Remarks
Rep. Carolyn Maloney
Financial Institutions Subcommittee
May 8, 2007

This is the third in a series of hearings that the full Committee and this Subcommittee are holding on the topic of subprime lending and what legislative action, if any, might be appropriate to address the rapidly growing subprime mortgage crisis.

We started with a hearing March 27th in which we heard from the federal regulators on their proposed guidance to strengthen underwriting and correct abuses in subprime lending, and from industry and consumer representatives on what the likely effect of that guidance might be.

We then had a hearing on April 17th on how subprime borrowers presently facing default or foreclosure could be assisted by the housing GSEs, the FHA, or the private sector.

Our topic today is the role of the secondary market in subprime mortgage lending.

We will specifically examine how that market has contributed to the expansion of the subprime mortgage sector and what characteristics of the secondary market should be considered when proposing remedies for borrowers or reform of the subprime lending system.

The crisis in subprime lending is wide-ranging and complex, of several of our Subcommittees. I want to specially acknowledge the prior work of Congressman Kanjorski, Chairman of the Capital Markets Subcommittee, and his staff, their contributions in this particular area, and to thank them for to this hearing.

I also want to welcome all the witnesses, and to thank them for making time to appear before us today to help us understand and grapple with the highly complicated and powerful dynamic of securitization.

There is no question that the huge growth of the secondary market from 1986 on has greatly supported the expansion of credit and the availability of mortgage financing on a much wider basis than ever before.

With the legal structure put in place by the Tax Reform Act of 1986, and its predecessor the Secondary Market Mortgage Enhancement Act of 1984, mortgage backed securities burst out of the GSEs and became private sector business.

Private label issuers moved quickly to utilize the full range of the market opportunities available through the creation of REMICs - Real Estate Mortgage Investment Companies.

REMICS not only offered tax advantages but also made mortgages an investment in which large investors could participate, since they could structure the risk to meet their needs.

Since the tax laws and accounting rules made it very difficult to alter the securities in the "static pool" of a REMIC, investors could take a fixed part of the payment stream and know what risks they were exposed to.

In the popular press, the irresponsible growth of the subprime market is often blamed on the securitization process. We read every day that borrowers were put in mortgages they could not repay because of the pressure on Wall Street to satisfy the appetite of investors, both foreign and domestic, and the vast fortunes to be made doing so.

I hope the witnesses today will put some facts and structure to those generalities and explain how we can make sure the incentives in this market are aligned with sound policy and not against it. Also, I hope they can explain the difficulties and issues that are presented by current proposals to restructure loans that have been securitized.

To some extent, we began this discussion in our last hearing when the housing GSEs and the FHA came in to tell us what they are doing to help borrowers move out of loans that are resetting to unaffordably high rates.

By some estimates, the GSEs and the FHA can help 50 percent of the borrowers in this predicament, because by having made twelve months of regular payments on their loans these borrowers qualify for a better, fixed rate loan from these entities.

That still leaves a lot of borrowers in need of help. Also, while in our last hearing we discussed how to help the borrowers in this crisis, in this hearing I also want to explore what we can and should do to avoid a repeat of this vicious cycle in the next housing bubble.

One point that all players in the industry have been quick to point out is that no one makes money when a borrower gets put on the street.

If true, that should provide a strong motivation for all participants to help borrowers stay in their homes through a market based solution.

That is the guiding principle behind recent efforts such as the FDIC conference three weeks ago, or Senator Dodd's summit last month.

I am generally a supporter of market based solutions, and I am hopeful that these efforts at dialogue provide a way for the private sector to find a solution.

But, as these hearings should make clear, this Committee is by no means waiting for the private sector to do what it thinks is right to solve this rapidly growing crisis.
Market-based solutions sometimes don't provide sufficient protections to those with little market power – in this case, our constituents who face the loss of their home.

To help shift the balance, states have pioneered assignee liability protections that have had some good results, although the Georgia fiasco demonstrates what happens when one state goes too far, and the power of the ratings agencies and the market to shut down a remedy that does not meet market needs.

My intent in this hearing today is to elucidate what Congress or regulators can do to encourage, support, or if necessary mandate changes to the incentives that created the problem we face today, without creating unanticipated problems in the market.

It is a difficult assignment but one we must take up.