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U.S. HOUSE COMMITTEE ON THE JUDICIARY

SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

"THE GROWING MORTGAGE FORECLOSURE CRISIS: IDENTIFYING SOLUTIONS AND DISPELLING MYTHS"

JANUARY 29, 2008

Chairperson Sánchez, Ranking Member Cannon, and members of the Subcommittee: I am Wade Henderson, president and CEO of the Leadership Conference on Civil Rights (LCCR). Thank you for the opportunity to testify in today's hearing on identifying solutions to address the growing epidemic of home mortgage foreclosures our nation is currently facing.

LCCR is the nation's oldest, largest, and most diverse coalition of civil rights organizations. Founded in 1950 by Arnold Aronson, A. Philip Randolph, and Roy Wilkins, the Leadership Conference seeks to further the goal of equality under law through legislative advocacy and public education. LCCR consists of approximately 200 national organizations representing persons of color, women, children, organized labor, people with disabilities, the elderly, gays and lesbians, and major religious groups. I am privileged to represent the civil and human rights community in submitting testimony for the record to the Committee.

There is a great deal that can be said about what led to this foreclosure crisis, what impact it will have, what could have been done to prevent it, and what our best options are now as our nation tries to face it. Today, I want to focus my remarks on one of the best of those options: H.R. 3609, the "Emergency Home Ownership and Mortgage Equity Protection Act of 2007." At the outset, I should add that LCCR fully supports the compromise version of this bill that was adopted last December by the full Committee. It is a strong and thoughtful proposal that will save hundreds of thousands of families from losing their homes in the coming years.

"The Growing Mortgage Foreclosure Crisis" – A Quick Overview

For the past several years, when I have testified or otherwise discussed the need for changes in our nation's mortgage lending system, I have usually gone into a detailed explanation of precisely what was going wrong, and what the likely consequences for homeowners and the economy would be. At this stage, with an obvious crisis now upon us, I no longer think that a lengthy background discussion is necessary. So I will briefly summarize instead.

As this Subcommittee is all too aware by now, the mortgage lending industry engaged in the widespread use of utterly reckless and predatory lending practices during the nationwide housing market "boom" that took place in the first half of this decade. While the use of *responsible* subprime lending can create meaningful homeownership opportunities for people who might otherwise be excluded, many borrowers were deceptively steered into expensive subprime mortgages even though they qualified for prime loans.[1] In addition, many lenders took exotic practices such as "2/28s," "interest-only," "pay-option," "low-doc" or "no-doc" mortgages, prepayment penalties, and "yield spread premiums," and made them commonplace, abandoning sensible loan underwriting standards in the process.[2] Such practices guaranteed that massive numbers of borrowers would be unable to handle their monthly payments, and would soon face the prospect of losing their homes.

The consequences are still unfolding, but one thing is certain: they will be staggering. Home foreclosure rates are rapidly increasing throughout the nation and, according to an estimate by the Center for Responsible Lending, as many as 2.4 million borrowers – just in the subprime market alone – are likely to lose their homes.[3] The wave of foreclosures will have an especially harsh impact on racial and ethnic minority homeowners who, according to several studies, were roughly two to three times more likely to be steered into high-cost loans than white borrowers, with strong disparities persisting even after credit factors were taken into account.[4] As such, LCCR and its member organizations have a large stake in policies aimed at mitigating this crisis.

<u>"Identifying Solutions" – The Merits of H.R. 3609</u>

Turning more directly to the subject of today's hearing, I want to briefly explain why LCCR strongly supports H.R. 3609, the "Emergency Home Ownership and Mortgage Equity Protection Act of 2007." I should add that we wholeheartedly endorse the version that was recently adopted

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[1] *See, e.g.* Rich Brooks and Ruth Simon, "Subprime Debacle Traps Even Very Credit-Worthy," *Wall Street Journal*, December 3, 2007 at A1.

[2] *See, e.g.* Comptroller of the Currency John C. Dugan, sharply criticizing widespread use of "no/low-doc" loans:

> Sound underwriting – and, for that matter, simple common sense – suggests that a mortgage lender would almost always want to verify the income of a riskier subprime borrower to make sure that he or she had the means to make the required monthly payments. But the norm appears to be just the opposite: nearly 50 percent of all subprime loans last year accepted stated income. . . . I do find it telling that, when faced with new housing market conditions, lenders have responded first by tightening standards on stated income. . . . Apparently verified income is viewed as a critical factor in determining whether a loan can be saved, which of course begs the question: if loan verification is such an important predictor of the borrower's ability to repay in the current environment, why wasn't it equally important when the loan was first made?

News Release: "Comptroller Dugan Expresses Concern Over 'Stated Income' Subprime Loans"; *Comptroller of the Currency*; May 23, 2007; available at http://www.occ.gov/ftp/release/2007-48.htm.

[3] Center for Responsible Lending, "Subprime Lending is a Net Drain on Homeownership," CRL Issue Paper No. 14 (available at http://www.responsiblelending.org/pdfs/Net-Drain-in-Home-Ownership.pdf), March 27, 2007.

[4] *See* Debbie Gruenstein Bocian, Keith S. Ernst, and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, at 19 (available at http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf), May 2006; National Community Reinvestment Coalition, *Income is No Shield Against Racial Differences in Lending: A Comparison of High-Cost Lending in America's Metropolitan Areas* (available at http://ncrc.org/pressandpubs/documents/NCRC%20metro%20study%20race%20and%20income%20disparity%20July%2007.pdf), July 10, 2007.

by the full Committee, and I want to thank you, Chairman Conyers, and Representatives Chabot and Miller for working out such a sensible compromise.

H.R. 3609 will give hundreds of thousands of borrowers who are in danger of foreclosure a chance to save their homes through the use of Chapter 13 bankruptcy proceedings. Under its terms, bankruptcy courts will have several options for saving subprime and nontraditional mortgages that would otherwise end in foreclosure: they can 1) reduce the principal owed on a subprime or non-traditional mortgage to reflect the actual value of the home, 2) reset interest rates to affordable-but-fair levels, and 3) eliminate prepayment penalties and other abusive fees. Taking a pragmatic approach, H.R. 3609's provisions will only apply to loans made between Jan. 1, 2000 and the date of enactment, and it will sunset after seven years. While we certainly think it would be a good idea to make these changes permanent, the compromise is well-targeted for the current foreclosure crisis and its benefits will be substantial.

We believe, for several reasons, that using bankruptcy proceedings to avert foreclosures is one of the best policy responses available for the ongoing home mortgage meltdown. One key advantage – especially as we face an economic slowdown of unclear proportions – is its cost. Because loan modifications in bankruptcy court do not involve public funds, H.R. 3609 will not give the appearance of a "bailout" or raise moral hazard issues. Indeed, for people who want to go through bankruptcy court to save their homes, it will still come at a heavy enough cost – monetary and otherwise – to encourage wiser financial decisions in the future.

At the same time, H.R. 3609 will benefit other homeowners and our economy at large. Every home that gets saved from foreclosure – or from abandonment by borrowers who anticipate it because they cannot refinance or modify their loans[5] – helps to protect the value of surrounding homes from being eroded, meaning that other homeowners will be less likely to find themselves "upside down" on their own mortgages – a vicious cycle that, if left unchecked, can lead to even more foreclosures.

Needless to say, empty houses are more than just eyesores; they also drain local government resources and can even pose serious public safety hazards. While H.R. 3609 will not save every home, we do believe that it will greatly help to control the "bleeding," protecting neighborhoods and communities from even more financial harm than they might otherwise experience – and hopefully for long enough to allow housing markets to recover on their own.

<u>"Dispelling Myths" – Opposition to H.R. 3609 Does Not Add Up</u>

For the reasons I have set out above, LCCR greatly appreciates your efforts to enact H.R. 3609, and we will do what we can to help. At the same time, however, I cannot help but notice that this is now the subcommittee's third hearing on the bill – and that you have taken the even more unusual step of holding today's hearing *after* the measure was already cleared by the full

[5] There is anecdotal evidence that some borrowers are resorting to so-called "jingle mail," in which they abandon homes following unsuccessful efforts at refinancing, short sales, or loan modifications. *See, e.g.* Gretchen Morgenson, "Cruel Jokes, and No One is Laughing," *New York Times*, Jan. 18, 2008; Peter Y. Hong and Andrea Chang, "Pain goes through the roof," *Los Angeles Times*, Jan. 23, 2008.

Committee. Between that fact, and the title that you chose for today's hearing, it appears there are still some very serious misconceptions about H.R. 3609 that are interfering with its prospects.

I find the opposition to H.R. 3609 to be especially frustrating because it is has generally come from industry representatives who, for many years, and despite the best efforts of civil rights and consumer groups, have been reluctant to fully acknowledge the true nature of the problem we are facing. To give you one example, as late as October of last year, an industry witness insisted before your subcommittee – as the industry repeatedly did throughout last year, even after the problems with unsustainable lending practices became painfully obvious to the public at large – that foreclosures are mostly the result of "unemployment, divorce, and illness," or temporary financial setbacks, and *not* the result of loan products themselves.[6] The staggering recent growth in foreclosure rates throughout the country, particularly for subprime and nontraditional loans, strongly suggests otherwise – and it is unsettling to speculate whether such industry posturing might have delayed efforts to mitigate that growth.

Opponents of H.R. 3609 have also suggested that the bill is not needed because the industry is working to resolve the foreclosure crisis. In particular, they point to evidence that the industry is increasing the use of loan modifications and repayment plans.

Without a doubt, I am encouraged that many lenders and servicers in the industry now acknowledge that there are serious problems, and are taking steps to save homeowners from mortgages that were virtually destined to fail. I am also proud that many LCCR member organizations have been working diligently throughout the country, as intermediaries between lender and borrowers, in these efforts to reduce home foreclosures.[7]

According to data recently published by the Mortgage Bankers Association, 53,573 permanent loan modifications were reported in the third quarter of last year. Another 182,702 borrowers

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[6] In an October 2007 hearing before this Subcommittee, Mortgage Bankers Association Chairman-Elect David G. Kittle told Rep. Hank Johnson (D-GA) that "we keep talking about the mortgage products putting these people into foreclosure. . . . There are three main reasons for a foreclosure, Congressman, are unemployment, divorce, and illness not the mortgage products. So that need[s] to be said." Hearing, U.S. House Subcommittee on Commercial and Administrative Law: "Straightening Out The Mortgage Mess: How Can We Protect Home Ownership And Provide Relief to Consumers in Financial Distress?" *Federal News Service*; October 30, 2007.

This mirrors previous statements by the MBA, *e.g.*: "There is no evidence that product choices by borrowers are determinative of defaults or foreclosures. Different products have different default rates but the product choice does not cause the default." Statement of John M. Robbins, CMB, Chairman of Mortgage Bankers Association, before U.S. House Subcommittee on Financial Institutions and Consumer Credit, March 27, 2007, at 14.

Similarly, Countrywide Financial Corp. Chief Executive Angelo Mozilo claimed in May 2007 that "regulation, in my opinion, has caused part of the problem. When they attacked the pay option and interest-only loans, that really put a dent in a lot of the product, which is perfectly good product." "Countrywide Chief Decries Subprime Regulation," *Reuters*, May 21, 2007.

[7] The National Fair Housing Alliance, for example, in partnership with fair housing centers in New Orleans and Gulfport, has been providing direct assistance for nearly two years to hurricane-affected homeowners whose mortgages are in default. Even if Hurricane Katrina had not struck the area, most of the borrowers would be facing foreclosure because their loans were never affordable relative to their incomes. Its efforts have resulted in a number of successfully modified loans.

were placed into temporary repayment plans, which are usually meant – and usually only effective – for making up a few missed payments caused by a temporary financial setback.[8]

Again, any modification of a troubled mortgage loan is a positive development. Yet the MBA's data also shows that the number of foreclosures in the same period, 384,388, dwarfed modifications by a nearly seven-to-one margin.[9] Furthermore, without further information about the nature of the modifications granted to date, it is not clear whether they are actually sustainable in the long run. Countrywide, for example, had previously acknowledged during an investor call that most of its modifications merely "involved deferring overdue interest or adding the past due amount to a loan," not reducing interest rates or principal balances.[10]

Another voluntary effort to stave off foreclosures, the so-called "Paulson plan," is also a positive development – but is also insufficient to deal with the national foreclosure crisis. It will only reach a small number of subprime borrowers who are expecting significant interest rate resets, not anyone whose loan has already reset – and for the small number of borrowers who do qualify, it will only buy time.

In short, we applaud any and all voluntary industry efforts to stave off foreclosures. But until they are *proven* to be sufficient, they cannot in any way be a substitute for meaningful, broad-based legislative intervention. The stakes are simply too high.

Opponents of H.R. 3609 also argue that allowing bankruptcy courts to modify loans will make credit more expensive. The Mortgage Bankers Association, for example, predicts that mortgage rates would increase from 1.5 to 2 percent due to the prospect of bankruptcy cramdowns.

If true, this would certainly pose a legitimate concern. Yet it is not clear, either from previous congressional testimony or other materials on its "Stop the Bankruptcy Cram Down Resource Center" website,[11] how the MBA arrived at this figure. More importantly, because the Conyers-Chabot substitute version of H.R. 3609 only allows Chapter 13 cramdowns on already-existing mortgages, and only in cases where foreclosure is imminent (which would otherwise result in far more expensive losses due to the foreclosure process), it is difficult – at best – to comprehend how the substitute bill would lead to higher interest rates on loans in the future.

In an effort to more fully understand the basis for the industry's concern about higher interest rates, I examined the materials on the MBA's website. One recent letter to the House of Representatives, signed by 12 organizations opposed to the compromise version of H.R. 3609, quoted a Congressional Budget Office report – a report that found that the cost of the bill "*would* be higher interest rates" (emphasis added).[12] Hoping that the CBO report might shed more light

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[8] Mortgage Bankers Association, "An Examination of Mortgage Foreclosures, Modifications, Repayment Plans, and Other Loss Mitigation Activities in the Third Quarter of 2007," Jan. 2008, at 22.
[9] *Id.*
[10] Gretchen Morgenson, "Can These Mortgages be Saved?" New York Times, Sept. 30, 2007; *see also* Center for Responsible Lending, "Voluntary Industry Modifications Insufficient to Address Foreclosure Crisis Alone; Judicial Modification Needed," CRL Issue Brief, Jan. 28, 2008.
[11] http://www.mortgagebankers.org/stopthecramdown.
[12] American Bankers Association, *et al.*, letter: "Oppose H.R. 3609, the Emergency Home Ownership & Mortgage Equity Protection Act," (undated), at 1, available at

on the issue, I looked at the report – which, instead, said that the cost "*could* be higher interest rates, although the magnitude of the increase is difficult to predict and could depend on the exact change in policy" (emphasis added).[13] Sadly, instead of answering my question about H.R. 3609, the report only raised new questions about its most vocal opponents.

Like the industry opponents of H.R. 3609, I too am concerned about the need to preserve access to affordable credit for underserved populations. However, if the industry wants to avoid passing the risk of losses in bankruptcy proceedings on to borrowers, I have a few recommendations:

- It could carefully verify that borrowers have enough income to repay mortgages on a long-term basis;
- It could eliminate yield-spread premiums, which encourage brokers to steer borrowers into more expensive loans than their credit records would warrant;
- It could eliminate prepayment penalties, which make it harder for borrowers to refinance into loans that might save their homes;
- It could closely scrutinize appraisals before approving loans; and
- It could escrow additional expenses such as taxes and insurance.

In short, the industry could be far more careful in the future than it has been in the past. The use of responsible, sustainable subprime lending practices *can* expand home ownership, prove rewarding to investors, and avoid widespread foreclosures or any other losses. Before such lending can resume, however, it is essential that Congress do everything in its power to mitigate the current troubles plaguing the marketplace. This includes the enactment of H.R. 3609.

Thank you for both the opportunity to speak today and for your leadership as we move forward in addressing the foreclosure crisis. I look forward to answering any questions you may have.

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http://www.mortgagebankers.org/files/HouseJointLetterRegardingMortgageBankruptcy.pdf.
[13] Congressional Budget Office, "Options for Responding to Short-Term Economic Weakness," Jan. 2008, at http://www.cbo.gov/ftpdocs/89xx/doc8916/MainText.4.1.shtml.