**Statement**

**of**

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**President and CEO**

# National Association of Affordable Housing Lenders
# on
# "The Role of the Secondary Market in Subprime Mortgage Lending"

## Subcommittee on Financial Institutions and Credit
## House Committee on Financial Services
## U.S. House of Representatives

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CELEBRATING 30 YEARS OF SUCCESSFUL COMMUNITY INVESTMENT

NAAHL represents America's leaders in moving private capital to those in need, 200 organizations committed to increasing lending and investing private capital in low- and moderate-income (LMI) communities. This "who's who" of private sector lenders and investors includes 50 major banks, 50 blue-chip non-profit lenders, and others in the vanguard of affordable housing, including insurance companies, community development corporations, mortgage companies, financial intermediaries, pension funds, and foundations.

**TOGETHER WE CAN**

In the fall of 1999, the premier advocate for increasing lending and investing in underserved areas challenged NAAHL to be a leader in finding practical solutions to the problem of predatory lending. Gale Cincotta, whom many of you knew, the founder of National People's Action in Chicago and a prime mover in achieving the Community Reinvestment Act 30 years ago, worked closely with NAAHL members. She knew that they were, and are, America's pioneering lenders and investors in low and moderate income communities. Even though Gale was ill and frail, she made the effort to come and speak to us about abusive lending practices in Chicago that were victimizing borrowers, their neighbors and their communities. Gale also emphasized that the consequences would undermine 20 years of our mutual, very successful effort to bring private capital to underserved areas. Our members agreed that NAAHL would commit to be part of the solution to this problem, which was also surfacing in other cities and states.

NAAHL's focus on ensuring that private capital was not only accessible to low and moderate income persons, but was provided on <u>fair terms</u> as well, culminated in our February 2001 symposium on the challenges and practical solutions to abusive lending practices. The symposium brought together mortgage experts from local and Federal governments, insured institutions, advocacy groups, and GSEs. This convening of practitioners, all people of good will and extraordinary knowledge and experience, included then Secretary of HUD Mel Martinez, who shared his own perspective on the problems and solutions from his experiences with Cuban immigrants and as a country executive. After acknowledging the very real challenges to ensuring that mortgages did not include abusive terms. Secretary Martinez assured participants that "Juntos Podemos, Together We Can."

The report from the first symposium was very well received by policymakers, with then Senate Banking Chairman Paul Sarbanes calling it "the roadmap" for ending abusive lending. Senator Sarbanes often credited NAAHL for sharpening his own focus on meaningful solutions, including recommendations for stronger oversight because, as he liked to quote from our report, "In a town with no sheriff, the bad guys are in charge." We take pride in the fact that policymakers adopted several of the recommendations from that symposium, including expanding greatly the universe of lenders required to report under the Home Mortgage Disclosure Act (HMDA), and increasing reporting under the Home Ownership and Equity Protection Act (HOEPA). In addition, the symposium emphasized the critical importance of a <u>level playing fi</u>eld for all mortgage lenders, and shared banks' and states' best practices in conducting due diligence of brokers, other consumer protection initiatives, and enforcement.

NAAHL also participated in the HUD/U.S. Department of Treasury Joint Task Force on Predatory Lending, and worked with Members of Congress, Federal regulators, states' Attorneys General, to raise awareness, but also hone in on practical solutions to ending abusive and predatory loans. Some of the Task Force recommendations have been implemented; others have not. But the report provided an excellent summary both of the problems in several urban markets, and some practical solutions.

Over the past 5 years there has been growing, bipartisan, Congressional attention to stopping abusive lending, and some states' and local governments have implemented significant reforms. The bank regulators' determination to stop abusive terms without ending legitimate loans to subprime customers, with strict examination and revisions to regulations and guidance governing insured institutions, has been evident. As Comptroller John Dugan recently pointed out "The plain fact is that national banks have relatively small share of the subprime mortgage market. Last year, they originated less than 10 percent of all subprime mortgages, and the delinquency rate for such loans has run about half the industry average."

How then, we all have wondered, could this extreme increase in subprime loans happen, especially after Freddie Mac reported that half of the borrowers with subprime-priced mortgages could have qualified for a prime loan?  How has the country moved so quickly to a 2-tiered system of mortgage lending?

While there is plenty of responsibility for this condition all around, the secondary market has a town with no sheriff.  GSEs' role in the extreme rise of exploding loans is yet another, very painful example of the turmoil resulting from Congress' failure to enact H.R. 1427.  The lack of GSE oversight and a bipartisan compromise signed into law more than 20 years' ago, facilitated the extreme increase in subprime loans.

**LOOKING FOR LOANS IN ALL THE WRONG PLACES**

For the past several years, even Fannie and Freddie's best "seller/servicer" customers have complained to the GSEs that they refuse to help primary lenders meet the credit needs of their communities.  The GSEs *fear of buying* single family mortgages made to CRA-eligible, qualified borrowers with little cash to bring to the purchase was seen as outdated by experienced lenders.  Fannie Mae and Freddie Mac's resistance to consumer-friendly, CRA-eligible, conventional, sound prime loans, banks and non-profit lenders told them, meant GSEs were leaving a lot of good business on the table.  For example, in 2005 alone, $314 billion dollars of CRA-eligible, consumer-friendly, single family mortgages were made.

Despite a charter change directing the GSEs to *lead the industry* in ensuring that access to mortgage credit is available to low and moderate income families, Fannie Mae and Freddie Mac have not yet brought the benefits of a government-sponsored secondary market to the prime segment of the market. Unfortunately, the consequences the GSEs leaving too much good business on the table from single family and multifamily CRA-eligible mortgages on affordable housing are now becoming clear.

First, the primary market for CRA loans is increasingly *constipated* for lack of capital. Billions of dollars in CRA-eligible loans remain on the books of the originating lenders, unless and until the lenders can replenish their supply of funds to do more. Primary lenders, both banks and non-profits, have to peddle sound loans like Fuller Brush men of old. Investors include pension funds, insurance companies, and other organizations but involve mostly expensive, time consuming private placements.

Second, Fannie and Freddie have fueled the extreme increase in subprime loans through portfolio investments in the triple-A rated pieces of securities backed by subprime loans. Presumably, their investments will pay off. Others in the entire mortgage chain are clearly at risk.

Press reports on securitization of subprime loans in 2006 revealed that Fannie Mae and Freddie Mac are major financiers of subprime loans through purchase of MBS. In 2004 the two GSEs purchased 44% of the $401 billion of securities backed by private label, subprime mortgages, for approximately $176 billion; in 2005 they purchased 35% of the $507 billion in MBS backed by subprime, for approximately $178 billion; and the first half of 2006, they purchased about $78 billion, about 25% of the total subprime MBS sold during that time period, according to *Inside Mortgage Finance* (September 18, 2006). There were about $600 billion dollars worth of subprime mortgages originated in 2006. (*Standard & Poor's Weighs In On the U.S. Subprime Mortgage Market*, April 2, 2007). Subprime mortgages accounted for an increasing share of originations in recent years, from 7.9 percent in 2003 to 20 percent in 2005. (*Inside Mortgage Finance, December1, 2006).*

Third, it appears that "a healthy chunk," perhaps $200 billion dollars or more, of these subprime MBS were used by Fannie Mae and Freddie Mac for "affordable housing" goals' credit. As the Los Angeles Times reported on 1/18/2007,

*"Several experts call Fannie Mae and Freddie Mac key enablers of sub-prime excess. 'What are they doing,' Chuck Cross, a former Washington State official, asked rhetorically, 'buying loans from a company that just suffered the second-biggest predatory-lending settlement in history?"*

Because the GSEs say they only purchase the safest tranches of private label securities backed by subprime mortgages, they are well protected against defaults, and Fannie Mae says its average loan-to-value ration on loans is only 54%. But because Fannie Mae and Freddie Mac truly are the nation's mortgage market makers, the practices had a troubling, if subtle, impact. Instead of the GSEs adapting to the needs of the affordable housing market, <u>the market has evolved</u> <u>by adapting to what the GSEs will buy</u>. Fortunately, OFHEO Director James Lockhart announced early this year that the GSEs should follow the same guidance issued by the bank regulators, both for loan purchases, and securities investments.

Issuing GSE debt to purchase triple A-rated, presumably risk-free securities backed by high-yielding, subprime mortgages with terms the GSEs renounced in their regular purchase programs (higher debt to income ratios; less money down; lower credit scores), while rejecting prime loans from their best customers with similar terms because they are less lucrative, is still another example of why H.R. 1427 reforms are needed. Strengthening of the affordable housing goals, and tougher enforcement authority for OFHEO are critical to rebalancing the mortgage market.

*WHERE DO WE GO FROM HERE?*

LEVEL THE PLAYING FIELD

*Close the barn doors on examination and reporting.*

Less than one-third of all mortgage lenders are banks. The 50,000 non-bank lenders fall under the purview of HUD and the FTC, and do not undergo bank-like examinations.

*Apply the same regulations and guidance to all mortgage lenders, and enforce them as strictly.*

California's Greenlining Institute recently wrote to the bank regulators about their strengthened guidance on subprime loans. Greenlining expressed concerns that "these guidelines could have the unintended consequence of forcing an increasing number of low and moderate income owners into the unregulated subprime market. Perhaps it would be better for the regulators to consider supporting and encouraging Congressional legislation that would regulate all home loans and those who participate in originating or developing the secondary markets for such loans. That is, legislation should be considered to cover federally unregulated mortgage brokers (who are generally the largest abusers in the subprime market) and the Wall Street investment bankers, such as Morgan Stanley and Lehman Brothers, that are responsible for most of the financing of the subprime market and, in fact, have shares in many subprime companies. Consideration should also be given to covering the insurance industry and hedge funds that adversely influence the housing market. (See for example, recent articles estimating that Wall Street investment bankers are responsible for 60% of recent subprime loans, Wall Street Journal 03/12/2007 and New York Times 03/13/2007 on New Century Financial and New York Times, 03/11/2007, "Crisis Loans in Mortgages")."

For example, the ability to repay a loan should be required for subprime loans. Loans should not be made that require resources beyond current and expected borrower income for repayment (e.g. requiring collateral liquidation).

REVIST EXISTING "FILTERS" THAT FAILED

Well- intended statutes like the Secondary Mortgage Market Enhancement Act (SMMEA) of the mid-eighties, and the GSE Charter changes in the early nineties to clarify Fannie Mae and Freddie Mac's responsibilities to affordable housing, have not had the intended results. SMMEA provided some of the benefits of government – sponsorship to investment banks to facilitate their issuance of MBS. As a precautionary filter, Congress restricted those benefits only to securities which qualified for the highest ratings of a national rating organization. Financial engineers quickly invented ways to get top ratings that had nothing to do with the quality of the underlying loans. In addition to enacting reform of GSE oversight and goals, Congress should hold oversight hearings on reforming SMMEA.

BUILD ON WHAT WE KNOW WORKS

In late 2004 NAAHL convened a second symposium "Together We Can –Again." As before, NAAHL convened experts from all sectors to evaluate progress and brainstorm solutions to remaining problems. The report highlights:

- How comprehensive examination of banks acts as a deterrent to predatory practices among federally insured and regulated banks and thrifts
- The role of brokers and other non-bank lenders, and such practices as "push marketing" which encourage borrowers to take on more debt that they can afford or need
- Collaborative and creative partnerships to deal with this multi-faceted challenge, and the role of counseling and financial education
- The role of states as "laboratories of democracy", and the issues involved in state versus federal legislative approaches

It also documents the novel mitigation efforts invented for communities struggling with victimized borrowers and neighbors. Particularly striking is that despite what appears to be in very different cities, NAAHL members Century Housing in Los Angeles and Neighborhood Housing Services of Chicago independently invented the exact same wheel to support LMI homeowners.

Both Century and NHS had found ways to cut through the complexity of the mortgage market, to get otherwise qualified homebuyers with little cash to bring to the table into homes, and keep them. But predatory lenders in each city caused many at- risk homeowners also to approach these non-profits for foreclosure counseling. Two thousand miles apart, Century and NHS quite independently figured out in partnership with local government not only how to keep these families in their homes, but also how to resolve consequences of predatory abuse for the community.

On June 25, 2007 NeighborWorks, the umbrella organizations of NHS Chicago and 200 other NHS affiliates around the country, with backing from lenders and in partnership both with community –based and national organizations like NAAHL, will launch a national media campaign, with one toll –free number for any and all homeowners who feel at risk. The campaign hopes to drive struggling homeowners to **call 888-995-HOPE**, where HUD –certified counselors will be available 24 hours a day, 7 days a week, speaking in both English and Spanish. They can coach callers on lender options, non-profit resources, and credit counseling. As appropriate, the counselor can also link callers with their lenders, or a local NeighborWorks organization, for face to face counseling.

Finally, meaningful updating of CRA incentives by the bank regulators has provided a boost to all lenders' efforts. Updating decade-old CRA regulations to acknowledge the importance of community development lending would also make a real difference. Together We Can!


LOOKING FOR LOANS IN ALL THE WRONG PLACES?
CALL NAAHL
202-293-9855