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Domestic Policy Subcommitte
Oversight and Government Reform Committee
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11:30 a.m.

"Examining the Continuing Crisis in Residential Foreclosures and the Emerging Commercial Real Estate Crisis: Perspectives from Atlanta."

I extend my thanks to the United States House Domestic Policy Subcommittee for inviting me to testify regarding the development of the residential foreclosure crisis in Georgia. My name is William J. Brennan, Jr., and I've been an attorney at Atlanta Legal Aid for the last 41 years. For the past 21 years, I've served as the director of the Home Defense Program, a special unit of the Atlanta Legal Aid Society focusing on fraudulent practices targeted against homeowners and homebuyers.

Over the decades, the Home Defense Program has provided legal representation, legal advice, and referrals to low and moderate income homeowners who have been victimized by home equity and home purchase scams, foreclosure rescue scams, and above all, predatory mortgage lending. We also participate in community education efforts aimed at warning homebuyers and homeowners of the abuses and scams found in the mortgage market.

When a homeowner comes to the Home Defense Program for help, we begin by investigating their case for legal claims. Those legal claims vary in the type of remedy they provide. In some cases, we are able to use them to obtain cancellation of the abusive mortgage. In others, we are able to obtain a loan modification for the homeowner that lowers the interest rate, lowers the monthly payments, and, most importantly, lowers the principal balance. With seniors living on a fixed, limited income who may not be able to afford a mortgage payment, we seek to put in a place a reverse mortgage where the abusive lender takes a substantially short payoff in exchange for a settlement of the homeowner's legal claims.

During the course of my career at Atlanta Legal Aid, and through my representation of thousands of homeowners, I have watched the evolution of subprime, predatory lending grow from a problem of lack of access to good credit in low-income and minority neighborhoods, to a series of waves of abusive lending targeted at these same communities beginning in the 90s and cresting in the mid 2000s, culminating in the financial and economic crisis that has battered this nation's economy for the last two

years. And while national commentators look at the stock market and proclaim the end of the recession, millions of homeowners are facing foreclosure and the loss of their homes as a direct result of the mortgage meltdown.

There are three primary trends I wish to discuss today that I have observed over the last 41 years of my career. First, I would like to discuss the changes in the types of mortgage loans bearing predatory, abusive features. The second trend is the disturbing increase in predatory mortgage lending by national banks and their subsidiaries. Finally, preemption at the federal level and a weakening of predatory lending laws at the state level have stripped consumers and their advocates of many of the tools they were using to fight predatory lending.

History

I began my career as a staff attorney at the Atlanta Legal Aid Society in 1968 in northwest Atlanta. At the time, I was struck by the high rates of minority homeownership in the communities I worked in. Most of the low and moderate-income homeowners in these communities had good, affordable FHA and VA loans. While these loans were slightly more expensive than the best bank loans, they were underwritten well and serviced effectively. However, because many traditional lenders and banks did not make loans in these communities, there was not enough access to good credit. In the late 60s and early 70s, many of the homeowners in these communities were made second mortgages that were filled with abusive features like high interest rates, high points and fees, and worthless products like credit insurance where the creditor was the named beneficiary.

Predatory mortgage lending largely remained confined to second mortgages made by local hard money lenders for several years. In the late 1980s, we began noticing a large number of foreclosure rescue scam cases in the Atlanta metro area. Con artists were finding homeowners in trouble and reaching out to them, promising they would save their homes. Instead, these scammers wound up stealing their homes and the valuable equity in the homes. I formed the Home Defense Program in 1988 as a special unit to combat these scams, and received HUD Community Development Block Grant funds from the DeKalb County, Georgia Community Development Department to do this work.

In the early 90s, we started seeing a stream of cases that would serve as a warning bell for events to come. Fleet Finance, a subsidiary of the largest national bank in New England, Fleet Bank, had headquartered itself in Georgia and was making atrocious refinance mortgage loans to low-income, largely minority homeowners. These loans carried outrageous interest rates ranging from 19 to 29%, and high points and fees (sometimes exceeding 10%). Many of these loans were flipped repeatedly, stealing equity from homeowners. Finally, many of these loans were securitized – one of the first warning signs I saw that trouble was brewing in the secondary mortgage market. My colleague at the Home Defense Program, Karen Brown, and I partnered with private attorneys and Georgia's Attorney General to combat Fleet, coordinating our cases and strategies. The Attorney General eventually won a 115 million dollar judgment against Fleet, while

private attorneys won multiple class action settlements against Fleet Finance. The Home Defense Program obtained excellent settlements for nearly 50 homeowners, and brought national media attention to Fleet's practices, including a segment on 60 Minutes. As a result of these events, Fleet Finance was forced out of business.

After the Fleet Finance debacle, we assumed that major national banks would want to stay away from subprime, predatory mortgage lending. We were sadly mistaken. In the mid to late 1990s, nearly every major national bank jumped into the subprime market in an abusive and destructive way.[1] For example, the Home Defense Program began taking on a high volume of cases involving The Associates, a finance company owned by Ford Motor Company. The Associates was eventually the subject of a segment on ABC's Primetime Live regarding its abusive mortgage lending practices, which featured one of the Home Defense Program's client-homeowners. Ford attempted to distance itself from Associates by selling it. To our dismay and astonishment, Associates was eventually purchased by CitiGroup and eventually merged with CitiFinancial, the finance company arm of CitiGroup. Other banks, like First Union, Chase, Wells Fargo, and Washington Mutual opened subprime lending subsidiaries, purchased freestanding subprime lenders to fold into their business, or else made subprime mortgage loans directly out of their bank branches. This happened despite the fact that there was a clear pattern emerging regarding the life cycle of abusive standalone subprime lenders: they popped up, reaped huge profits for several years, and then collapsed because their predatory business model either proved unsustainable or else attracted the attention of state attorneys general or federal regulators like the FTC. This pattern has repeated itself at the national banks in the last two years, as they have been forced to shutter most of their subprime subsidiaries due to massive losses.

The entry of the national banks into the subprime mortgage market coincided with two other developments that helped cause the current meltdown. First, while many of the predatory mortgages we had seen in the 1980s and 1990s had outrageous points and fees and interest rates that would make credit card companies blush, the loan amounts were often small and so the payments were still "affordable." This meant that while the homeowners lost equity and were grossly overcharged and taken advantage of, they still generally did not lose their homes. However, in the late 1990s and early 2000s, we began to notice that subprime mortgage refinances were being made with higher and higher loan balances and, accordingly, higher and higher monthly payments. This increase in monthly payments drastically heightened the risk that homeowners would lose their homes to foreclosure and eviction.

Second, like the Fleet loans, many of these loans were securitized and sold onto the secondary market. As demand for these securities grew, propped up in part by the high yields gained from the comparatively high interest rates, the investment banks took notice. For example, Lehman Brothers began underwriting securities based on loans originated by First Alliance Mortgage Company. Eventually Lehman began acting as a lender for First Alliance, capitalizing it so it could make more and more abusive, predatory loans. This happened despite the fact that internal Lehman investigations

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[1] *See Banks Take Over Subprime*, National Mortgage News, November 15, 1999, at 1

revealed that First Alliance had extremely suspect lending and sales practices.[2] First Alliance eventually and inevitably collapsed in 2000. This sour experience did not dissuade Lehman and the other major investment banks from jumping feet first into the subprime business.

As the national banks, investment banks, and freestanding subprime originators churned through millions of subprime loans in an effort to fill pools of mortgages for the purposes of issuing securities, they ran into a problem in the early 2000s: financially eligible borrowers who could afford a mortgage were becoming increasingly scarce. Potential customers for subprime loans already had mortgages, and in fact were often mortgaged to the hilt. Instead of backing off, these institutions plunged ahead, with disastrous consequences. They made a deliberate decision to continue making mortgages, even when it was clear that there were few people left who had the ability to pay such a mortgage. The fact that unaffordable mortgages inevitably lead to default and foreclosure was apparently of no concern to them. Because most of these mortgages were being securitized, the originator was often out of the picture within weeks, if not days, while the parties investing in and holding the loans falsely claimed they had clean hands and no legal liability as assignees. This combination – originators who retained no stake in the loans, and assignees who could claim immunity to lawsuits regarding the predatory mortgages they held – has proven disastrous. In fact, the subprime securitization system was purposely designed to disperse risk in a way that immunized investors from the legal consequences of making the unaffordable mortgage loans that were the foundation of the securities they invested in.

To make unaffordable mortgage loans seem affordable, originators began designing and using so-called "affordability" products like adjustable-rate mortgages, or "ARMS," where the interest rate changed; hybrid-ARMs where the rate was fixed at a teaser rate for 2 to 3 years and then steadily and inevitably went up; interest-only loans where the borrower made only interest payments for 5 or 10 years (resulting in payment shock when the interest-only period expired); and finally, the Frankenstein of loan products, Pay-Option Arms, which combined adjustable interest rates, interest-only payments, and negative amortization. These mortgages included four levels of permissible payments with intention of deceiving borrowers into believing they could afford the mortgage at the lowest payment levels. However, these payments that would often double, triple, or even quintuple after only a few years.

Originators also intentionally threw underwriting out the window, progressing from low-documentation loans, to no-documentation loans, to stated-income loans. In virtually every case we have seen, borrowers would provide proof of their correct income, which was duly ignored. In fact, we began seeing the following distinct features in the loan applications of the Home Defense Program's clients. First, loans were being made with the income on the applications falsified, without the borrower's consent or knowledge. Second, loans were being made with no income on the application at all, despite the fact that the borrower provided correct income documentation. Finally, many loans showed the borrower's correct income – yet the loan was still entirely unaffordable on its face.

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[2] *In re First Alliance*, 471 F.3d 977 (9th Cir. 2006).

Closing attorneys, settlement agents, and even loan officers right out of bank branches would conduct shotgun closings, racing through documents to prevent borrowers from discovering abusive features or irregularities. In those cases where our clients realized they had an adjustable rate or other non-fixed mortgage, they were promised that they could refinance before their payments reset. These promised refinances never happened, leaving homeowners stuck in an unaffordable mortage.

The increasing demand for these mortgage-backed securities spurred the development of abusive lending practices and the deterioration of underwriting standards. As a result, all of the parties on the securitization chain saw huge profits – the originating lenders by charging high closing costs for terrible loans, the investment banks and national banks by underwriting and sponsoring the pools, and the ratings agencies by giving investment-grade ratings to subprime mortgage-backed securities that they failed to investigate.[3] Perhaps the worst development on the investor-side of things was the growing involvement of Fannie Mae and Freddie Mac. These once-venerable institutions, which had once prided themselves on providing capital for fair, affordable home purchase mortgages, began purchasing immense amounts of subprime mortgage-backed securities. For example, in a 6-month period in 2004, they purchased nearly 61% of Ameriquest's securities, nearly 40% of Countrywide's securities, and nearly 64% of Fremont's securities.[4] All three of these companies have been widely recognized as among the most reckless subprime originators. By purchasing these companies' securities, Fannie and Freddie provided capital to these companies allowing them to continue their predatory lending practices. In 2000, I testified before the United States House Committee on Banking and Financial Services, warning that if Fannie and Freddie were permitted to purchase large volumes of subprime securities that they risked their own collapse and the health of the nation's economy.[5] I took no satisfaction in watching those fears come true last summer.

Against this backdrop, two key events occurred in the early part of this decade that contributed to the scope of the crisis in Georgia. First, lenders and other players in the mortgage finance industry (including national banks and the rating agencies) gutted a Georgia law that would likely have ameliorated much of the crisis' impact in Georgia. Second, federal regulators utterly and embarrassingly not only abdicated their responsibility to oversee national banks and their subsidiaries – they actively preempted the application of consumer protection laws to national banks. These regulators blithely asserted that national banks were not the problem.[6] However, as time and study has made clear, national banks and their subsidiaries made huge amounts of subprime loans that were unaffordable and doomed to foreclosure.[7]

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[3] Mara Der Hovanesian, *Pointing a Finger at Wall Street*, BUSINESS WEEK, August 11, 2008 at 80.
[4] *See GSE Appetite for Subprime MBS Classes Remains Stout*, INSIDE B&C LENDING, July 26, 2004, at 3 (attached as Exhibit A).
[5] *Hearing Before the H. Committee on Banking and Financial Services*, 111th Congress (2000) (testimony of William J. Brennan, Jr.) (*available at* http://financialservices.house.gov/banking/52400bre.htm).
[6] Robert Berner and Brian Grow, *They Warned Us*, BUSINESS WEEK, October 20, 2008, at 38.
[7] Who's Behind the Financial Meltdown: The Top 25 Subprime Lenders and Their Wall Street Backers, May 6, 2009 (*available at* http://www.publicintegrity.org/investigations/economic_meltdown/the_subprime_25/full_list).

These events came about after the initial passage of the Georgia Fair Lending Act ("GFLA") in 2002. In 2000, in response to the increasing presence of abusive lending in Georgia, advocates, led by State Senator Vincent Fort began pressing for the passage of a strong anti-predatory lending law along the lines of the first predatory lending law passed in North Carolina in 1999. Although no bill was passed in 2000 or 2001, the cause was taken up by then-Governor Roy Barnes, a longtime consumer advocate, in 2002. The Home Defense Program and Senator Fort were intimately involved in Governor Barnes' push for a strong bill, and in 2002 GFLA was passed and immediately hailed as the strongest anti-predatory lending law in the nation. This law prohibited abusive lending practices, and included a strong assignee liability component, making the ultimate holder of the mortgage liable for violations of the law. By exerting discipline on the secondary market through assignee liability, Georgia advocates hoped to drive the worst predatory lending practices out of the state.

To the discredit of the national banks, federal regulators, rating agencies, and other financial institutions, much of this good was quickly undone. In 2003, under a flurry of intense lobbying and a blizzard of checks,[8] GFLA was gutted, with many of its strongest provisions removed or substantially weakened. National banks and subprime originators descended on the Georgia capital, with Ameriquest playing a major role. At one point, Ameriquest withdrew from Georgia mortgage lending and claimed they would not come back. Quite frankly, the state would have been far better off if they had stuck to that promise. To this day, many of the worst loans we see are Ameriquest loans.

Also contributing to the weakening of GFLA was the rating agency Standard and Poors. Standard and Poors claimed that because of GFLA's assignee liability provisions, they would stop rating securities which included any Georgia loans. This is of course one of the same ratings agencies that gave investment grade ratings to deeply flawed subprime mortgage-backed securities that were filled to the brim with abusive loans. At the same time they abandoned their responsibility to examine the securities they were rating, they were actively seeking to weaken consumer protection laws. Of course, at this juncture, Standard and Poors knew that it stood to make hundreds of millions of dollars rating subprime mortgage-backed securities in the future.

At that point, I must admit, we thought the worst was over. Then the Office of the Comptroller of the Currency and the Office of Thrift Supervision stepped onto the scene. Again to our dismay, in July 2003 John Hawke, head of the Office of the Comptroller of the Currency, assisted national banks in their efforts to take advantage of the subprime market by ruling that GFLA did not apply to national banks or their subsidiaries.[9] Given that much of the subprime and predatory lending flowing from national banks was being done by their subsidiaries, these preemption determinations had a significant impact. Far from being leaders in the provident extension of credit, national banks were now free to stoop to the level of the lowest common denominator.

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[8] *See* Glenn R. Simpson, *Lender Lobbying Blitz Abetted Mortgage Mess*, WALL ST. J., Dec. 31, 2007 at A1.
[9] Robert Berner and Brian Grow, *They Warned Us*, BUSINESS WEEK, October 20, 2008, at 40.

Conclusion

The financial industry destroyed much of the good stemming from the initial passage of GFLA. Unwise and imprudent federal preemption further weakened the state of consumer protection in Georgia. Today we can all see the effects. More than 12,000 foreclosures were scheduled for the Atlanta metro area in October, and more than 100,000 homes are expected to be scheduled for foreclosure this year – shattering the record set last year.[10] Major financial institutions have collapsed or been severely weakened by their reckless business practices, countless jobs have been lost, and neighborhoods have been left abandoned and empty. Unfortunately, it appears that lessons have not been learned. My understanding is that the latest version of the Consumer Financial Protection Agency bill, an urgently needed reform, has provisions allowing for federal preemption of state laws which seek to prohibit consumer abuses. It is my hope that Georgia will, in the future, once again be at the forefront of consumer protection. That hope is an empty one if the hard work of Georgia advocates, legislators, and citizens can be undone by federal regulators funded by the very institutions they regulate. Furthermore, reform of lending practices is urgently needed at the federal level, to provide a baseline of responsible underwriting in the extension of credit to consumers.

Finally, it is most disturbing to see that our clients, most of whom are facing foreclosure as a direct result of the reckless behavior of the financial institutions that created the subprime mortgage debacle, are being offered no or minimal relief. These national banks and investment banks manufactured and then, ironically, purchased the subprime-mortgage backed securities that are now known as "toxic assets." In short, they brewed a poison and then drank it. They have subsequently driven the economy to the brink of disaster and been the recipient of trillions of dollars of taxpayer money. While they eat at the trough of federal tax dollars, homeowners have been offered a weak modification program called the Making Home Affordable Program that has no mechanism for enforcement and which fails to recognize and address the predatory lending abuses perpetrated over the last decade. The disparity between these two outcomes is as telling as it is disturbing. Banks have been taken care of, while millions of homeowners are left to face foreclosure and eviction.

Thank you for your consideration of these comments.

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[10] Michael E. Kannell, *Metro Atlanta Foreclosures Swamp Last Year's Record*, September 16, 2009 (*available at* http://www.ajc.com/business/metro-atlanta-foreclosures-swamp-140045.html)

EXHIBIT A

lin, Homecomings Financial, IndyMac, and Option One.

Also covered by the survey are broker opinions on lender A-, 80-10-10 and 80-20, reduced-rate and low downpayment programs. Other topics covered by the survey include the reasons that brokers drop major wholesale lenders and why they choose not to use well-known lenders for their customers.

For more information on the survey report, contact John Campbell at Campbell Communications, (202) 363-2069.✦

GSE Appetite for Subprime MBS Classes Remains Stout

Fannie Mae and Freddie Mac remained hungry for subprime MBS classes during the first half of the year – and issuers were ready to fill their plates, a new *Inside B&C Lending* analysis reveals.

Clearly, the government-sponsored enterprises have become a key part of the strategies of most major subprime securitizers – a fact evidenced by the ever-growing percentage of their business that issuers are earmarking for delivery to one or both of the secondary market giants.

Highlighting that trend is a surge in issuance of so-called "GSE classes," or subprime MBS tranches that consist of loans with balances under the $333,700 conforming loan limit.

According to data compiled by *Inside B&C Lending*, 25 issuers – many of them first-time GSE sellers – completed deals containing such classes during the first half of the year. Combined, those firms delivered $73.44 billion in MBS classes, or 50.9 percent of their total production, to Fannie and Freddie. That was up markedly from the same period in 2003, when the firms combined to deliver just 39.7 percent of their production to one or both of the GSEs.

Overall, GSE classes accounted for 47.2 percent of the record $159.40 billion in subprime MBS issued through the end of June, up from 33.6 percent during the same period in 2003. On average, the top issuers grew their GSE production by a stout 157.8 percent during the period, with most major players at least doubling their volume.

Subprime Issuers by GSE Volume in 2004

(Through June 30, 2004 - Dollars in Millions.)

		2004			6 Months-2003			GSE Change
Rank	Issuer	GSE	Total	% GSE	GSE	Total	% GSE	2003-2004
1	Ameriquest Mortgage	$11,435.2	$18,578.0	61.6%	$4,474.6	$9,770.7	45.8%	155.6%
2	Countrywide Financial	$7,632.0	$20,349.9	37.5%	$113.3	$6,003.0	1.9%	6636.1%
3	Lehman Brothers	$6,921.9	$12,827.5	54.0%	$3,030.4	$6,341.1	47.8%	128.4%
4	Option One	$5,642.2	$8,795.8	64.1%	$4,488.0	$8,594.8	52.2%	25.7%
5	Washington Mutual	$5,470.0	$8,851.1	61.8%	$0.0	$4,148.7	0.0%	NA
6	New Century	$5,457.8	$10,598.9	51.5%	$4,737.9	$8,338.7	56.8%	15.2%
7	CS First Boston/ABSC	$4,609.2	$7,834.1	58.8%	$3,103.5	$6,264.5	49.5%	48.5%
8	First Franklin	$3,797.0	$7,468.1	50.8%	$1,163.0	$2,172.8	53.5%	226.5%
9	Fremont Investment	$3,418.8	$5,333.3	64.1%	$1,645.7	$2,224.0	74.0%	107.7%
10	WMC Mortgage	$3,220.4	$5,311.2	60.6%	$1,238.4	$2,369.0	52.3%	160.0%
11	Morgan Stanley	$2,831.9	$6,840.0	41.4%	$332.0	$1,086.9	30.5%	753.0%
12	GMAC-RFC	$2,648.7	$8,989.5	29.5%	$2,675.0	$6,450.6	41.5%	-1.0%
13	NovaStar	$1,632.0	$3,306.6	49.4%	$1,076.2	$2,800.0	38.4%	51.6%
14	Bear Stearns	$1,484.9	$3,697.0	40.2%	$0.0	$0.0	NA	NA
15	Fieldstone Mortgage	$1,354.3	$2,506.8	54.0%	$0.0	$0.0	NA	NA
16	Wells Fargo	$980.2	$1,422.6	68.9%	$0.0	$316.1	0.0%	NA
17	CDC Mortgage Capital	$788.0	$1,645.1	47.9%	$0.0	$1,448.5	0.0%	NA
18	Merrill Lynch	$669.2	$1,100.0	60.8%	$0.0	$528.2	0.0%	NA
19	Accredited Home Loans	$603.0	$1,382.9	43.6%	$0.0	$694.3	0.0%	NA
20	Centex	$588.0	$2,850.0	20.6%	$179.3	$1,300.0	13.8%	227.9%
21	IndyMac	$563.6	$791.8	71.2%	$0.0	$0.0	NA	NA
22	Finance America	$483.0	$917.6	52.6%	$0.0	$0.0	NA	NA
23	Equifirst	$448.8	$1,023.7	43.8%	$0.0	$0.0	NA	NA
24	Homestar	$399.0	$446.5	89.4%	$0.0	$0.0	NA	NA
25	Goldman Sachs	$361.2	$1,362.2	26.5%	$227.6	$864.5	26.3%	58.7%
	Total for top 25 Issuers:	**$73,440.3**	**$144,230.3**	**50.9%**	**$28,484.9**	**$71,716.3**	**39.7%**	**157.8%**
	Total All Issuers:	**$75,244.9**	**$159,395.2**	**47.2%**	**$29,348.2**	**$87,339.0**	**33.6%**	**156.4%**

Source: Inside B&C Lending.