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**The Subprime Mortgage Market Collapse:
Causes and Solutions**

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THE SUBPRIME MORTGAGE MARKET COLLAPSE: CAUSES AND SOLUTIONS

JUSTICE ACTION CENTER CAPSTONE

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CARLOS L. LOPEZ

On Sunday, April 27, 2008, the *New York Times Magazine* published a feature story uncovering the mysteries behind the credit rating agencies' evaluation of mortgage-backed securities ("MBS") and their involvement in the subprime mortgage market meltdown.¹ So many players are involved in this colossal market failure that the *New York Times* could easily devote a feature length article to explain each participant's role in the debacle. In fact, the major print media has published thousands of articles covering the market collapse on a daily basis, and the twenty-four-hour cable news network, CNN, has created a special investigations unit—titled *Inside the Mortgage Crisis*—that centers on the housing market, lending, and the credit crunch affecting low- and middle-income Americans. Most notable among this series is *Busted! Mortgage Meltdown*, in which a former Ameriquest mortgage broker revealed how brokers systematically and intentionally pushed borrowers into mortgages that they could not afford.

The subprime mortgage market collapse has proved so large and complex that three Justice Action Center affiliates chose to research and analyze three distinct aspects of it. In this joint project, Ruth S. Uselton examines the exotic mortgage products and terms that contributed to the foreclosure crisis; Amy L. Festante explains Wall Street's role in securitizing these mortgages and how the MBS market was allowed to spiral out

¹ Roger Lowenstein, *Triple-A Failure*, NY TIMES, Apr. 27, 2008.

of control; and Carlos L. Lopez analyzes the proposals for regulatory reform and legislative attempts to mitigate damages in the wake of this massive market failure.

Today, according the Mortgage Bankers Association, more than nine hundred thousand homes are in foreclosure—up 71 percent from 2007.² Forty-two percent of these foreclosures that were started in the fourth quarter of 2007 were subprime adjustable rate mortgages (“ARMs”), and twenty percent were prime ARMs.³ With more than half of all new foreclosures resulting from this relatively new loan product—aimed primarily at subprime borrowers—which also happened to be a major product fueling the MBS market on Wall Street, there is little doubt that the lenders and rating agencies failed to conduct reasonably adequate due diligence. The fallout from this perfect storm of greed, predatory lending, and oversight failures, will not truly be known for years to come. New foreclosures are certainly on the way, and legislative and regulatory responses are changing every day. This joint Capstone project, however, attempts to piece together the major issues behind the subprime market failure from what is currently known about the loan products used and the process of securitization of those loans.

² Les Christie, *Foreclosures Hit All-Time High*, CNNMoney.com, Mar. 6, 2008, available at http://money.cnn.com/2008/03/06/real_estate/defaults_continue_climb/index.htm.

³ Mortgage Bankers Association, Press Release, *Delinquencies and Foreclosures Increase in Latest MBA National Delinquency Survey*, Mar. 6, 2008, available at <http://www.mbaa.org/NewsandMedia/PressCenter/60619.htm>.