JOINT ECONOMIC COMMITTEE
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SCHUMER ADDRESSES THE SUBPRIME HOUSING CRISIS AND POSSIBLE RECESSION AT THE BROOKINGS INSTITUTION

Joint Economic Committee Chairman Outlines Myths Surrounding the Subprime Housing Crisis, Addresses the Bush Administration's Failure to Respond, and Offers Policy Solutions To Keep Families in Their Homes and the Economy on Track

Washington, DC – U.S. Senator Charles E. Schumer, Chairman of the Joint Economic Committee and Chairman of the Senate Banking Subcommittee on Housing, Transportation, and Community Development, addressed the twin challenges of the subprime lending crisis and of a potential recession in a speech at the Brookings Institution today. In his speech, *"A Call to Action on the Subprime Mortgage Crisis: Putting Common Sense Ahead of Ideology"* Senator Schumer discussed the shortcomings of the Bush administration's recent measures to address the subprime mortgage crisis, the myths that have propelled this crisis, and proposed a series of major, alternative steps the federal government should take to protect homeowners from foreclosure and the U.S. economy from recession. Schumer joined former Treasury Secretary Lawrence Summers in the Economic Studies event.

"The subprime crisis has become a symbol of the Bush Administration's serious mishandling of so many economic and domestic policy priorities," Schumer said. "The housing mess, which has hit homeowners and neighborhoods with massive foreclosures, credit markets with mountains of debt, and the economy with weak job and economic growth, is further evidence that this administration is ideologically handcuffed and cannot step up to the plate to solve major problems."

<u>*Schumer offered seven policy solutions that would help address the subprime mortgage crisis:*</u>

1. **To alleviate the current crisis, ensure that there is someone on the ground to help out struggling borrowers.** Through their relationships within the community and with lending organizations, housing counseling agencies are able to bring troubled borrowers and their lenders together to begin working out mortgage problems. Senator Schumer, with Senators Brown and Casey, and with critical help from Senator Murray, got $180

million in the omnibus appropriations bill that passed last night in the Senate, over the Administration's objections, for foreclosure prevention counselors. However, more resources are needed.

2. **Provide additional flexibility to Fannie Mae and Freddie Mac to provide liquidity to the markets.** Senator Schumer introduced legislation that would temporarily raise the portfolio caps for Fannie and Freddie by 10%, with 85% of the increase targeted towards refinancing subprime borrowers. Schumer also introduced legislation that would raise the conforming loan limits for the GSEs. Secretary Paulson, as well as Chairman Bernanke, has supported an increase in the GSE's conforming loan limits. This kind of targeted help, although potentially more risky for the GSEs, is why they were created in the first place. These measures would increase liquidity to the troubled subprime and jumbo loan markets and make more refinancing options available for subprime borrowers.

3. **Introduce new legislation to provide additional liquidity to the markets.** This legislation will increase private activity bond cap and temporarily allow states and localities to use single-family tax-exempt bonds—known as Mortgage Revenue Bonds or MRBs—to refinance subprime loans at risk of foreclosure. Currently, mortgage refinancing is not permitted under the MRB program. The legislation will also allow states to use this increase in the bond cap for affordable multifamily rental housing, an important resource for families who have already lost their homes to foreclosure. The Schumer legislation would double the amount of increased bond cap that the Bush Administration has proposed; make a portion of the increased cap permanent, and give states and localities the flexibility to respond to a wide range of mounting housing needs.

4. **Amend the bankruptcy code to make primary home loans eligible for the same remedies that are available on other, less important debts.** Judicially mandated loan modifications could be a highly effective tool for helping families recover from subprime loans, but today's bankruptcy code prevents courts from providing relief on mortgage loans. In fact, the law singles out the home mortgage loan as the one debt the courts are not permitted to modify. Senator Schumer supports a measure that would amend the bankruptcy code to temporarily exclude primary home loans from the remedies that are available on other, less important debts. This would allow borrowers to pay the fair market value of their home and to keep that home, rather than seeing the home sold to a third party for its liquidation value.

5. **Enact major reforms to the rules that govern the mortgage lending industry, improving the regulation of mortgage brokers and non-bank lenders.** Federal laws are needed to impose new standards of care for mortgage originators, create a requirement that originators consider a borrower's ability to repay a loan, prohibit appraisal fraud, reduce or eliminate "liar loans", eliminate prepayment penalties and create effective remedies so that borrowers who do receive predatory or fraudulent loans have some recourse to restore their financial health. In May, Senator Schumer introduced the first legislation to do just that—the Borrower's Protection Act. Schumer also co-sponsored Senator Dodd's recently introduced bill, which preserves many of the original proposals in the Borrower's Protection Act.

6. **Create an easy-to-read one-page disclosure form with all of the information that a borrower needs to make an informed decision on their mortgage.** Senator Schumer introduced legislation to require the banking regulators to create such a one-page mortgage disclosure form with all of the critical information on payments and fees that would impact the borrower. This information will give borrowers a clearer picture of the agreement that they're signing and allow them to more easily compare loans to ensure that they get the best deal.

7. **Closely examine the role of that the rating agencies played in the explosive growth, and subsequent problems of the secondary mortgage market.** The risks associated with subprime mortgages and the related securities were drastically underestimated by the credit rating agencies. One reason for this, which merits closer examination: most rating agencies are paid by the companies they rate rather than by the investors who use the ratings. A more reliable rating system that provides accurate information about the value of securities will greatly reduce the fear and uncertainty that are creating the current credit crisis.

Schumer presented the four myths that have propelled the Bush Administration's inadequate response to the subprime mortgage crisis:

MYTH: Vastly expanded home ownership from subprime lending: Subprime lending led to millions of brand-new, first-time homeowners in America.
FACT: Only a small percentage of subprime borrowers were first time homeowners. According to the chief national bank examiner for the Office of Comptroller of the Currency, only 11 percent of subprime loans went to first-time buyers last year. According to the Center for Responsible Lending, the subprime crisis will lead to a net loss in homeownership.

MYTH: The unqualified borrower: Subprime borrowers couldn't have qualified for better loans, and thus that the subprime market is the only place they could have gotten a mortgage.
FACT: In truth, many of the subprime borrowers were eligible for prime loans. Based on the Wall Street Journal's analysis of borrowers' credit scores, 55 percent of subprime borrowers had credit scores worthy of a prime, conventional mortgage in 2005. By the end of last year that percentage rose to over 61 percent, according to their study.

MYTH: Borrowers can easily understand all the terms of their mortgage loans. When market participants have full knowledge about transactions, the results are efficient. And subprime borrowers had all of the information about their mortgage terms and payments at their fingertips before they signed their loan documents.
FACT: Mortgage documents seem to be designed to hide information from the borrower. The truth is that almost no one reads their entire mortgage document's fine print, few hire special real estate lawyers to walk them through the home purchase, and given the complexity of mortgage documents, many borrowers can be easily manipulated into bad loans by unscrupulous brokers and lenders.

MYTH: The free market, left alone, will fix everything: Left alone, free market forces will correct the disruptions caused by the subprime crisis.
FACT: The market did not contain this problem within the subprime segment. In fact, the crisis has spread into the global economy. In August of this year, a severe credit crunch in the U.S. credit markets began, forcing financial institutions to limit the amount of loans that they offered to individuals and companies. As the administration looked on, the credit crisis trickled into the Alt-A and prime mortgage markets, pushing up mortgage rates for borrowers with even the best credit. The tightening of lending and lack of confidence in credit quality has led to shrinking investment and consumption, a slowdown in domestic economic growth, and even threatens a slowdown in the global markets.

Senator Schumer's entire speech, as prepared for delivery: *"A Call to Action on the Subprime Mortgage Crisis: Putting Common Sense Ahead of Ideology"*

The Joint Economic Committee, established under the Employment Act of 1946, was created by Congress to review economic conditions and to analyze the effectiveness of economic policy.
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