/bulletin/2009/pdf/hmda08draft2.pdf>).

<sup>54</sup> See R.B. Avery, K.P. Brevoort, and G.B. Canner (December 2007), Table 11, page A96.

<sup>55</sup> See Debbie Gruenstein Bocian, Keith Ernst and Wei Lee, “Race, Ethnicity and Subprime Loan Pricing.” *Journal of Economics and Business*, Vol. 60, Issues 1-2, January-February 2008, at 110-124; see also “Debbie Gruenstein Bocian and Richard Zhai, “Borrowers in High Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans,” January 2005, available at [http://www.responsiblelending.org/mediacenter/press-releases/archives/rr004-PPP\\_Minority\\_Neighborhoods-0105.pdf](http://www.responsiblelending.org/mediacenter/press-releases/archives/rr004-PPP_Minority_Neighborhoods-0105.pdf)

<sup>56</sup> See *Risky Borrowers*, supra note 39.

<sup>57</sup> This number is based on 9 million foreclosures projected by 2012 (Credit Suisse Projections, supra note 6) although the actual number of foreclosures is likely to be higher than we thought when we wrote this report. We combined the Credit Suisse projections with state distributions of 3Q2008 prime and subprime foreclosure starts as reported in 3Q 2008 MBA National Delinquency Survey. For each state, CRL applied the share of higher-rate loans that went to African-Americans and Latinos (from 2005-2007 Home Mortgage Disclosure Act data) to the total number of that state’s projected subprime foreclosures to arrive at the projected subprime foreclosures for each these groups. CRL derived a similar prediction for non-subprime foreclosures for each state for each group. The sum of the subprime and non-subprime foreclosures for each group became the total four-year projected foreclosures for each group.

<sup>58</sup> According to the 2007 Survey of Consumer Finance, the median net worth for white, non-Hispanic families in 2007 was \$171,200, compared to \$28,300 for families of color. See Table 4 of the Survey of Consumer Finance (Tables based on Internal Data, Estimates in Nominal Dollars), available at <http://www.federalreserve.gov/PUBS/oss/oss2/2007/scf2007home.html>.

<sup>59</sup> For a more detailed discussion of the failure of the federal banking regulators to prevent abusive lending practices, see Testimony of Eric Stein, supra note 28.

<sup>60</sup> For example, Professor Cathy Lesser Mansfield and Alan White, then a legal aid attorney, collected default and foreclosure data from SEC filings in 2000, and they found the foreclosure and seriously delinquent rate for subprime was 4.62 percent, compared to 2.57 percent for FHA loans, which serve comparable borrowers. Alan M. White and Cathy Lesser Mansfield, *Subprime Mortgage Foreclosures: Mounting Defaults Draining Homeownership* (May 12, 2000), presented to the HUD-Treasury Joint Task Force on Predatory Mortgage Lending (May, 2000), available at <http://facstaff.law.drake.edu/cathy.mansfield/subprime.html> [hereafter White-Mansfield study]; Testimony of Prof. Cathy Lesser Mansfield Before the U.S. House of Rep. Committee on Banking and Financial Services (May 24, 2000).

<sup>61</sup> Ellen Schloemer, et al, Keith Ernst, Wei Li, and Kathleen Keest, *Losing Ground*, Center for Responsible Lending (Dec. 2006) at Table 4, p. 13. A failed loan, as used here, is one which was either foreclosed on or “prepaid in distress,” meaning that the loan balance went to \$0 in any given month when it had been listed as in foreclosure, bankruptcy, or real-estate owned by the lender (REO) the previous month.

<sup>62</sup> This and other examples are described in detail in the Testimony of Patricia A. McCoy, testifying before the U.S. Senate Committee on Banking, Housing and Urban Affairs, (March 3, 2009), at 19-20, available at [http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing\\_ID=11be680d-04db-42cc-89bf-7fe4ffe4d9cd&Witness\\_ID=b6ba604a-d441-43e3-9951-1fbab4b11e57](http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=11be680d-04db-42cc-89bf-7fe4ffe4d9cd&Witness_ID=b6ba604a-d441-43e3-9951-1fbab4b11e57).

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<sup>63</sup> See Michael Powell, *Bank Accused of Pushing Mortgage Deals on Blacks*, New York Times, (June 6, 2009), available at [http://www.nytimes.com/2009/06/07/us/07baltimore.html?\\_r=1&partner=rss&emc=rss](http://www.nytimes.com/2009/06/07/us/07baltimore.html?_r=1&partner=rss&emc=rss).

<sup>64</sup> 15 U.S.C. § 1691c(a)(1)(A).

<sup>65</sup> Information on OCC's enforcement actions is contained in annual reports that the U.S. Attorney General provide to Congress. See U.S. Attorney General, Annual Report to Congress Pursuant to the Equal Credit Opportunity Act, available at [http://www.usdoj.gov/crt/housing/housing\\_special.php](http://www.usdoj.gov/crt/housing/housing_special.php). Despite the lack of referrals, in 2002 the DOJ filed a complaint alleging that Mid America Bank, an OTS-regulated bank, engaged in a pattern or practice of redlining on the basis of race.

<sup>66</sup> Wall Street Reform and Consumer Protection Act of 2009 (H.R. 4173), which passed the House of Representatives on December 11, 2009.

<sup>67</sup> See Testimony of Laurie Goodman before the House Financial Services Committee (Dec. 8, 2009), available at [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/goodman.pdf](http://www.house.gov/apps/list/hearing/financialsvcs_dem/goodman.pdf), see also Shawn Tully, Lewie Ranieri Wants to Fix the Mortgage Mess, Fortune Magazine (Dec. 9, 2009) [hereinafter "Ranieri Article"].

<sup>68</sup> First American Core Logic, *supra* note 5.

<sup>69</sup> Homeowners with equity in their homes are generally able to refinance into lower rate loans and are much less likely to get in a situation where they require assistance.

<sup>70</sup> Laurie Goodman, Roger Ashworth, Brian Landy, Ke Yin, Negative Equity Trumps Unemployment in Predicting Defaults, Amherst Mortgage Insight, Amherst Securities Group (Nov. 23, 2009) [hereinafter "Amherst Mortgage Insight"].

<sup>71</sup> Although many decry the phenomenon of "walkaways," when people voluntarily default on their mortgages, there are actually far fewer such walkaways than economic theory might predict. See, e.g., Roger Lowenstein, *Walk Away from your Mortgage!*, New York Times (January 10, 2010) (it would be economically rational for more people to walk away from their mortgages). However, it is clear that at some level, the disincentive of being underwater will have an impact on the homeowner's success in continuing with the mortgage.

<sup>72</sup> Andrew Haughwout, Ebiere Okah, and Joseph Tracy, *Second Chances: Subprime Mortgage Modification and Re-Default*, Federal Reserve Bank of New York Staff Report (December 2009).

<sup>73</sup> Servicers with large POARM books are moving many of these homeowners into 10 year interest-only loans, which is helpful in the short term but is ultimately only postponing the day of reckoning if the housing market does not enter another bubble period before 10 years is up.

<sup>74</sup> Amherst Mortgage Insight.

<sup>75</sup> See Testimony of Julia Gordon before the House Committee on Financial Services (Dec. 8, 2009), available at <http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/Gordon-Loan-Modification-Testimony-12-8-09-final.pdf> [hereinafter "Gordon Testimony"].

<sup>76</sup> See Howell Jackson, *Build a Better Bailout*, The Christian Science Monitor (Sept. 25, 2008), available at <http://www.csmonitor.com/Commentary/Opinion/2008/0925/p09s02-coop.html>; see also Andrew Jakabovics, *Sustainable Mortgage Modifications: Setting Clear Benchmarks to Measure Progress and Identifying Possible Next Steps to Contain the Foreclosure Crisis*, Center for American Progress (March 2009), available at [http://www.americanprogress.org/issues/2009/03/pdf/mortgage\\_modifications.pdf](http://www.americanprogress.org/issues/2009/03/pdf/mortgage_modifications.pdf).

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<sup>77</sup> Experian-Oliver Wyman Market Intelligence Report, *Understanding Strategic Default in Mortgages Part I*, Sept. 2009.

<sup>78</sup> See Gordon Testimony; see also National Taxpayer Advocate, *2008 Annual Report to Congress*, p. 341, 391-396.

<sup>79</sup> Bills are already pending in both chambers of Congress that would achieve this goal (H.R. 3451 and S. 1731).

<sup>80</sup> Mark Zandi, "Homeownership Vesting Plan," Moody's Economy.com (December 2008) (available at [http://www.dismal.com/mark-zandi/documents/Homeownership\\_Vesting\\_Plan.pdf](http://www.dismal.com/mark-zandi/documents/Homeownership_Vesting_Plan.pdf)).

<sup>81</sup> Lewis S. Ranieri, "Revolution in Mortgage Finance," the 9th annual John T. Dunlop Lecture at Harvard Graduate School of Design (Oct. 1, 2008), available at [http://www.jchs.harvard.edu/events/dunlop\\_lecture\\_ranieri\\_2008.mov](http://www.jchs.harvard.edu/events/dunlop_lecture_ranieri_2008.mov); Ranieri Article.

<sup>82</sup> We are only focusing here on the loan modification portion of the Administration's Home Affordable Program. The refinancing portion has also had somewhat more limited reach than had been anticipated. See news release from the Federal Housing Finance Agency (Nov. 2, 2009). We have not even addressed HUD's Hope for Homeowners (H4H) program because so far, it has not emerged as a viable alternative.

<sup>83</sup> Making Home Affordable Servicer Performance as of Nov. 2009, available at <http://www.financialstability.gov/docs/MHA%20Public%20121009%20Final.pdf>

<sup>84</sup> Renae Merle, *Quarter of Borrowers in Anti-Foreclosure Plan are Behind*, Washington Post (Dec. 5, 2009), available at <http://www.washingtonpost.com/wp-dyn/content/article/2009/12/04/AR2009120404449.html>.

<sup>85</sup> See Testimony of Alys Cohen, National Consumer Law Center, before the House of Representatives Subcommittee on Housing and Community Opportunity of the House Committee on Financial Services, September 9, 2009.

<sup>86</sup> One Pennsylvania bankruptcy judge has recently provided troubling details of how "communications" between servicers and their outside law firms take place almost entirely through automated systems without any human interaction. In re Taylor, 407 B.R. 618 (E.D. Pa. 2009). That judge concluded, "The thoughtless mechanical employment of computer-driven models and communications to inexpensively traverse the path to foreclosure offends the integrity of our American bankruptcy system."

<sup>87</sup> For more information on Pennsylvania's program, called the HEMAP program, see Gordon Testimony at 12.

<sup>88</sup> Steve Cook, *One-third of African-Americans are Turned Down for Mortgages*, UPI.com (Oct. 1, 2009), available at <http://www.upi.com/Real-Estate/2009/10/01/One-third-of-African-Americans-are-Turned-Down-for-Mortgages/7991254433528>.

<sup>89</sup> Id.

<sup>90</sup> Id.

<sup>91</sup> <http://bucks.blogs.nytimes.com/2010/01/05/how-loan-modifications-impact-credit-scores/?hp>.

<sup>92</sup> "Soaring Spillover Cost of Foreclosures," Center for Responsible Lending, available at <http://www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-accelerating-foreclosures-to-cost-neighbors-436-billion-in-2009-alone-73-4-million-homes-lose-5-900-on-average.html>.