SUBPRIME CRISIS:
LENDERS AND INVESTMENT BANKERS BUILT IT, SOLD IT AND NOW THEY NEED TO FIX IT

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My name is Bruce Marks. I am the CEO of the Neighborhood Assistance Corporation of America (NACA). NACA is a non-profit community advocacy and mortgage company. We were the first organization to expose predatory lending back in 1991 in Boston, Massachusetts. We exposed the lending practices of Fleet Bank and after a four and one-half year war, we won. As a result Fleet initiated a huge lending program, made many of the victims of its predatory lending whole, settled the law suits, and provided NACA with a mortgage commitment that became the foundation of our program. NACA has continued the campaigns against the largest lenders in the country, including Bank of Boston, The Associates, Ford, First Union and others.

SUBPRIME CRISIS IMPACT:

The human side of the subprime crisis is that over two million homeowners are at risk of losing their homes. If immediate action is not taken, the repercussions of allowing this meltdown will affect virtually every community, drive our economy into recession and impact economies oversees. The most effective and just remedy is for the lenders and investors who created and profited from the subprime crisis to restructure the loans. This does not require tax payer dollars to bail out an industry that has profited hugely from this scheme.

We need to clearly understand how we have come to the brink of a massive financial crisis. The subprime industry consists of trillions of dollars in mortgages, but the business was never about creating homeownership. It was always about generating billions of dollars in fees and huge profits. Since these mortgages were never structured to be affordable over the long-term, the financing only provided for temporary occupancy with the foreseeable and inevitable result for many homeowners being foreclosure and financial devastation.

SUBPRIME LENDING INDUSTRY:

There are six major players that are financially connected in the subprime lending. They are the borrowers, brokers, lenders, investment bankers, rating agencies and investors. The ones at most risk of loss (i.e. short end of the stick) are the borrowers and the investors. The brokers, lenders, investment bankers and rating agencies have already profited by charging billions of dollars in fees stolen from the borrowers and, to a lesser extent, the investors (i.e. pension funds, insurance funds and others). The investors purchased loan securitizations believing they would get returns much greater than the conventional returns. If they had actually read the prospectuses and documents they would not have purchased these loans since it was clear that they are not affordable and this crisis was just a matter of time. The silent players who facilitated this scheme are the regulators. They were not just asleep at the switch, but refused to exercise their authority in limiting the inevitable subprime lending crisis.

The scheme was structured as follows: Financial players are always looking to create new products. Around five years ago, subprime mortgages packaged as secured debt obligations dramatically increased. They were based on what world-wide investors considered the safest investment: American Real Estate. These subprime mortgage products were designed to, in theory, yield significantly higher returns than other investments with virtually no risk.

The demand was tremendous – far beyond expectations. Investors from around the world were demanding more and more of this product. The initial product was not enough to satisfy the demand. The next version was an adjustable rate mortgage resetting at higher rates, but this still could not produce enough product. Next came the negative amortization product through option ARMs where borrowers increase their mortgage debt over time. Even this could not satisfy the world-wide demand. The last version was the no verification document or "liar loan." These loans were so outrageous and unrealistic that they began defaulting almost immediately. Thus in February 2007, the investor community and public got the first indication of the beginning of this crisis.

The marketing of these defective products was also insidious. To generate the huge numbers of borrowers, people with an intense desire or need for homeownership were targeted and exploited. They were often low and moderate income or minority borrowers. To target these borrowers they created a financial structure that encouraged mortgage brokers to exploit their own communities. Mortgage brokers were paid primarily through back-end points or yield-spread premiums (YSP). Brokers knew what the best rate would be for the borrower – par rate (i.e market rate). But in order to get any significant compensation they needed to convince the borrower (i.e. lie) that the lowest rate the borrower could get was actually much higher then the available rate. The higher the rate the more the YSP and income.

Not only were the interest rates unaffordable, but the overall mortgage amount was also unaffordable. Borrowers were encouraged to borrow more than they wanted and more than they could afford. While in the past community banks limited the amount borrowed to what could realistically be paid, the new players made more money the greater the loan amount. Since the brokers, lenders and investment bankers made a percent of the loan amount and investors just wanted more product, they were throwing huge amounts of money at borrowers. Who can blame the borrowers when the most "reputable" and powerful financial institutions were encouraging them to borrow more and more. To keep borrowers from refinancing into a more affordable loans and to pay back the YSP paid to the brokers, lenders implemented steep pre-payment penalties. To keep investor's appetite ravenous for more product, there was an affordability or teaser period of two to three years. Thus, they created the illusion that these securitized debt obligations were and would continue to perform. In fact borrowers were making their payments at these affordable rates, but would be unable to at interest rates greater than 10%. Who can afford double digit interest rates over the long-term?

RESPONSIBILITY FOR SUBPRIME CRISIS

Some in Congress and the Administration are apologists for the lending industry, portraying this crisis as one created by "risky borrowers" taking advantage of generous lenders. Nothing could be further from the truth. These hard-working Americans did not design these “exotic” products and package them for world-wide investments. Blaming borrowers would be the same as if car a maker designs and sells cars which suddenly go into over-drive causing a huge number of fatal accidents, and rather than having a massive industry recall to fix the defective car, we penalize the car owners as negligent drivers.

This subprime crisis is not about “risky borrowers.” It is about risky and greedy lending. These “exotic” products are unique in their type and magnitude. The vast majority are adjustable rate mortgages (ARMs), but these ARMs are not like the adjustable rate mortgages we used to know, for they do not decrease if the prime rate or other indexes go down. These are Strangulation ARMs that are structured to always increase resulting in foreclosure or financial ruin for the majority of borrowers. They are initially affordable but dramatically increase over three to four years to more than 10% even if the lending indexes decrease. There was no perceived subprime crisis prior to 2007 when the initial payments were affordable. Homeowners could afford the rates they were charged initially at 6, 7, or 8 percent. But double-digit interest rates over the long-term will transform anyone into an at-risk borrower. The borrowers became “risky borrowers” due to the greed of the brokers, lenders, investment bankers and investors. This is not about risky borrowers this is about risky loans. This is not about subprime borrowers but about subprime lenders. This is not about irresponsible borrowers it is about irresponsible lending. This is about greed.

To protect their investments the brokers, lenders and rating agencies employed their full arsenal to prevent state legislatures from enacting consumer protection legislation and reforms. January 16, 2003 was a significant day in their campaign. On this day, Standard and Poor’s stated that they would not rate any loans originated or serviced in Georgia as a result of the consumer safeguards the Georgia legislature had enacted the previous year. Particularly egregious from S&P’s perspective was the requirement that investors would be responsible for violations in the origination of the loan. Moodys and Fitch soon followed, which provided the justification to gut the law in the subsequent legislative session.

COUNTRYWIDE:

These loans – trillion of dollars worth – have generated huge profits for the brokers who originated the loans, the lenders who purchased them, the rating agencies that evaluated them, and the investment bankers who packaged and sold them to investors. The New York Times investigative articles on Countrywide, the country’s largest mortgage company, detailed how they structured employee incentives that exploited borrowers by imposing large costs on the borrowers, and pushed many into unaffordable mortgages. Additionally, the billions of dollars in bonuses paid out last year by the investment bankers reflect the profitability of the subprime lending market.

Countrywide has become the prime example for both predatory lending and predatory servicing. This is emblematic of the magnitude of the crisis given that they are the country’s largest lender. Their size has allowed them to attracted billions of dollars in loans and investments to try to stay afloat. Now Countrywide is feeling the effects of financial stress. It is ironic that Angelo Mozilo, Countrywide CEO, who must now borrow on subprime terms on the commercial market can barely survive, while he expects hundreds of thousands of hard working borrowers with unaffordable sub-prime loans to survive on such terms. In fact, it is our understanding, Treasury Secretary Paulson asked Bank of America's CEO, Ken Lewis to purchase Countrywide this past August. That would be equivalent to Countrywide's loss mitigation strategy of selling someone's home at a loss to prevent foreclosure or in Countrywide's circumstances – Bankruptcy.

It is unconscionable to consider any form of bailout of Countrywide or even provide them with additional credit without requiring dramatic policy changes and restructuring of the loans they have made and service to the many hardworking homeowners that currently are being squeezed by their Strangulation ARMS and other predatory products. Even in light in the current crisis when the borrowers seek assistance all Countrywide does is request more money. Thus people deplete their 401ks, and borrow from friends and family to give Countrywide more money on a mortgage that will never be affordable. Their greed shows no limits.

SUBPRIME CRISIS SOLUTION

These defective products, like in the car recall analogy, require the recall-restructuring of loans on a massive scale. Developing a borrower focused solution based on what the borrower can afford is the only viable remedy. This requires lenders who service the loans to reduce the interest rate and/or reduce the outstanding mortgage balance to what the homeowner can afford. This can accurately be determined by documenting the homeowner's net income, required debt payments, necessary expenses with the remaining amount available for the mortgage payment.

Even though this is the best solution, lenders refuse to restructure loans, and in order to prevent foreclosures demand more money while maintaining the unaffordable mortgage. In light of this continued exploitation, the regulators must exercise their power to require lenders to restructure their loans. This remedy addresses the interests of all parties involved: the investor can obtain a reasonable return, homeowners can keep their homes, and the local tax base can be maintained.

SUBPRIME CRISIS GOVERNMENT AND GSE PROPOSALS

The plans put forth by the Administration and Congress will have no significant impact on this crisis. The President's plan focuses on the Federal Housing Administration ("FHA"). The number of loans they will be able to do will be a small percentage of the need. In addition, the numbers will dwindle as home values continue to decline and borrower's credit become worse. The initiatives to expand the authority of Fannie Mae and Freddie Mac will have even less of an impact on this crisis. The increase in their portfolio limits and conforming loan limits have the primary impact of increasing their profits and returns for their shareholders. Before any consideration of benefiting their bottom lines the following needs to occur:

1. Disclosure:
    a. Amount of subprime loans they have in their portfolio and what they have securitized.
    b. The performance of their subprime loans.
    c. Results of their workout solutions.

2. Prohibitions on purchasing loans with the following:
    a. Pre-payment penalties.
    b. Back-end points or yield spread premiums.
    c. Loans that do not provide a net tangible benefit to the borrower.
    d. Loans that are not qualified at fully-indexed rates.

3. Create a refinance Product with the following criteria:
    a. Conventional interest rate
    b. Two late payments over past 12 months
    c. Can have up to a 90 day late

4. Loss Mitigation Standard for subprime loans:
    a. Stop all resets.
    b. Restructure loans to what the homeowners can afford based on a debt to income formula or budget.
    c. Eliminate all pre-payment penalties.

5. Setting a National Standard for Mortgage lending
   Fannie and Freddie are now in a position to set a national standard on how lending needs to be done nationwide. Lenders do not have the alternative options for selling their loans and will adhere to what standard Fannie and Freddie set. Thus all lenders who sell their loans to Fannie or Freddie must establish and adhere to a policy for their business that is the loss mitigation standard stated above.

Congress should not expand Fannie Mae and Freddie Mac's lending authority until they commit to require lenders who place loans with them to also restructure loans and eliminate their predatory practices. Also, any expanded authority for the GSE's should prevent them from engaging in subprime lending. The GSE's need to keep to their primary mission of expanding homeownership for low and moderate income people on affordable terms. This means addressing the needs of subprime borrowers by providing loans at the conventional rate. There should be no economic incentive to push borrowers into the "more profitable" subprime loans. In fact, the notion that higher rates compensate for increased credit risk has not materialized. High rates for subprime borrowers have become a self-full-filling prophesy with greater defaults.

The argument that these are contractual obligations that must be met highlights the fundamental decision that politicians and decision-makers need to make. Do they represent the lenders and investors who created this crisis or the homeowners who are at risk of foreclosure? The reality is that if these loans are not restructured the investors will have a virtually worthless investment. Restructuring makes sense for all the parties.

The difficulty has been on who has the authority to force the restructuring. These securitized debt obligations were structured to operate on automatic pilot. Thus there is no apparent manual override to restructure the loans so that the borrower can keep their home and the investor can obtain a reasonable return. The lenders who service these loans can restructure them if they are at risk of default, but few servicers are doing so. They persist in continuing their predatory practices by demanding money from borrowers to prevent foreclosures on loans that are not affordable. Thus predatory servicers are in fact stealing the future from borrowers who are using their retirement savings and borrowing from family and friends to keep their home. Fannie Mae and Freddie Mac can and must be part of the solution.

The regulators have a responsibility to insure safety and soundness. If immediate action is not taken and millions of homeowners will lose their homes, communities will be devastated, tens of millions of other homeowners will not be able to sell or refinance due to significantly reduced property values, and the safety and soundness of our financial institutions will be impacted. In addition, allowing these foreclosures to go forward will have a devastating impact on the tax base of communities throughout the country affecting the many services funded through property taxes. The Office of Thrift Supervision (OTS), Office of the Comptroller of the Currency (OCC), Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) need to make sure that all of the financial institutions they regulate adhere to the above Loss Mit policy and Limitations for subprime loans.

NACA has begun this process by bringing to Countrywide's regulator, the Office of Thrift Supervision (OTS), Countrywide borrowers who need their loans restructured. NACA will be submitting thousands of more cases to both the OTS and other regulators to force lenders to restructure their loans. For non-cooperative lenders the regulators can and must impose "Cease and Desist" orders.

Also the major substantive legislation needed immediately is to allow bankruptcy judges to restructure unaffordable loans. It is outrageous that judge's can modify mortgages on investment properties not residential mortgages.

NACA MODEL– THE RIGHT WAY TO DO "SUBPRIME LENDING"

NACA has done lending the right way. We lend to what the mortgage industry considers "subprime borrowers". We provide prime loans to such borrowers and they become prime borrowers. The NACA terms are the best in the industry. We provide one mortgage product and we counsel people into this product. The mortgage is:

- No Downpayment
- No Closing Costs (paid by the lender)
- No Fees
- No Perfect Credit

At a below market fixed rate. The current rate is 5.50% 30yr fixed (as of 9/18/07).

While the mortgage market has shutdown in the sub-prime area and many conventional lenders have imposed tighter criteria, NACA continues to move forward without changes. We have become the standard for how lending should be done. We have over thirty offices nationwide and are rapidly expanding.

NACA has commitments for NACA's mortgage product of $10 Billion from the two largest banks in the country – Bank of America and Citigroup. This is for both purchase and refinance. NACA has also stepped forth with a One Billion dollar commitment to refinance borrowers out of their predatory loans on the best terms available.

CONCLUSION

This is a crash, but it is in slow motion. Massive foreclosures DO NOT need to happen. There is still time to prevent them. Borrowers are not asking for a handout, all they are asking for is to make their mortgages affordable. A fixed rate that provides a reasonable profit for the lender and long-term homeownership for the borrowers.

All politician's need to take a stand, from the Congress, to the presidential candidates, to the city counselor. They must stand with the homeowners to force the restructuring of these loans and prevent massive number of foreclosures. NACA is again leading the charge against the predatory lenders. We ask that the hundreds of thousands of borrowers and who have an unaffordable loan to come forward. So many people blame themselves; so many people are embarrassed; so many people do not believe that they have options. It is not their fault. They must come out of the shadows and join the fight! Contact NACA at www.naca.com. There is hope.

Everyone needs to be concerned even if they do not have a subprime or predatory loan. Neighborhoods are being devastated and it will only get worse. Politicians and regulators have ignored the plight of over two million homeowners who are at risk of foreclosure. The restructuring of loans is straightforward, attainable, and can be done at no cost to the taxpayer. This puts the responsibility where it rightly belongs – with the lenders and investors who created the crisis. As this crisis deepens, Congress and the Administration need to consider dramatic legislative and executive action to override any barriers that prevent the restructuring of massive numbers of borrowers at risk of foreclosure.