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Solving the Subprime Mortgage Crisis

Carlos L. Lopez
New York Law School
Class of 2008

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SOLVING THE SUBPRIME MORTGAGE CRISIS

CARLOS L. LOPEZ *
JUSTICE ACTION CENTER CAPSTONE

I. INTRODUCTION

The summer of 2007 became a flashpoint for a monumental financial crisis that had been simmering for years. Beginning in mid-summer, default rates on home mortgages characterized as "subprime" (those debts owed by mortgagors whose credit risk is considered high compared to average mortgagors) escalated well above the expectations of lenders and above the capability of the markets to absorb without significant disruption. The fall out from the high default rates has been dramatic.[1] Investors have lost hundreds of billions of dollars in a few short months, and millions of homeowners throughout the nation are facing the prospect of foreclosure.[2] The causes of this crisis include unprecedented laxness in lending standards resulting from the rise of securitization of mortgage-backed loans, predatory lending practices, and unwarranted optimism about the housing market in general.

This paper focuses on potential solutions and it explores two broad categories of solutions.[3] They are backward looking solutions that seek to help individual and

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*Carlos L. Lopez is a J.D. 2008 candidate at New York Law School.

[1] *See The Credit Crunch: Postcards from the Ledge*, THE ECONOMIST, December 19, 2007 (describing the crisis as the "shape-shifting menace that has vexed the world in 2007").

[2] *See id*. (estimating that subprime lenders will default on $200-$300 billion of mortgages).

[3] This paper is the third in a series dealing with the subprime mortgage crisis. The first two papers explore the effect of exotic loan products on the collapse of the subprime market and the role of securitization in the subprime market respectively. *See* Ruth S. Uselton, *Exotic Loan Products & the Collapse of the Subprime Mortgage Market*; Amy L. Festante, *Securitization's Role in the Collapse of the Subprime Mortgage Market*.

institutions already in trouble and prophylactic measures that seek to avert a similar meltdown in the future. Underlying both these approaches must be a rigorous analysis of the current crisis aimed at unwinding complex interrelationships between all the players (e.g. home owners, mortgage brokers, mortgage originators and servicers, investment banks and institutional investors such as hedge funds and pension funds). Only by understanding who the players are and what role they each play can a coherent solution be devised.[4] Efforts at unwinding the crisis into its constituent parts have already begun, but they are likely to be ongoing for some time because of the sheer complexity of the financial products that were created using subprime mortgages as a base, as well as the massive scope of the problem both in terms of dollars and the number of people involved.

However, because people and the overall economy are suffering right now, any action that is taken must be taken based on the imperfect information that is already available. That information suggests that many of the people suffering from the effects of the current crisis are at least partly to blame for their own misfortune.[5] Lenders overly relaxed their lending standards because the rising housing market and the growing securitization industry lulled them into believing that no loan was too risky. Investors bought huge pools of mortgages without conducting due diligence to asses the risk that the mortgages would actually be paid. Some of the home owners who are now facing foreclosure were speculators who purchased multiple investment properties gambling that

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[4] Alan S. Blinder, *Six Fingers of Blame in the Mortgage Mess*, N.Y. TIMES, September 30, 2007 (saying "[u]ntil we diagnose what went wrong with subprime, we cannot even begin to devise policy changes that might protect us from a repeat performance").

[5] *See generally, id*. Blinder assigns blame to home owners who borrowed recklessly, lenders who sold inappropriate loans to customers, bank regulators who failed to ensure that banks followed sound lending practices, investors who failed to adequately scrutinize their investments in securitized mortgage pools; investment banks who devised inscrutably-complex financial instruments using mortgage pools; and the credit rating agencies who helped create the very credit instruments that they then proceeded to rate.

real estate prices would continue to soar. Other home owners knew that they would not be able to afford their mortgage payments without relying on refinancing two or three years down the road. They too gambled that real estate prices would continue rising so as to ensure their ability to refinance.

Thus, the question is to what extent should the government expend taxpayer resources to rescue people from the consequences of their own irresponsible decisions? Perhaps the answer is that the government should do nothing. Any kind of government bail out would force society in general to bear the cost of poor choices made by these individuals. This may be unfair to taxpayers who chose not to gamble on the real estate market but nevertheless will be forced to shoulder some of the fallout. Further, there is concern that a government bail out would create a moral hazard – that is, a willingness on the part of the government to subsidize the cost of risky behavior may encourage more risky behavior in the future. While it is important to keep these concerns in mind, it is equally important to note that society in general is already bearing some of the cost of this crisis and is likely to continue to do so in the future.[6]

The U.S. economy is headed into recession, if it is not already in one, and the causes of the slowdown have their roots in the subprime crisis.[7] Nowhere is this more apparent than in the credit crunch. Lenders are now reluctant to lend money because of the huge losses they are incurring on subprime loans. Borrowed capital is the lifeblood of the economy and without it everything shrivels up: corporate mergers stall; private equity deals disappear; retailers go bankrupt or are forced to close stores throughout the

[6] *See* William Safire, *On Language: Moral Hazard*, N.Y. TIMES SUNDAY MAGAZINE, April 6, 2008 (quoting Treasury Secretary Henry Paulson as saying "[w]e are very aware of moral hazard …but our primary concern right now … is the stability of our financial system, the orderliness of our markets").
[7] *See Latest Economic Tea Leaves Point to Recession*, N.Y. TIMES, April 18, 2008.

country, etc. The lack of capital also contributes to a worsening of the housing market. Borrowers are having a hard time qualifying for loans because of stricter lending standards. Without eligible buyers, home owners cannot sell the homes they can no longer afford and this leads to foreclosures. Foreclosures drive down the price of housing because too many empty homes in a concentrated area open the door to blight and criminality. In other words, forcing people to suffer from their poor choices to ensure that they will not repeat their mistakes is an important factor to be taken into account in any governmental relief effort, but concerns about the fairness to taxpayers of bailing out investors and lenders are misplaced since taxpayers are going to bear some of the cost one way or another.

With that in mind, let us turn to some specific relief efforts. Section II deals with mitigating the harm that has already occurred (i.e. bailing out people and institutions who are already in trouble). Section III deals with prophylactic solutions to prevent a resurfacing of a similar crisis. The prophylactic solutions focus on a better regulatory system at the national and state level. As with any complex regulatory system, significant tensions exist that need to be resolved. For instance, this regulatory scheme will have to balance the need for clear, nationwide regulation with the need to allow space for the traditional role of state level regulation of home lending. The federal government should not preempt state regulation in this field, but neither should it assume that the states will fix the problems on their own. Another significant tension is that between the need for regulation and an awareness that over-regulation is detrimental because it drives up the cost of loans and reduces their availability.

II. Mitigating the harm

A. Federal Efforts at foreclosure relief

1. The Paulson Plan (Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans of the American Securitization Forum).

In light of the Bush administration's enthusiasm for a laissez-faire approach to the economy, it is not surprising that from the onset of the subprime crisis in mid-summer 2007, the President and his top economic advisors, including current Secretary of the Treasury and former chief of Goldman Sachs Henry Paulson, have stressed their belief that the crisis would be resolved not by governmental action but through efforts led by the lending industry itself.[8] The administration's natural disposition to market-based solutions was bolstered by concerns that governmental action would be seen as a "bail out" for irresponsible lenders and borrowers. Such a bail out, it was thought, might provide some quick fixes in the short term but would ultimately reward lenders and borrowers for their irresponsible behavior and thus encourage more irresponsible behavior in the future. In economic terms, the administration was worried that a government bail out for lenders and borrowers would reduce or eliminate the costs of their actions and thus make those actions economically rational because of their benefits, even potential or uncertain benefits. The same concept, known as moral hazard, is also seen in the insurance industry where it is theorized that insured individuals are more likely to take risks because the potential costs of those risks are borne by the insurer.

[8] *See generally, Bush Faults Easy Money for Volatility*, N.Y. TIMES, August 9, 2007 (noting that President Bush and Secretary Paulson viewed the financial turmoil as a natural adjustment from improvident lending practices and that it would sort itself out).

With a somewhat obsessive worry about being seen as bailing anybody out, Secretary Paulson, with the blessings of President Bush, began talks with members of the lending industry. The talks resulted in an agreement in early December sometimes referred to as the Paulson Plan or Project Lifeline.[9] The Paulson Plan is actually an agreement among members of the mortgage industry on a set of guidelines for dealing with the fallout of the subprime crisis and it is similar to a plan recently implemented in California. The agreement was memorialize by the American Securitization Forum in its Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans. The Paulson Plan focuses on the problem of borrowers with adjustable rate mortgages ("ARMs") which are set to adjust upward. This is a significant group of borrowers because of its sheer size. The Federal Reserve Board estimates that approximately 1.8 million subprime ARMs are expected to reset to higher interest rates in the next two years. Approximately 1.2 million of these loans (two-thirds) are held by borrowers who can afford their current, introductory, rates but will not be able to afford higher payments after their loans reset.

Project Lifeline divides these approximately 1.2 million borrowers into three segments. The first segment is comprised of borrowers who are current on their loan payments, meet credit score thresholds and have sufficient equity in their homes to make them likely eligible for refinancing opportunities. These borrowers would generally be able to refinance their homes without government or industry help except for one of the most pernicious characteristics of subprime loans – prepayment penalties.

[9] *See* American Securitization Forum, *Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans, Executive Summary*, December 6, 2007.

Lenders make subprime loans based on the following rationale. Some potential borrowers are ineligible for standard ("prime") loans because of their poor credit history. Nevertheless, some lenders are willing to risk lending to these borrowers as long as the lenders are compensated for the extra risk. As a result, subprime loans have higher interest rates than prime loans. Many subprime loans are structured as ARMs with low introductory rates, known as teaser rates, that later reset to a higher rate. During the introductory period, however, borrowers who make timely payments improve their credit scores. In some cases, improved credit scores and a record of timely payments during the introductory period of the loan cause the borrowers to become eligible for prime loans. These borrowers could then refinance their homes and achieve fixed interest rates that are lower than the adjustable rates of their original loans. This is great for the borrowers, but it deprives the subprime lenders of the benefit of collecting at a high interest rate because of their willingness to take a high risk.

As a result, most subprime loan agreements contain a penalty for prepayment of the loan. The prepayment penalty deters borrowers from refinancing by increasing the amount they must borrow in order to refinance the home. In many cases, the penalty raises the amount needed to a level that either exceeds the borrower's equity in the home or exceeds the refinancing bank's loan-to-value tolerance and therefore makes refinancing impossible. For instance, a subprime borrower (A) who owes $200,000 on a home that is worth $225,000 has $25,000 of equity in the home. If A's credit score has improved during the two years he has owned the home because he has been diligent with his payments, he may be eligible to refinance into a prime mortgage. A prime lender could lend A $200,000 with which to buyout A's subprime lender. The prime lender

could be confident in making such a loan because of A's improved credit score and because A's home is worth $25,000 more than the loan amount so that the prime lender is protected by the value of its collateral should A default on the loan. However, if A's subprime loan comes with a 5 percent prepayment penalty, he will need to borrow $210,000 to buyout his subprime loan. This amount represents 94 percent of the home's value and it is likely to exceed the prime lender's loan to value tolerance.

Project Lifeline encourages servicers of loans in this segment to structure refinances to avoid prepayment penalties wherever possible. Servicers are also encouraged to take all reasonable steps to encourage or facilitate refinancing for borrowers in this segment.

The second segment addressed in the Paulson Plan is comprised of borrowers who are current on their loans but are unlikely to be eligible for refinancing because of poor credit scores, low or no equity in their homes or a history of delinquent payments. Under the Paulson Plan, these borrowers are eligible for fast-track loan modification which would freeze the interest rate at the introductory level for up to five years. Because these borrowers are current on their loans, freezing the interest rate at the introductory level, which they are already paying, should keep their payments affordable and thus defer or avoid foreclosure.

The third segment is comprised of borrowers who are not current on loan payments at the existing introductory rate and do not qualify for refinancing. Project Lifeline does little more than pay lip service to the importance of lenders working with these borrowers on a loan-by-loan basis. But, Project Lifeline acknowledges that foreclosure is a realistic possibility for borrowers in this segment. In December, a *New*

York Times article estimated that 22 per cent or nearly 400,000 of the 1.8 million ARM loans that are set to adjust upward in the next two years fall into this third segment.

The National Community Reinvestment Coalition ("NCRC"), an association of community-based organizations that promote access to banking services for working families, is ambivalent about the Paulson Plan. The NCRC agrees that the plan is an important step forward in dealing with the crisis, but expressed dismay over the plan's narrow scope and voluntary nature. NCRC has five specific concerns about the Paulson Plan. First, the plan's success is contingent on the ability of servicers to unbundle loans from securitized pools and then adjust them, but the plan does not address what will compel or motivate investors who hold the securitized pools to allow for unbundling and adjustment. In fact, the plan itself states that servicers will not take any action that is prohibited by the pooling and servicing agreements.

As the plan also acknowledges, some of these agreements contain language that bars or limits adjustments to the mortgages contained in them. The NCRC is right to fault this aspect of the Plan, but it should be noted that while respecting the terms of pooling agreements drastically limits the effectiveness of the Paulson Plan, it is also an inevitable consequence of the Bush administration's insistence on industry-led solutions. Obviously, the mortgage industry wants to limit the number of foreclosures because foreclosures are expensive and inefficient. In that regard, the interests of borrowers and lenders are somewhat aligned, but the industry also wants to protect the securitization market because it has been immensely profitable. As a result, the Paulson Plan treads lightly to the benefit of the industry and the detriment of borrowers. But a much more significant reason for the Plan's refusal to interfere with securitization pool agreements is

simple – the mortgage industry must obey the law and cannot change the law even to solve a crisis affecting millions of people and costing hundreds of billions of dollars. Securitization pooling agreements are legally binding contracts. As a result, no amount of industry-led problem solving can make much headway because the laws must be changed and they can only be changed through governmental action.

The voluntary nature of the Paulson Plan presents another problem according to the NCRC. A plan affecting such a large number of people can only be successful if it is consistently applied throughout the nation. But consistency is not realistically possible for a plan that relies on individual lenders to determine how best to reach out to and engage homeowners.

The NCRC also believes that a five-year rate freeze may be insufficient. Realistically, a rate freeze only defers foreclosure for the duration of the freeze unless the borrower can find a way to afford his or her payments after the freeze ends. For most borrowers, the only way to do so is to refinance into a standard fixed mortgage. The Paulson Plan's rate freeze for borrowers in the second segment is premised on the belief that at some point during the rate freeze home values will start to increase, thus making refinancing possible. The NCRC is more pessimistic about the prospects of the housing market over the next five years because many high-concentration foreclosure areas throughout the nation have experienced double digit price declines in housing. As a result, the NCRC believes that the housing market will need longer than five years to recover to the point where borrowers in the second segment will have a realistic opportunity to refinance.

The fairness of the plan is another area of concern to the NCRC. The plan is pragmatic in that it attempts to resolve the crisis as efficiently as possible – albeit with the inherent limitations of voluntary action already discussed. But the plan does not address the fact that many borrowers ended up in this untenable situation as a result of unfair or predatory lending practices. As a result, the plan forces the victims of such lending practices to continue to pay to the extent that they are able and only then is any form of relief provided to them. Not only is this unfair, in the eyes of NCRC, but it is ill-conceived because it treats the crisis as being primarily the result of regional economic downturns and some speculation on house prices when "excessive mortgage broker fees, irresponsible loan products, inadequate underwriting, bloated appraisals, abusive prepayment penalties, and fraudulent servicing practices have been the major contributor to the foreclosure crisis that is sweeping the nation."

Finally, the NCRC faults the Paulson Plan for not addressing the increasing problem of vacant houses. This problem is two-fold. First, an increase in vacant houses in moderate-income neighborhoods compounds the problem of decreasing home values. It does so because it increases the surplus of available houses and because vacant houses tend to attract vandalism and crime. Second, the NCRC is concerned that investors could buy large numbers of vacant houses in hopes that the housing market will recover. This would result in a shortage of moderate and middle-income housing down the road.

As an alternative to the Paulson Plan, the NCRC suggests that the federal government draw on its own history of successfully dealing with complications in the housing market and implement bold solutions in the vein of the Homeowners Loan Corporation or The Resolution Trust Corporation.The Department of the Treasury

reported that as of mid-February 2008 more than 90 per cent of the subprime servicing market and nearly 70 per cent of the entire mortgage servicing industry agreed to participate in Project Lifeline.[10]

2. The Economic Stimulus Act of 2008 and higher limits on loans that can be purchased or guaranteed by Fannie Mae and Freddie Mac

In early 2008, worries about a possible economic downturn fueled by a continuing softening of the housing market, a tightening of the credit markets as a result of the subprime crisis, and increasing default rates on prime loans, prompted the federal government to consider enacting an economic stimulus plan. Initial reluctance by some members of the administration and Congress to a stimulus plan was overcome when Ben Bernanke, chairmen of the Federal Reserve Board, told some members of Congress that he supported a stimulus plan so long as the measures employed to head off a possible recession were quick and temporary.[11] After some debate, a consensus developed that the crux of any stimulus package had to be tax rebates to most Americans in order to spur consumer spending, which is thought to be crucial to heading off a recession.[12] Thus the bill that eventually emerged, the Economic Stimulus Act of 2008 ("ESA"), provided tax rebates of varying sizes for most American families.[13]

However, a lesser publicized part of the bill provided direct assistance to homeowners in the form of a temporary increase in the size of mortgage loans that Fannie Mae and Freddie Mac can purchase or guarantee.[14] This is important because the

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[10] *Full HOPE NOW Alliance Adopts Project Lifeline*, Treasury Press Release February 19, 2008.
[11] *Fed's Chairman Is Said To Back Aid to Economy*, N.Y. TIMES, January 17, 2008, A1.
[12] *Tax Rebate or Payment: A Policy Debate*, N.Y. TIMES, January 20, 2008, A18.
[13] Economic Stimulus Act of 2008, Pub. L. No. 110-185; 122 Stat. 613 (2008).
[14] *See* ESA § 201.

nationwide drop in housing values combined with tightening credit standards have made it difficult for home owners to refinance mortgage payments that they can no longer afford in the private sector. Before enactment of ESA, homeowners with so-called "conforming" loans – that is those loans not exceeding the $417,000 cap – still had the option to refinance through Fannie Mae or Freddie Mac. But homeowners with jumbo loans could not do the same. The temporary increase expands the number of homeowners who can refinance their mortgages and therefore avoid foreclosure. The increase applies only with respect to loans originated between July 1, 2007 and December 31, 2008.[15] The actual maximum dollar amount that Fannie Mae and Freddie Mac may purchase pursuant to ESA is tied to the median home prices in the applicable area and the median home prices are to be determined by HUD.[16]

It may seem that the problems of homeowners with jumbo loans are beyond the scope of a series of papers dealing with the subprime crisis, but the reality is that the previous cap on Fannie Mae and Freddie Mac loan purchases was so low that many home owners in metropolitan areas such as New York were ineligible for refinancing through those agencies. For instance, according to the *New York Times*, the median home price in the New York-White Plains-Wayne, New Jersey metropolitan area was $523,300 in the fourth quarter of 2007.[17] Thus, an owner of a median priced home in New York who made a 10 per cent down payment and financed the rest would have a mortgage of approximately $470,000, making him or her ineligible for refinancing through Fannie Mae or Freddie Mac under the pre-ESA limits. What this means is that in areas with high median home prices, non-conforming jumbo loans were not limited to the wealthy. In

[15] *See id.*
[16] *See id*.
[17] *Washington Lends a Hand*, N.Y. TIMES, February 23, 2008, C1.

such areas, the average home owner had a jumbo loan and therefore the average home owner was ineligible for refinancing through Fannie Mae and Freddie Mac.

Further, the interest rates on jumbo loans have always been slightly higher than the rates for conforming loans because of the fact that help from the federal government was unavailable on the former.[18] But the current difference in interest rates is almost a full percentage point. According to the *New York Times*:

> [f]or a high-priced home, 1 per cent can make a big difference. A monthly payment on a jumbo 30-year loan of $729,000 at 7 percent, would be $4,850. Monthly payments on a conforming loan of the same amount, at 6 percent would be $4,371, a $479 difference.[19]

The new limits will mitigate this problem, but it remains to be seen how much effect they will have. The changes in loan limits went into effect in early March 2008. Some experts, like Gus Faucher, director of macroeconomics at Moody's Economy.com, believe "[o]f all the various strategies proposed to help the housing market, … this one has the greatest potential …"[20]

3. The Fed has cut the Federal Funds rate six times since the summer of 2007

In early July 2007, before the default rates on subprime mortgages reached crisis levels, the Fed Funds rate was 5.25%. By late July or early August, high default rates on subprime loans forced many large banks to realize that they had huge exposure to subprime loans and therefore stood to lose billions upon billions of dollars. As a result, many banks sharply curtailed new loans causing a widespread seizure of the credit markets. The credit crunch not only made it difficult for home owners to refinance and

[18] *See id.*
[19] *Id*.
[20] *Id*.

for prospective home owners to get a mortgage in the first place, it also forced several mortgage lenders into bankruptcy and brought the private equity business temporarily to a screeching halt. The Fed responded by initiating a series of cuts in the Fed Funds rate.

The Federal Funds rate is the rate that private banks charge each other on overnight loans and it is controlled by the Federal Open Market Committee, chaired by Ben Bernanke.[21] The Fed cannot literally set the rate of interest by fiat, but the Fed does control the supply of money. So when the Fed wishes to lower the interest rate the Open Market Committee directs the New York Fed to inject cash into the system by lending money to major dealers in government securities.[22] Conversely, to increase the interest rate, the Committee directs the New York Fed to borrow money from major dealers in government securities. Unlike ordinary banks, the Fed has the exclusive power to create new money. If an ordinary bank were to lend money to another bank, there would be no net increase in the money supply, but when the Fed wishes to decrease the Fed Funds rate, it actually issues new money to lend thereby creating a net increase in the money supply.[23] The net increase in money does not directly affect interest rates, but it increases the liquidity of banks and the only thing that banks can do with liquidity is to lend it. As a result, cash-flush banks will tend to offer loans on terms more favorable to borrowers (i.e. at lower interest rates) because the banks' supply of liquidity will be outpacing the demand for liquidity. Generally then the effect of a decrease in the Fed Funds rate is to stimulate the credit markets.

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[21] *The Education of Ben Bernanke*, N.Y. TIMES SUNDAY MAGAZINE, January 20, 2008.
[22] *See Id*.
[23] *See Id*.

The first rate cut came in September. The Fed cut the rate to 4.75%.[24] This was followed by another cut in October, which brought the rate down to 4.5%, and again in December, which brought the rate down to 4.25%.[25] In January 2008, the Fed cut the rate by 0.75% – the biggest rate cut ever – bringing it down to 3.5%. Later in January, the Fed cut the rate down to 3%. Finally, in mid-March the Fed cut the interest rate to 2.25% where it remains as of this writing.[26]

The Fed's efforts seem to have averted a complete seizure of the credit markets, which would have had a devastating effect on the U.S. economy. For instance, private equity deals such as leveraged buyouts continue to go ahead, albeit for much smaller sums than prior to July 2007. But the rate cuts do not appear to have done much to alleviate home foreclosures. The problem is that the softening of the home market, which began long before the credit crunch, has continued. As home values continue to drop, they will eventually fall to the point where home owners actually owe more on their mortgages than their homes are worth. This is not disastrous for home owners who can afford their monthly payments and have no intention of selling in the near future, but the consequences are dire for home owners who hold ARMs that are due to reset to a level at which the monthly payments become unaffordable. This group of home owners must refinance or face foreclosure. However, refinancing is not a realistic option when the mortgage exceeds the value of the home. Banks, even those flush with cash due to a series of rate cuts, are unlikely to lend more than the value of the collateral (i.e. the home).

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[24] *See* http://www.federalreserve.gov/fomc/fundsrate.htm.
[25] *See Id*.
[26] *See Id*.

4. Modification of mortgages in bankruptcy

The bankruptcy code of the U.S. provides relief for borrowers who are overleveraged while simultaneously providing a fair procedure through which creditors have an opportunity to collect at least some of the debt owed to them. For homeowners, Chapter 13 protection may allow them to restructure their debt in such a way as to allow them to prevent foreclosure.[27] Section 1322(b)(2) of the bankruptcy code establishes the principle that the rights of creditors are subject to modification by a bankruptcy court.[28] Exempted from this principle, however, are creditors whose claims are "secured only by a security interest in real property that is the debtor's principal residence …"[29] In other words, the rights of mortgage lenders are not subject to modification in bankruptcy. At the time the code was enacted, Congress apparently believed that "mortgage lenders [were] performing a valuable social service through their loans [and] needed special protection against modification thereof...."[30] Chapter 13 does allow home owners to cure defaults and then to continue making payments, thus avoiding possible foreclosure.[31] Thus, the protections of Chapter 13 were adequate in a time when most loans were of the conventional, fixed rate kind. But the inability of bankruptcy courts to modify the underlying rights of creditors is a real obstacle at a time when many foreclosures are the result of ARMs that become unaffordable upon reset. For instance, a court is barred from converting an ARM into a fixed rate loan because such action would be a modification of the creditor's rights. Some scholars argue that "[i]t is time to recognize that a

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[27] *See* Henry E. Hidebrand III, *Let's Remove Special Bankruptcy Protection for Subprime Mortgages*, 26-7 ABIJ 14 (2007).
[28] 11 U.S.C. § 1322(b)(2).
[29] *Id*.
[30] *Grubbs v. Houston First American Savings Ass'n, 730 F.2d 326 (5th Cir. 1984).*
[31] *See* Hidebrand, *supra* note 27 at 14.

modification to § 1322(b)(2) could facilitate the preservation of a mortgage for the benefit of both the borrower and the lender."[32]

Some members of Congress agree. There are currently two bills in Congress, one in the House and the other in the Senate, that would do away with the § 1322(b)(2) exception for mortgages in some way. The Emergency Home Ownership and Mortgage Equity Protection Act of 2007, H.R. 3609, was introduced by, among others, the Chairman of the House Financial Services Committee, Barney Frank. The bill would completely eliminate the mortgage exception and allow bankruptcy courts to modify the rights of mortgage lenders just as they would any other creditor. The Helping Families Save Their Homes in Bankruptcy Act of 2007, S. 2136, was introduced into the Senate by, among others, New York's senior Senator Charles Schumer. This bill would preserve a general exception to the ability of bankruptcy courts to modify the rights of mortgage lenders, but allow courts to modify those rights where, after certain permissible deductions from the borrower's income, he or she has insufficient monthly income to retain possession of the home by curing a default and maintaining monthly payments. In such cases, the bill would allow the court to convert the mortgage into a 30-year fixed-rate mortgage.

Considering the devastating consequences of foreclosure for a home owner, as well as the economic losses that foreclosures impose on lenders, allowing bankruptcy courts to modify mortgages at least in some cases may be an important step in solving the subprime crisis.[33]

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[32] *id*. at 34.
[33] *See id*.

B. Mitigating the harm to investors

As discussed above, the largest single phenomenon that gave rise to explosive growth in the subprime mortgage industry and to its current crisis is the practice of securitizing home mortgages. Securitization is a process whereby a bank or other company that originates mortgage loans bundles hundreds or even thousands of mortgage loans together into pools and either sell the pools outright to investors or issues debt collateralized by pools. Conceptually, securitization is good for the originators and the investors who either buy or lend based on the securitized mortgage loans. When the mortgage loan pools are sold, they are sold for a price that is high enough for the originator to recoup its capital and make a modest profit. However, the price is low enough that the investors buying the pools will ultimately profit when the underlying mortgagors repay their loans (principal debt plus interest). When the mortgage loan pools are used as collateral, they act as a guaranteed income stream for the debtor upon which the lender can take a security interest to ensure against the risk that the debtor will default.

Securitization of mortgage loans became increasingly popular in recent decades as loan originators realized that by employing a securitization business model they could recoup their capital much quicker than they could through the traditional lending model, which required the originator to hold a loan for its entire life. Since most home loans have a term of thirty years, the traditional model of home lending left originators waiting to recoup their capital for decades. By contrast, originators using a securitization model can recoup their capital within days of making the loan. The length of time an originator must wait to recoup its capital is significant because it directly affects the volume of

loans it is able to make. Originators relying on a traditional home lending model are able to make many fewer loans than originators relying on a securitization model because the latter have more free capital. In addition to the profit that originators generate from selling their mortgage loan pools, they also generate substantial profit by charging various origination fees in connection with each new home loan. Therefore, securitization, by freeing up more capital and thereby allowing originators to make more loans, also increases the profitability of originators. This explains why the practice has become so widely popular. In fact, securitization has created a market for mortgage companies such as Countrywide. These mortgage companies rely on the vast amount of capital they are able to generate through securitization in order to make as many home loans as possible. They cannot survive without making a large number of new home loans constantly; therefore they could not exist if they had to rely on the traditional home lending model. The securitization model is also advantageous to borrowers because it increases the volume of home loans being made.

However, the securitization model is premised on one assumption, without which the entire industry would collapse. That assumption is that the underlying mortgagors will pay their debts or at least that the level of defaults will remain within a forecasted range. The importance of this assumption cannot be overstated. Investors buy these mortgage loan pools fully expecting that X number of mortgagors will pay Y dollars over the life of the loans to yield Z return for the investors. Without that assumption, the investors would not buy the mortgage loan pools and originators would be forced to retain their home loans. As a result, many originators would suffer significant losses or even go out of business.

The reliability of this key assumption, at least in situations where mortgage loan pools act as collateral for debt offerings, has been left in the hands of the three credit rating agencies, Moody's Investor Service, S&P, and Fitch Ratings. These agencies serve as gatekeepers by evaluating the risks of debt offerings. When the debt offerings are collateralized by mortgage loan pools, an important element of the credit rating agencies' job is to determine the credit risk of the mortgages comprising the pools. Unfortunately, investors have been surprised recently by losses in investments that received high credit ratings from the agencies. Many of these losses are associated with unexpectedly high default rates by mortgagors. In some cases, the default rates are unexpected because investors did not realize the extent to which the mortgage loan pools they invested in were comprised of subprime loans.

The fact that a substantial number of debt offerings backed by mortgage loan pools containing a high percentage of subprime loans have wreaked havoc in the financial markets over the last six months suggests that regulation is needed to force the credit rating agencies to take their gate keeping role seriously. In a *Wall Street Journal* article, Arthur Levitt, Jr., a former chairman of the Securities and Exchange Committee ("SEC"), described the problem with the credit rating agencies by saying that they "are playing both coach and referee in the debt game."[34] The agencies rate the very same companies that are paying their fees. Because of this, the agencies have a considerable interest in ensuring that the debt offerings of their clients are marketable. That is that the debt offerings receive an acceptable rating. Mr. Levitt compared the conflicts of interest of the credit rating agencies to the conflicts of interest of auditing firms of the Enron era

[34] Arthur Levitt Jr., *Conflicts and the Credit Crunch*, OPED, WALL STREET JOURNAL, September 7, 2007.

scandals. Just as the accounting firms were held to account by Congress, primarily through the Sarbanes-Oxley Act, Mr. Levitt suggested that the credit rating agencies must be held accountable.

A good start, according to Mr. Levitt, is the Credit Rating Reform Act of 2006 ("CRRA").[35] The CRRA is primarily a registration act which requires all "nationally recognized statistical rating organizations (NRSROs)" to register with the SEC. Each NRSRO must describe its procedure and methodology for issuing credit ratings in its application for registration. After the initial registration, all NRSROs must file an annual report with the SEC either certifying that there have been no material changes to their procedures and methodology for issuing credit ratings, or a list detailing the material changes. The CRRA grants the SEC exclusive enforcement authority over any NRSRO that issues credit ratings in contravention of its own procedures and methodologies. But, the act explicitly prohibits the SEC or any state or local government from regulating either the substance of any credit rating or the procedures and methodologies to be used. In other words, the act only goes so far as to give the SEC authority to ensure that the NRSROs obey their own rules. In addition, the act requires that NRSROs establish and enforce a written policy and procedure on managing conflicts of interest.

Mr. Levitt argued that the CRRA is only a first step. In order to address the problem seriously more oversight is needed. For one thing, he noted that the CRRA's prohibition against regulations judging the quality of the standards by which the agencies issue credit ratings is similar to the oversight in place for auditors pre-Enron. Mr. Levitt encouraged Congress to pass legislation that would in his view make the credit rating

[35] Pub. L. No. 109-291, 120 Stat. 1337.

agencies more reliable. First, he noted that the SEC needs the power to set standards for issuing credit ratings and the power to discipline credit rating agencies that deviate from those standards. Next, Mr. Levitt argued that individuals who work for a credit rating agency and help a firm structure a financial instrument should be prohibited from going to work for that firm for at least one year. This proposed rule is similar to a requirement imposed on auditors by Sarbanes-Oxley. Mr. Levitt noted that the rule is necessary in order to foster independence among the employees of the credit rating agencies. Another of Mr. Levitt's suggestions is that transparency in the credit rating industry be increased by requiring companies who are issuing debt to disclose any services a credit rating agency has provided in connection with the issuance and rating including any consulting or structuring of the transaction and the amount of fees related to those services that were paid to the credit rating agency.

Mr. Levitt also said that holding credit agencies liable for "malfeasance that is more than mere negligence" would be advantageous. He admitted, however, that this suggestion is more controversial than his other suggestions because the credit rating agencies are likely to claim that their ratings are a form of constitutionally protected speech. Mr. Levitt discounted this argument however, because he claimed that any First Amendment claim based on ratings of structured financial products that the agencies themselves helped to create would be very weak.

Since the credit rating agencies play a pivotal role in ensuring the reliability of the unique operational assumption that allows the securitization industry to function (that debtors will pay their debts), oversight along the lines suggested by Mr. Levitt is crucial

to restoring the integrity of an industry whose health is vital to the overall health of the U.S. and world economies.

Mr. Levitt's article made one final commonsense observation that merits discussion. Investors themselves, especially large institutional investors, should consider this summer's financial crisis as a wake up call for them to play more of an active role in evaluating the risks of their investments. The credit rating agencies offer a guide, not a stamp of approval.

III. Preventing a resurfacing of the subprime crisis

A. Federal efforts

A central concern among advocates for home owners has been that weak federal legislation might be enacted. Advocates fear that a weak federal law would be worse than no federal action because any federal legislation in this area could preempt state laws that in some cases, especially in states like New York and California, already provide strong protection for borrowers. A recent bill introduced by the chair of the Senate Banking Committee, Sen. Christopher Dodd (D-Conn.) has allayed some of the fear. The proposed Homeownership Preservation Act of 2007 ("HPA")[36] provides strong protection for borrowers and, critically, it contains a clause that explicitly precludes federal preemption.[37] Courts are instructed that the bill and regulations promulgated under it are to be deemed supplemental to relevant state laws and are "not to be interpreted as preempting state laws that provide equal or greater protection."[38] HPA's strong protections for borrowers and lack of preemption have won it the endorsement of the

[36] S. 2452.
[37] *See* HPA § 801(b).
[38] *Id*.

NCRC, which in an email to its members noted that "[t]his legislation offers the most meaningful protections yet. It includes some of the strongest language we have seen and incorporates a number of significant provisions NCRC members and allies called for."

The bill divides borrowers into three broad groups and provides certain protections on a categorical basis. Title III of HPA includes all home loan borrowers and it imposes certain duties on mortgage originators[39] and mortgage brokers.[40] Mortgage originators, under the HPA framework, are charged with five affirmative duties. They are to safeguard and account for any money handled for the borrower; to follow reasonable and lawful instructions from the borrower; to act with reasonable skill, care, and diligence; to act in good faith and with fair dealing in any transaction, practice, or course of business in connection with the originating of any home mortgage loan; and to make reasonable efforts to secure a home mortgage loan that is appropriately advantageous to the borrower, considering all of the circumstances, including the product type, rates, charges, and repayment terms of the loan.[41] In addition, HPA prohibits originators from "steering" borrowers into loans that are more expensive than the least costly loan for which a particular borrower qualifies.[42] In cases where an originator does not offer the loan that is the least costly for a particular borrower, the originator is required to disclose the fact to the borrower and indicate that other originators may offer such a loan.

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[39] The term "mortgage originators" is defined in § 2 of HPA as "any creditor or other person, including a mortgage broker, who, for compensation or in anticipation of compensation, engages either directly or indirectly in the acceptance of applications for home mortgage loans, solicitation of home mortgage loans on behalf of consumers, negotiation of terms or conditions of home mortgage loans on behalf of consumers or lenders, or negotiation of sales of existing home mortgage loans to institutional or noninstitutional lenders. It also includes any employee or agent of such person."

[40] The term "mortgage broker" is defined in § 2 of HPA as "a person who, for compensation or in anticipation of compensation, arranges or negotiates or attempts to arrange or negotiate home mortgage loans or commitments for such loans, refers applicants or prospective applicants to creditors, or selects or offers to select creditors to whom requests for credit may be made."

[41] *See* HPA § 301(a).

[42] *See* HPA § 301(c).

These duties, particularly the duty to make efforts to secure a loan that is "appropriately advantageous to the borrower" attempt to address what is perceived to be one of the underlying causes of the subprime crisis – a lack of attention on the part of lenders to the ability of borrowers to pay back their loans. Apathy on the part of lenders resulted from the nature of the securitization business because most loans are no longer kept on the books of the originator. Instead they are securitized and sold in bundles to investors.[43]

In addition to imposing affirmative duties on mortgage originators, HPA also explicitly requires that originators base their determination that a potential borrower can afford a loan on documentation of a potential borrower's ability to pay back the loan.[44] For example, mortgage originators must verify all of a potential borrower's sources of income by examining his or her tax returns, payroll receipts, bank records, or other appropriate documentation.[45] The originator's determination must also be based on the borrower's debt-to-income ratio.

The affirmative duties imposed on mortgage brokers are more succinctly stated but, in some sense, even stricter than those imposed on originators. For instance, HPA deems a fiduciary relationship to exist between a broker and borrower in every home mortgage loan.[46] In essence, a fiduciary duty means that all brokers are required to use the utmost good faith in dealing with borrowers and to put the interests of borrowers above all other interests, including the broker's own interest.[47] HPA also requires that

[43] *See generally*, Festante, *supra* note 3.
[44] *See* HPA § 301(d).
[45] *See id.*
[46] *See* HPA § 301(b).
[47] *See id.*.

brokers clearly disclose to all borrowers the total compensation that a broker would receive from each of the loan options presented to a borrower, as well as any other information that could materially affect a borrower's ability to obtain his or her intended benefit from the loan.[48]

A second category of borrowers is described in Title I of HPA. These are borrowers with "high-cost mortgages." A high-cost mortgage is defined to mean, for a first mortgage, a consumer credit transaction secured by a principal dwelling where the annual percentage rate ("APR) of interest will exceed the yield on U.S. Treasury securities having comparable periods of maturity by more than 8 per cent at the time the transaction is consummated.[49] For a junior mortgage, the term is applicable where the APR exceeds the applicable yield on U.S. Treasury securities by more than 10 per cent. Alternatively, whether a home loan is a high-cost mortgage can be determined with reference to the total points and fees payable in connection with the loan. For a loan of $20,000 or more, a high-cost mortgage is one where the applicable total points and fees exceed 5 per cent of the total loan amount.[50] For a loan of less than $20,000, a high-cost mortgage is one where the applicable total points and fees exceed the lesser of 8 per cent of the total loan or $1,000.[51]

Since the protections of Title III of HPA are applicable to all home loans, the protections for borrowers with high-cost mortgages supplement the already significant baseline protections afforded to all borrowers. The first and most controversial protection offered by Title I is that it prohibits prepayment penalties in connection with high-cost

[48] *See id.*
[49] *See* HPA § 101(a).
[50] *See id.*
[51] *See id.*.

mortgages.[52] As discussed above, prepayment penalties play an important role in whether or not a borrower is able to refinance his or her mortgage. As a result, elimination of, or curtailment of, prepayment penalties has been a cornerstone of advocacy policy for groups like NCRC.

Another pernicious "exotic" loan technique that advocacy groups have decried is the balloon payment. A loan with a balloon payment requires a series of, typically affordable, payments, but then requires a large payment that far exceeds the other payments. Balloon payments can cause a borrower to default on his or her loan either because the balloon payment was not clearly disclosed so that it comes as a surprise or because the borrower erroneously believed that he or she would be able to refinance the mortgage before the balloon payment became due. HPA does away with balloon payments for high-cost mortgages by prohibiting, in most cases, any scheduled payment that is more than twice as large as the average of all other previously scheduled payments.[53]

HPA contains several other specific protections for high-cost mortgages such as prohibiting the acceleration of debt by the lender except in cases of default or breach of a material provision of the loan[54] and prohibiting structuring a loan with the deliberate aim of avoiding the requirements of HPA.[55] But more significantly, HPA prohibits mortgage originators from making a high-cost mortgage loan that involves refinancing a pre-existing home mortgage loan unless the new loan will provide a "net tangible benefit" to the borrower. This final protection for borrowers with high-cost mortgages underscores

[52] *See* HPA § 102(a).
[53] *See* HPA § 102(b).
[54] *See id.*
[55] *See id.*

the main thrust of HPA, which is to require mortgage originators and brokers to put the best interests of borrowers above their own best interests.

The final category of borrowers that are afforded special protection by HPA are subprime borrowers. The protections for such borrowers are laid out in Title II. A subprime mortgage loan is defined to mean a home mortgage loan in which the APR exceeds the greater of two thresholds.[56] The first threshold is called the Treasury security rate spread. Under this threshold a home mortgage loans is subprime if the difference between the APR on the loan and the yield on U.S. Treasury securities with comparable rates of maturity exceeds 3 per cent on a senior loan or 5 per cent on a junior loan. The second threshold is called the conventional mortgage rate spread. Under this threshold a home loan is subprime if the difference between the APR on the loan and the annual yield on conventional mortgages is equal to or greater than 1.75 percentage points for senior loans or 3.75 percentage points for junior loans.[57]

HPA imposes a general requirement on originators to determine whether or not a particular borrower has an ability to pay a given subprime or other nontraditional loan prior to entering into the transaction.[58] To that end, HPA lays out a series of factors that an originator must consider when determining a borrower's ability to pay. These factors include the borrower's income, the borrower's credit history, the borrower's other debt payments and obligations, and the borrower's current employment status, as well as other factors.[59] Interestingly, HPA contains a rebuttable presumption that the loan was made without regard to payment ability if at the time the loan was made the total monthly debts

[56] *See* HPA § 2.
[57] *See id.*
[58] *See* HPA § 201(a).
[59] *See id.*.

of the borrower exceeded 45 per cent of the borrower's total monthly gross income.[60] Title II also bars prepayment penalties on subprime loans and imposes the same net tangible benefit requirement as Title I with respect to subprime loans that refinance a home mortgage loan.

B. State efforts

1. The Nationwide Mortgage Licensing System (NMLS)

Forty-two states, including New York, have indicated their intent to require individual mortgage loan originators to be registered with the state and certified to conduct business. According to Richard H. Neiman, the New York Superintendent of Banks, New York's participation in this effort "is a testament to our commitment to reducing mortgage fraud and identifying individuals who attempt to evade enforcement by simply migrating across state lines."[61] Of the forty-two states, fifteen plan to use the NMLS online system to register and track mortgage loan originators.[62] Seven of these states have already enacted legislation mandating the use of NMLS. New York is one; article 12-E of the New York Banking Law went into effect on January 1, 2008 requiring all new applications for certification as a mortgage loan originator to be processed through NMLS.[63] Mortgage loan originators who were previously certified must begin transferring their certification information onto NMLS. In addition to registering with NMLS, mortgage loan originators are required to submit supplementary documents

[60] *See id.*
[61] NYS Banking Department press release Dec. 19, 2007.
[62] *See* http://www.stateregulatoryregistry.org/NMLS/AM/Template.cfm?Section=Participating_States1.
[63] *See id.*

directly to the Banking Department. These documents include fingerprints, credit history, and other documentation related to financial and criminal history.[64]

The New York law instructs the superintendent to determine if the "general character and fitness and the education qualifications of the applicant are such as to warrant belief that the applicant will engage in mortgage loan originating honestly, fairly, and efficiently."[65] The superintendent is to make this determination based on one or more of four grounds.[66] These include whether the mortgage loan originator has been convicted of certain crimes involving an activity which is a felony involving theft or fraud.[67] In addition, the superintendent may refuse to issue a certification if the mortgage loan originator has had a similar authorization revoked by banking regulators in another state.[68] The superintendent may also decide not to issue a certificate to managers or employees of entities who had certifications revoked by regulators in other states.[69]

In principle, NMLS would facilitate the superintendent's task by centralizing relevant information about applicants. However, because only seven states are currently using NMLS, its benefit will be limited for the foreseeable future. As the database grows, so will its usefulness, but New York need not wait for other states to implement the system before beginning to reap the benefits. Article 12-E mandates that by 2010 the transition to NMLS be completed. Therefore, in a few short years banking regulators in New York will have all the registration information for every mortgage loan originator in the state at their disposal in one centralized database. Regulators in other states could also

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[64] *See* NY CLS Bank § 599-c (2008); 3 NYCRR § 420.4; 3 NYCRR SP MB § 107.
[65] NY CLS Bank § 599-c(2).
[66] NY CLS Bank § 599-c(3)(a).
[67] *See id.*
[68] *See id.*
[69] *See id.*

benefit significantly from New York's transition to NMLS. States that intend to participate in NMLS but have either not yet begun or not yet completed their transition to the system will still have access to the database, which means that regulators in those states will be able to gauge the reliability of prospective mortgage loan originators coming to their states from New York. Considering the sheer number of banks and individual mortgage originators that operate in New York – with estimated aggregate assets in excess of $1.8 trillion[70] – regulators from other states will benefit greatly by having access to NMLS.

2. HALT Task Force

In March 2007, then Governor Spitzer created an interagency task force charged with halting abusive lending transactions. HALT is chaired by Superintendent Neiman and on December 13, 2007 he testified before the state senate and gave an update on its progress.[71] Neiman said that HALT's first priority was the collection of data to begin quantifying the level of the problem in New York. Specifically, HALT has so far identified patterns in higher-cost or subprime lending in New York; the rate of delinquency for subprime products statewide; and the counties most impacted by escalating foreclosures.[72]

In order to identify patterns in subprime loans, HALT examined so-called "higher-cost" loans, which are those where the APR exceeds the rate on the treasury security of corresponding maturity by 3 per cent for a first lien and 5 per cent for a subordinate lien. Such loans account for less than 30 per cent of all loans statewide, but

[70] New York Banking Department press release December 19, 2007.
[71] Testimony of Richard H. Neiman on "Subprime Mortgages and Foreclosures in New York" before the Committee on Banks, New York State Senate, December 13, 2007 (Hereinafter Neiman Testimony).
[72] *See id.* at 2.

the number is increasing. According to Neiman, in 2005, higher-cost loans accounted for 25.04 per cent of new loans but by the end of 2006 the number had crept up to 27.87 per cent.[73] Although the increase appears marginal, it is expected to increase. Moreover, higher-cost loans are not evenly distributed among categories of borrowers. Neiman noted that HALT's research confirmed several external studies finding that minority borrowers and minority communities receive higher-cost loans at a disproportionate rate.[74] For instance, statewide for every one borrower in a neighborhood with a low minority population who obtained a higher-cost loan in 2006, two borrowers in high-minority neighborhood received a higher-cost loan. In some counties the disparity was even greater. In Westchester County the disparity was more than 4 to 1; in New York County the disparity was almost 4 to 1; and in Kings County the disparity was almost 3 to 1.[75] According to Neiman, a big concern with disparities such as these is "whether overqualified minority borrowers are being discriminated against and steered into higher-priced loan products."[76]

HALT also examined the delinquency rates on subprime loans in New York and compared those rates to the delinquency rates on subprime loans throughout the country. With respect to fixed rate subprime loans, New York fared slightly better than the national average with 6.28 per cent of these loans being more than ninety days past due compared with 6.61 per cent nationwide. However, with respect to subprime adjustable rate mortgages, New York's delinquency rate was almost two full percentage points

[73] *See* Neiman Testimony at 2.
[74] *See id*. at 3.
[75] *See id*. at 3-4.
[76] *Id*. at 3.

higher than the national average (17.59 per cent for New York compared with 15.63 per cent nationwide).[77]

Finally, HALT examined the foreclosure rates in New York and compared them to nationwide rates. The percentage of subprime fixed rate mortgages in New York that were in foreclosure was 3.39 while the nationwide rate was slightly lower at 3.12. The percentage of subprime ARMs in foreclosure was 13.25 while the nationwide rate was 10.38.

The significantly higher rate for delinquencies and foreclosures for ARMs is especially disturbing, according to Superintendent Neiman, because more than 25 per cent of New Yorkers with subprime ARMs had FICO scores of 660 and above, which indicates that they may have qualified for more affordable, fixed-rate loans.[78]

Unfortunately, HALT predictions, as well as national predictions, indicate that the subprime meltdown will continue to worsen in waves over the next several years as more and more ARMs reset to higher interest rates. HALT proposed some potential legislative solutions to this problem, but there are also several steps that HALT recommends for individuals who are facing imminent foreclosure. The first and most crucial step is for a delinquent borrower to contact his or her lender or servicer as quickly as possible.[79] The servicer or lender is in a position to modify the loan and is often willing to negotiate a workout arrangement that will not only prevent foreclosure but will preserve the borrower's credit history. Second, troubled borrowers should contact the New York State Banking Department in order to speak with specially trained staff who can help

[77] *See id.* at 3-4.
[78] *See id*. at 5.
[79] *See id.* at 7.

borrowers file a complaint against their lenders or refer borrowers to appropriate service providers.[80]

HALT also recommends that troubled borrowers contact certified housing counselors who can provide advice on options and resources for dealing with debt.[81] Borrowers should also obtain independent legal advice, according to HALT. This is so because an attorney can review a borrower's loan documents to ensure that the loan does not violate any anti-predatory lending laws.[82]

In addition to these general suggestions for troubled borrowers, HALT has engaged in more detailed outreach and consumer counseling initiatives.[83] For example, HALT has been holding day-long summits across New York to address the unique problems in different regions of the state. In addition, HALT participates in a public service ad campaign organized by a group called NeighborWorks America. HALT also participates with other state agencies in a 40-year fixed rate loan program, which offers loans with low, fixed monthly payments to borrowers, as well as the "Keep the Dream" program, which created a $100 million fund for use in offering refinancing options to eligible subprime borrowers facing a mortgage hardship.[84]

The HALT task force is also working to develop a legislative proposal that would require more in-depth evaluation of a borrower's ability to repay, prohibit certain loan practices, clarify mortgage brokers' duties to borrowers, and further strengthen state

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[80] *See id*. For assistance call 1-877-BANK-NYS.
[81] *See id.* A list of certified housing counselors may be obtained at http://www.banking .state.ny.us/legal41ac.htm
[82] *See id*. The New York Bar Association's Lawyer Referral Program can be reached at 1-800-342-3661. The Banking Department may also be able to offer assistance in locating free legal services for borrowers who cannot afford legal fees.
[83] *See id.* at 8.
[84] *See id.* at 9.

enforcement tools.[85] These goals appear broadly similar to those proposed at the federal level through the HPA. Importantly, should HPA become law it will not limit New York's ability to set even higher standards because HPA explicitly does not preempt state action.

[85] *See id.* at 10.

IV. Conclusion

The subprime crisis has affected interests as varied as the capitalization needs of the largest banks in the world on the one hand and the tight monthly budget of middle class families on the other hand. There are few “bad guys” because many of the victims played a role in bringing about their own predicament. For that reason some critics have suggested that the government should take a laissez-faire approach and let the chips fall where they may. However, the scope of this crisis makes such an approach both unwise and politically impossible. The losses from the crisis already number in the hundreds of billions of dollars and they continue to mount. Millions, maybe tens of millions, of foreclosures have already occurred or are looming. As we have seen, the crisis is already causing a slowdown in the U.S. economy. Without some form of governmental action, things could get progressively worse. Moreover, a democratically elected government – composed of individuals who hope to be reelected – simply cannot let so many of its citizens twist in the wind without taking some concrete steps to help.

The proposed solutions discussed above are a good start. Many more solutions are also in the works as this is a very dynamic topic. So long as the government remembers that any proposed solution must attempt to reconcile the interests of lenders, homeowners and taxpayers, as well as balance the need for uniform, clear federal solutions with independent solutions by the states we will be able to put this crisis behind us and hopefully learn from our mistakes.