TESTIMONY OF
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AMERICAN FEDERATION OF LABOR-CONGRESS OF INDUSTRIAL ORGANIZATIONS
AFL-CIO
ON BEHALF OF EXECUTIVE VICE PRESIDENT ARLENE HOLT BAKER

"Accelerating Loan Modifications, Improving Foreclosure Prevention and Enhancing Enforcement"

House Committee on Financial Services
December 6, 2007

Good morning, Chairman Frank, Ranking Member Baucus and members of the Committee. My name is Damon Silvers, and I am Associate General Counsel for the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO). I am here on behalf of our newly elected Executive Vice President, Arlene Holt Baker, who could not be here due to the death of her mother. The AFL-CIO represents more than ten million Americans and their fifty-five national unions.

Arlene, AFL-CIO President John Sweeney and Secretary Treasurer Richard Trumka have been all across our country in recent weeks talking to working people in their communities. Everywhere they have been, working men and women are panicked. They ask: What is going to happen to our health care, our pensions, and more and more often we hear, our homes? How am I going to make it when my health insurance premiums go up, my mortgage payments rise, gas prices have skyrocketed and I have to put more money into my pension? What is going to happen to my community and my family members when my neighbors lose their homes? Is my job in danger? What is happening to the American Dream?

In the last week, we have heard from hundreds of AFL-CIO members suffering from the credit crisis and in fear of losing their homes. One example is Kimberly Somsel of Westland Michigan, an unemployed single mother of two battling breast cancer and facing foreclosure due to a ballooning "2 and 28" loan payment. She is selling the family car and her furniture just to get by. Five houses on her block are threatened with foreclosure.

Whether you look at data from economists or talk to the ordinary people of this country you will get the same message—our country faces an urgent housing financial crisis that is threatening to spread into a full-blown recession, carrying the most serious consequences for the living standards of working families. These inter-related crises demand bold government action. Unless the government acts with urgency, hundreds of thousands of workers will lose their homes, millions of workers will suffer pension losses and further millions more will lose their jobs. We hope that responsible business

leadership will join government, but government must act in any case and sooner rather than later.

While recently the Treasury Department has moved in the right direction in looking to the mortgage servicers to restructure subprime loans, merely asking lenders to restructure loans will not be enough. We believe this crisis needs a much more aggressive approach that will be clearly understandable to the millions of Americans fearing the loss of their homes as teaser rates reset.

The U.S. mortgage market is the financial market most closely linked to the lives of American working families. The lack of effective regulation of mortgage markets has allowed these markets to be flooded with products that are misleading and exploitative, products marketed to tens of millions of Americans who work at low wage jobs or who have inadequate retirement income, so they are desperate for a financial short cut to either home ownership or adequate income.

The AFL-CIO supports this Committees' work to give homeowners more protections through H.R. 3915. The AFL-CIO urges H.R. 3915 be swiftly passed by Congress. However, we strongly urge Congress to ensure that on final passage H.R. 3915 provides for meaningful multiple avenues for enforcing consumer protection standards, including at a minimum the right for state attorney general's to enforce its standards.

The result was millions of mortgages structured with teaser rates, and more than a trillion dollars lent out on the assumption that housing prices would rise forever[1]. Of course, when housing prices fell, millions of Americans were stuck with mortgages they could not afford. The banks that put this all together are looking at the financial abyss. Mutual funds, money market funds and pension funds are facing major losses in bonds that were sold to them as investment grade[2]. And throughout our economy, credit is drying up.

The consequences of inaction will be foreclosure rates that have already doubled going higher still, with particularly devastating effects in Florida, California, the Southwest and the upper Midwest[3]. Falling real estate values will undermine the debt-financed consumer spending that has been powering economic growth over the past seven years and the tightening of credit markets will constrain business investment spending. The result is the looming prospect of recession with the most serious consequences for the living standards of working families. And there is no question there is a risk of a downward spiral as weakening economic conditions contribute to further housing defaults.

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[1] Edmund L. Andrews, "Democrats prepare bill to tighten loan rules," *NY Times*, September 9, 2007.

[2] See for example, Michael M. Grynbaum, "Fund Crisis in Florida Worrisome to State," *NY Times*, December 5, 2007.

[3] "Spreading the Misery," *NY Times*, November 29, 2007.

The subprime crisis is not just a subprime crisis, and it is not just a housing crisis or a financial crisis. It threatens to become a full-blown economic crisis affecting both growth and employment. This crisis's roots lie (1) in the lack of effective regulation of the mortgage and other financial markets and (2) on our economic policy makers' reliance on asset inflation to power economic growth in recent years. Falling or stagnant real wages, extreme inequality, and the dominance of financial gimmickry over good jobs that create real value have left tens of millions of Americans dependent on borrowing to sustain their standard of living[4]. Mr. Chairman, you have spoken often of the threat economic inequality poses to our nation and its values. Today we are discussing the consequences of our failure to create an economy based on good jobs.

Let us briefly review the data—subprime lending has grown from 5% of mortgage originations in 2001 to 20% in 2006[5]. Subprime loans have gone from predominantly 30-year fixed rates to predominantly exploitative structures with teaser rates, the so-called 2 and 28 structures. As a result, in the next 18 months, over $300 billion in teaser rate mortgages will reset at high cost interest rates. And according to the Federal Reserve Board, in 2005 these high cost mortgages accounted for 55% of purchase mortgages obtained by African Americans, 46% of purchase mortgages obtained by Latinos, and 17% of purchase mortgages obtained by non-Latino whites[6]. And the majority of subprime mortgages are refinancings, where the racial data are even more skewed.

Until this past week, the reaction from government has consisted of 1) the Federal Reserve's cutting interest rates, 2) the Treasury's creation of private liquidity pools in the secondary market, and 3) efforts in Congress to improve the housing market going forward. Each of these efforts is positive, and in particular the AFL-CIO strongly supports Congress moving forward to quickly pass this Committee's bills strengthening consumer protections (H.R. 3915), and improving the regulation of the Government Sponsored Enterprises (GSE's) (H.R. 1427), as well as Senator Durbin's bill giving bankruptcy judges the authority to restructure mortgage loans (S. 2136). The House should also pass H.R. 3609, introduced by Representatives Miller and Sanchez, which would allow borrowers to discharge mortgage debt in bankruptcy beyond the fair market value of the house.

A major contributing factor to the subprime mortgage crisis has been the disappearance of the Federal Housing Administration (FHA). Simply put, FHA is no longer a significant player in the single-family mortgage market and this has led to serious consequences. In the past seven years, FHA has been supplanted by subprime lenders. In 2001, of the $2.2 trillion mortgages originated, FHA/VA originated nearly 8% and the subprime share was 5%. In 2006 by contrast, of the $3 trillion mortgages originated, the

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[4] The personal saving rate fell to negative 1.0 percent in 2006 according to the Economic Report of the President transmitted to the Congress in February of 2007.

[5] Remarks by FDIC Chairman Sheila Bair at the Nikkin 18th Special Seminar on International Finance in Tokyo, Japan, November 14, 2007.

[6] Sue Kirchoff and Judy Keen, "Minorities Hit Hard by Rising Costs of Subprime Loans," *USA Today*, April 26, 2007.

FHA/VA share fell to less than 3%, while the subprime share rose to over 20%. Part of the solution to the subprime crisis must be a revitalization of FHA. That is why the AFL-CIO supports this committee's efforts in H.R. 1852 to reform and revitalize FHA and create a Low Income Housing Trust Fund.

But these steps together will not be enough to prevent massive economic damage and massive injustice. We must actually put the power and influence of the United States government in play to prevent millions of American families from losing their homes.

The reality is that for all the talk of business concern, banks and other mortgage originators are simply not restructuring these mortgages. Moody's reported in September, after this crisis was almost six months old, that only 1% of subprime mortgages were being restructured[7].

The result is that we are facing the certainty of a further dramatic escalation in defaults and foreclosures. While foreclosures are a normal part of economic life, when foreclosure rates escalate, particularly in geographically concentrated areas, they present a real danger to both economies and communities, and ironically, to the investors in whose name the foreclosures are being carried out.

So here is what must be done:

First: A MORATORIUM ON FORECLOSURES
There must be an immediate moratorium on foreclosures on subprime mortgages—any mortgage with a teaser rate structure. We cannot have homes foreclosed and fear stalking our communities while banks and government agencies negotiate over loan restructuring programs. Only a moratorium will create real incentives to restructure loans.

Second: RESTRUCTURE SUBPRIME LOANS FOR 30 YEARS AT TEASER RATES
The mortgage industry and government must create a structured program providing for the replacement of teaser rate loans, 2 and 28 loans, with conventional thirty-year mortgages at the teaser rate. This program will also have to address the consequences of falling property values in some cases, and provide solutions for allocating losses in ways that are fair to working Americans and have the least systemic. Experience both in the last real estate bust and in real estate busts in other countries suggests short-term solutions are unlikely to work.

Third: REWARD RESTRUCTURING—NOT FORECLOSURES
Servicers must renounce those servicing agreements that reward mortgage companies for foreclosing on homes rather than encourage refinancing or other workout strategies.

Fourth: TRANSPARENCY

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[7] Special Report on Structured Finance by Moody's Investors Services, *Moody's Subprime Mortgage Servicer Survey on Loan Modifications*, September 21, 2007.

Mortgage servicers must commit to publicly reporting company by company how many subprime loans they are servicing; how many have reset; how many have been restructured, and how many foreclosures are occurring and where.

Fifth: OUTREACH
There must be massive outreach under federal government auspices to subprime borrowers to let them know how they can keep their homes. The Treasury Department has encouraged this type of outreach by private groups, but in our view this effort should be much more extensive and should be clearly governmental in nature.

These recommendations flow directly from the AFL-CIO's recent successful experience with a very similar, but less severe, crisis.

In the fall of 2005, after Hurricanes Katrina and Rita, the mortgage industry offered hurricane victims 90 days of forbearance. As Christmas approached, the ninety days came to an end. As an atmosphere of panic began to build in the Gulf, the AFL-CIO worked together with the bank regulators, led by the FDIC, and community advocates in the Gulf, most prominently ACORN, to call a series of meetings with the entire community of mortgage lenders and secondary market participants.

In those meetings, we asked for one-year forbearance for mortgages in the Gulf, and a moratorium on foreclosures. Again, for the Gulf region, the stakes were enormous—the certainty that whatever recovery efforts were being made would be crushed by a further collapse of both the real estate market and the labor markets.

Out of those meetings came a short-term industry wide forbearance agreement, followed by a series of informal understandings and working relationships that led to the effective extension of forbearance for tens of thousands of Gulf homeowners for the full year we had originally asked for. Although there have been foreclosures in the Gulf region since hurricanes Katrina and Rita, the wave of mass foreclosures widely feared at the end of 2005 never occurred. The credit for that fact goes to all the participants in the dialogue—the bank regulators and the GSE's, the Mortgage Banking Association and other industry groups, and the advocates.

Although this experience has much to teach us, the current situation is actually far worse. That was a natural disaster—this is a man-made one, in which many homeowners fear their lender or servicer as the institution that is trying to take their home. In the Gulf, the dominant lenders were participants in the conventional market. Here, the lenders are much more fragmented, both vertically and horizontally. And of course, the Gulf was a regional crisis; this is a genuinely national one.

For these reasons, the subprime crisis requires a higher level of government involvement—to convince homeowners that they should come forward and ask for assistance, and to make sure bad actors in the mortgage industry understand there will be consequences for seeking to continue to take advantage of the public.

So these are the steps necessary to stabilize our housing markets, prevent cascading defaults, and safeguard our economy. They are also the steps necessary to protect the financial institutions and the investors, the very people who will likely complain about government interference.

These steps are not outside the possible. Even as the financial services industry as a whole is resisting the FDIC's recommendation for replacing 2 and 28 structures with 30-year fixed loans at teaser rates, the AFL-CIO's Union Plus mortgage program for union members is routinely doing just that for subprime customers. We understand some major banks are doing the same. Like many other non-profit groups, Union Privilege also provides a Hotline that offers counseling and assistance to union members facing financial crisis as a result of being caught in the subprime trap. So far, the program has helped over 600 union members and their families. This kind of help should be available to all Americans.

The Hotline was developed after a survey of union members found that nearly four out of 10 adjustable rate mortgage holders said they would not know where to turn for help if they had difficulty paying their mortgage. The Peter D. Hart Research Associates study also found that a majority – 51 percent – wants the government to help people facing foreclosure, and 77 percent say the government should do more to regulate the mortgage industry[8].

Some complain that there are legal obstacles. But the truth is that the servicing agreements give the power to servicers to modify loans in the face of the "imminent prospect of default." And that is certainly what we are facing. There is no question that the mortgage industry has the power to take each step we recommend voluntarily, and that the government can easily help them with the outreach to borrowers. But if the industry won't cooperate with government on this program, the Treasury, the regulators, and ultimately Congress must act to ensure the nation's interest is protected.

Chairman Frank, you have heard from the regulators, from FDIC Chairman Sheila Bair, who first called for wholesale restructurings, and we know you are working with the Treasury Department, which has now moved in that same direction. But I bring you the desperate pleas of union members and their families facing the loss of the American dream.

Some say, let working people suffer; markets left alone will get it right in the end. Yet somehow there is always help for the well-connected—cheap money for the banks, severance packages for their failed executives, billions in bonuses for the investment bankers who structured the mortgage deals. Workers, single women who are heads of households, people of color, the retired, are just collateral damage. But not this time--this time we must act to help the people who really need the help—the alternative is genuine economic crisis.

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[8] Survey of 500 homeowners with adjustable rate mortgages from September 13-25, 2007 conducted by Peter D. Hart Research Associates.

The AFL-CIO hopes that as you have led so far, Chairman Frank, you will bring business and regulators together to make real the program we have outlined—freezing foreclosures, giving working people mortgages they can live with, telling the public the truth about what Wall Street is doing and working with us to address growing economic insecurity. We stand ready to work with you to ensure the American Dream of home ownership and an economy that works for all. Thank you.