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**STATEMENT OF
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**"OVERSIGHT OF THE EMERGENCY ECONOMIC STABILIZATION ACT:
EXAMINING FINANCIAL INSTITUTION USE OF FUNDING
UNDER THE CAPITAL PURCHASE PROGRAM"**

**COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE**

NOVEMBER 13, 2008

Chairman Dodd, Ranking Member Shelby, and members of the Committee: I am Nancy Zirkin, Executive Vice President of the Leadership Conference on Civil Rights (LCCR). Thank you for giving me an opportunity to testify in today's hearing on the implementation of the Emergency Economic Stabilization Act of 2008 ("EESA").[1]

LCCR is the nation's oldest and most diverse coalition of civil and human rights organizations. Founded in 1950 by Arnold Aronson, A. Philip Randolph, and Roy Wilkins, LCCR 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, persons with disabilities, older Americans, LGBT Americans, and major religious groups. I am privileged to represent the civil and human rights community in submitting testimony for the record to the Committee.

I would like to start with a quick overview of why the staggering number of foreclosures nationwide, which ultimately led to the enactment of EESA, is of such critical importance to LCCR and the communities we represent. Simply put, expanding and preserving the right to the American Dream of homeownership has always been one of the key goals of the civil rights movement. It is vital because homeownership is the means by which most Americans build wealth and improve their own lives and the lives of their families, and homeownership is essential to the development of stable, healthy communities that make all Americans proud. For decades, the civil rights community has struggled to break down the barriers to fair housing itself, as well as the barriers to the credit that most Americans need to obtain housing. The resistance that racial and ethnic minority communities have faced in obtaining fair and sustainable mortgage loans, from the practice of redlining to the scourge of predatory lending, lies very much at the root of the crisis in which we now find ourselves today.

For years, civil rights and consumer protection groups argued that the modern system of mortgage lending was profoundly flawed, that countless numbers of irresponsible and abusive

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[1] Pub. L. 110-343.

loans were being made, and that without swift regulatory action, the consequences for both individual homeowners and the economy at large would be drastic.

Well before the foreclosure crisis erupted into the public eye and began to dominate news headlines throughout the country, LCCR and other groups pleaded with Congress, the Administration, and the financial services industry to quickly take sweeping measures to keep borrowers in their homes. After months of denial by many, I think it is now obvious to all that the mortgage crisis is anything but "contained" and that it merits aggressive action. To date, however – and despite the best efforts of you, Mr. Chairman, and many of your colleagues – the collective response, based on purely voluntary industry-led efforts, has done little to turn the tide.

While estimates of potential home foreclosure rates have varied widely as our economy continues to weaken, one thing remains fairly certain: they will be staggering. The ongoing 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.[2] As such, LCCR and its member organizations have a tremendous stake in policies that will mitigate this crisis. I would like to focus my testimony today on two policies in particular.

<u>The Continuing Need for "Mandatory" Foreclosure Relief</u>

While there are encouraging signs of progress in industry-led foreclosure prevention efforts, particularly the FDIC proposal that I will discuss below, LCCR strongly believes that the best way to promptly reduce foreclosures is to give homeowners the chance to have their loans modified in Chapter 13 bankruptcy proceedings. To this end, and while I recognize that this particular bill lies outside of the jurisdiction of your committee, LCCR has strongly urged Congress since last fall to enact S. 2136, the "Helping Families Save Their Homes in Bankruptcy Act of 2007." S. 2136 would give desperate homeowners badly-needed leverage to negotiate with loan servicers and therefore be able to obtain a voluntary modification outside of bankruptcy, and it would provide them with an important last resort when servicers are unwilling or unable to provide lasting, sustainable alternatives to foreclosure.

While Chapter 13 bankruptcy is obviously a drastic step, we believe, for several reasons, that there are several key advantages to making it available. One key benefit – especially as we face an economic slowdown of still-unknown proportions – is its cost. Because loan modifications in bankruptcy court do not involve the use of public funds, S. 2136 does not amount to a controversial "bailout" or raise moral hazard issues. Indeed, for people who wish to turn to

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

bankruptcy court to save their homes, it comes with serious enough consequences – monetary and otherwise – to encourage wiser financial decisions in the future.

At the same time, S. 2136 would greatly benefit other homeowners and our economy at large. As you know, every home that gets saved from foreclosure – or from abandonment by borrowers who anticipate foreclosure after borrower-servicer negotiations fail – helps to protect the value of surrounding homes from being eroded. This means that neighboring homeowners become less likely to find themselves "upside down" on their own mortgages – a vicious cycle that, if left unchecked, can lead to even more foreclosures.

We recognize that S. 2136 has faced very strong opposition from the financial services industry – a rather ironic stance, given the number of lenders that have themselves sought bankruptcy protection in the past several years. In particular, opponents argue that making Chapter 13 bankruptcy relief available for home loans would make investors hesitant to provide liquidity to the marketplace, thereby limiting “access to credit” for underserved populations such as the ones that LCCR represents.

Appeals to the need to preserve “access to credit” have long been popular within the financial services industry, particularly in opposition to the sensible regulation of credit and lending practices. On the surface, such arguments do sound compelling, given our nation’s long and unfortunate history of racial and ethnic discrimination in credit markets. Yet if the mere prospect of bankruptcy relief should somehow curtail “access” to the kinds of reckless and predatory “credit” that has routinely been extended to minority communities in recent years, rest assured that you will not hear any complaints from us.

Instead of saddling borrowers with higher costs or refusing to provide them with credit altogether, out of concern that troubled loans might be eventually modified in bankruptcy proceedings, perhaps lenders could simply be more careful. For example, they could:

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

As one prominent mortgage industry blogger has pointed out, the prospect of Chapter 13 relief for home mortgage loans served quite well as a “brake on lender stupidity”[3] before it was eliminated by the Supreme Court in 1993. Given the widespread abandonment of the above types of common-sense, responsible lending practices in recent years, such a brake might have been enormously helpful.

[3] Tanta, “Just Say Yes to Cram Downs,” *Calculated Risk*, Oct. 7, 2007, available at http://calculatedrisk.blogspot.com/2007/10/just-say-yes-to-cram-downs.html.

There are other steps that can also level the playing field between borrowers and loan servicers. For example, while many loan servicers do make good faith efforts to engage in loss mitigation, it would be helpful if Congress imposed an affirmative duty for all servicers to do so. Given the trouble that many borrowers have in simply communicating with servicers, we would also support requiring servicers to respond to information requests from homeowners in a timely manner, and also requiring them to provide better information about just what types of mitigation efforts are actually taking place.[4]

Mr. Chairman, we have been encouraged to learn that since your last oversight hearing on EESA in late October, several of the nation's largest banks and the GSEs have announced plans to aggressively ramp up their loan modification programs. The plans appear to be very similar to the Federal Deposit Insurance Corporation's (FDIC) ongoing program to modify loans held by IndyMac Federal Bank.

We applaud any and all voluntary industry efforts to stave off foreclosures. Every home that is saved from foreclosure is a step in the right direction. To date, however, and despite the best efforts of many lenders and loan servicers, industry-led loss mitigation efforts have not provided enough struggling borrowers with affordable, sustainable alternatives to foreclosure.

This is due, to a great extent, to the extremely complicated nature of modern lending practices. In particular, the majority of troubled mortgage loans in recent years have been sold into highly-complex securities, which have themselves been carved up and sold to thousands of investors around the world. In such cases, voluntary modifications usually cannot take place unless the pieces of these securities can be reassembled into individual, whole loans. Loan servicers often have insufficient authority, on their own, to substantially modify loans on behalf of investors. In addition, many borrowers have "piggyback" loans or second mortgages, which create inherent conflicts with primary mortgage holders that also prevent meaningful loan modifications.

We hope that the industry will continue finding ways to get around such obstacles. But until voluntary industry-led efforts result in long-lasting modifications on a very widespread scale, we believe they cannot in any way be a substitute for meaningful, broad-based legislative remedies that provide homeowners with the tools to protect themselves from preventable foreclosure. The stakes for our communities and our economy are simply too high.

The FDIC Plan

While I am disappointed that efforts to open up Chapter 13 relief to homeowners have been stymied so far this year, I am encouraged by some of the discussions and news reports that have arisen in the past several weeks, following the enactment of EESA. While we were critical of the law because it did not spell out explicit measures to help struggling homeowners at the same time that it helped Wall Street, EESA does appear to be opening the door to more promising measures.

[4] *See, e.g.*, H.R. 5679, "Foreclosure Prevention and Sound Mortgage Servicing Act of 2008."

In particular, we have been following with great interest the discussions led by you and FDIC Chairman Sheila Bair to establish a new mortgage loan guarantee program under Section 109 of the Act.

As we understand it, the proposed plan would provide new incentives for loan servicers to make currently-troubled mortgage loans more affordable for many homeowners. Servicers would attempt to reduce outstanding monthly mortgage payments for struggling borrowers to a thirty-one percent debt-to-income ratio ("DTI") through a series of steps:

- First, servicers would lower the interest rate on the loan to three percent for five years, followed by annual one-percent increases to no more than the market rate (currently 6.5%).
- If this rate reduction is not enough to reach the target DTI, the term of the loan would be increased to a maximum of 40 years from the date of origination.
- If the loan is still not affordable, servicers would defer enough of the loan principal, without charging interest on that portion, until the remaining balance of the loan fell within the appropriate DTI.

If these modification efforts result in a loan that can be successfully repaid for at least six months, the government would guarantee against losses on the new loan, on a 50/50 basis, for the following eight years. Informal estimates have suggested that such a plan could spare as many as three million homeowners from otherwise-certain foreclosure, at a cost of approximately $50 billion – a sum that would be allocated from currently-unused EESA funds.

We believe that if the plan can be implemented quickly – and, just as importantly, if it is quickly utilized by loan servicers, it would represent a major improvement over any other existing foreclosure-prevention strategies that have been attempted to date:

- It would provide loan servicers with significant incentives to modify loans, incentives that currently do not exist in private, voluntary foreclosure-prevention efforts such as the "Hope Now Alliance."
- Unlike foreclosure moratorium proposals,[5] the plan offers the hope of a lasting, sustainable solution to troubled loans – as opposed to what could be, without vital loan servicing reforms, a mere delay of the inevitable for most borrowers.
- By focusing on a borrower's first mortgage debt-to-income ratio, it would be much simpler for servicers to implement than the recently-enacted "Hope for Homeowners Act,"[6] and would not require the deep discount to current market value.

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[5] *E.g.*, California Gov. Arnold Schwarzenegger has proposed a 90-day stay of the foreclosure process for owner-occupied homes subject to a first mortgage, following the filing of a Notice of Default. Press Release, "Governor Schwarzenegger Prescribes Solutions to Keep Californians in their Homes," Office of the Governor, Nov. 5, 2008, at http://gov.ca.gov/press-release/10959/

[6] Division A, Title IV of the "Housing and Economic Recovery Act," Pub. L. 110-289. The Hope for Homeowners Act allows the Federal Housing Administration to insure up to $300 billion of loans that are refinanced to no more than 90% of the currently-appraised value of a home, in cases where a servicer or lender agrees to forfeit the remainder of a prior loan.

- By utilizing a target DTI of 31%, modifications under the plan are more likely to succeed – and therefore less likely to cost taxpayers – than the FDIC's highly-lauded modification plan for mortgages held by IndyMac Bank.[7]

Furthermore, by focusing on the root cause of our ongoing economic crisis – widespread foreclosures – the plan strikes me as a particularly wise use of taxpayer funds allocated to EESA. This is especially true given the controversies that have already erupted over how federal "bailout" funds are being utilized by some recipients on Wall Street.[8]

For these reasons, LCCR strongly believes that the FDIC plan is very much worth a try – but we urge that it be adopted as quickly as possible this fall. For one, based on nationwide foreclosure trends, hundreds of thousands of additional borrowers will be in danger of losing their homes – with continued devastating consequences for our economy. In addition, while details of the plan can be calibrated over time, it is vital that the Treasury Department set aside adequate EESA funds before they are used on other, less-effective economic recovery programs.

We are somewhat concerned that the FDIC plan could take a significant amount of time to get up and running. In addition, as is the case with other foreclosure-prevention efforts that have been initiated to date, it relies on the voluntary agreement of loan servicers, who still may or may not be willing – or even able, due to securitization issues – to agree to significant loan modifications. These concerns, however, do not in any way diminish our support for the plan, and we are very grateful to you, Mr. Chairman, and FDIC Chairman Bair, for your tireless efforts to help as many homeowners as possible in the midst of this crisis.

<u>The Critical Role of Fair Housing Laws in Loan Modification Efforts</u>

Before I conclude, and particularly in light of the fact that we commemorated the 40th anniversary of the Fair Housing Act this year, I would like to briefly underscore the need to ensure that any measures to implement EESA are done in a manner that is fully consistent with all applicable civil rights laws.

As you know, the ongoing mortgage crisis has profound underlying fair lending dimensions. It is imperative that any response addresses the significant disparate impact on communities of color and single female-headed households. To this end, we hope that in your oversight of EESA, you will help ensure that data on the progress of the Treasury Department's modification efforts is made publicly available. It is also vital that the Department's response is formulated and implemented in a manner that affirmatively furthers fair housing.

Federal law requires that all expenditures of federal funds for housing-related purposes be done in compliance with the Fair Housing Act. This means that under EESA, the Department must put in place comprehensive measures, for example, to ensure that:

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[7] *E.g.*, Renae Merle, "FDIC Restructuring Some IndyMac Loans," *Washington Post*, Aug. 21, 2008 at D01.
[8] See, e.g., Amit R. Paley and Binyamin Appelbaum, "Waxman Seeks Bank Data on Use of Bailout Funds," *Washington Post*, Oct. 29, 2008 at D03; Binyamin Appelbaum, "Banks to Continue Paying Dividends," *Washington Post*, Oct. 30, 2008 at A01;

- Its efforts to provide loan modifications for homeowners facing foreclosure are available without regard to protected class status;
- Any institution in which the government acquires an ownership stake, or provides other assistance under EESA, is not in violation of fair housing and fair lending laws with respect to loans that it makes or services; mortgage-backed assets in which it is involved as an issuer, underwriter or investor; loan modification efforts in which it engages; or marketing of its REO properties; and that
- Loan modifications are sustainable for long-term ownership.

Mr. Chairman, thank you again for the opportunity to speak today. I look forward to answering any questions you may have.