Statement of Ranking Member Spencer Bachus at the Financial Institutions Subcommittee Hearing on â€œThe New Regulatory Guidance on Subprime Hybrid Mortgages: Regulators And Responseâ€•

MARCH 27, 2007

Thank you Chairwoman Maloney, for convening this hearing into this important issue, one in which we both share a significant interest.

To quote former President Lyndon B. Johnson, “For many families, home ownership is a source of pride and satisfaction, of commitment to community life.” It is a well-known fact that the benefits of homeownership for families, communities and the nation are profound. Study after study links homeownership to higher educational performance of children, greater participation in civic and volunteering activity, improved healthcare outcomes, lower crime rates and less welfare dependency.

Homeownership rates in the U.S. are near the highest level in history – nearly 70 percent overall. Low interest rates and government policies we have promoted over the last decade to encourage homeownership have fostered a competitive marketplace. A large number of new homeowners have enjoyed one of the many benefits of homeownership -- using the equity in their homes for home improvements, family emergencies, debt consolidation, etc. Significant numbers of consumers were able to purchase homes and use the equity because of the subprime lending market which provides millions of Americans with credit that they may not have otherwise been able to obtain.

The origins of subprime lending date back to the Community Reinvestment Act. Passed in 1977, the CRA mandates that banks and thrifts meet the credit needs of all the communities in which they are chartered and from which they take deposits, including low- to- moderate income borrowers.

Nationally, subprime mortgage originations have skyrocketed since the early 1990s. Finance companies, non-bank mortgage companies, and, to a lesser extent, commercial banks have become active players in this area. In 1994, just $34 billion in subprime mortgages were originated, compared with over $213 billion in 2002 and $665 billion in 2005. The proportion of subprime loans compared with all home loans also rose dramatically. In 1994, subprime mortgages represented five percent of overall mortgage originations in the U.S. By 2002, the share had risen to 8.6 percent, and by the fourth quarter of 2006, the share had grown to 23 percent.

While the development of a robust subprime mortgage market has benefited many Americans, the significant turmoil in that market in recent days indicates that there were excesses. As the housing market began to cool in 2005, many subprime lenders tried to maintain their loan volume by loosening underwriting standards and offering adjustable rate mortgages featuring very low “teaser rates” that could “reset” at much higher rates once the introductory period expired. Borrowers assumed that they could either refinance or sell their homes at a profit once their interest rates reset at the higher levels.

However, with property values stagnating or falling in many parts of the country, a growing number of homeowners now find themselves trapped in high-cost loans, and delinquency and foreclosure rates have begun to spike upward. Recent statistics released by the Mortgage Bankers Association indicate that of the approximately 13 million subprime loans outstanding, roughly 4 percent are entering foreclosure. Not surprisingly, the subprime mortgage industry is experiencing a major shake-out, with many lenders finding it increasingly difficult to secure the financing needed to make new loans, and others ceasing operations entirely.

The Federal banking regulators represented at today’s hearing issued Guidance in September of last year that addressed potential safety and soundness concerns regarding certain subprime mortgage products. The guidance covered “interest-only” mortgages and “payment option” adjustable-rate mortgages and discusses the importance of carefully managing the potential heightened risks created by these loans.

Additionally, this past month the regulators issued proposed guidance addressing the treatment of adjustable rate mortgage products. The guidance specifies that a lender’s assessment of a consumer’s ability to repay their mortgage should be based on the fully indexed rate, assuming a fully amortizing repayment schedule. The guidance also emphasizes the importance of clear and balanced disclosures to prospective borrowers regarding the benefits of the loan. It is my belief that had this new Guidance been in effect previously, it could well have prevented the vast majority of the defaults we are seeing today.

Unfortunately, the new Guidance does not cover a broad swath of the subprime mortgage industry – such as mortgage brokers and state-regulated finance companies – where we have seen a good many of the problems. Twenty-nine of the states have adopted standards similar to those promulgated by the Federal regulators, and I urge those states that have not yet acted to do so expeditiously.

While I am encouraged by Chairman Frank’s recent pledge that he’d like to see this legislation move forward in the very near future, let’s not forget that we have been here before. Back in March 2006, I circulated a draft legislative proposal regarding predatory lending to then-Ranking Member Frank and other Democrats. That draft – which was identical to the North Carolina predatory lending law - initiated six months of conversations with other Members of Congress. Had we reached agreement, those protections would be in place today for consumers who are not covered by state laws.

Some of these protections include: examining a borrower’s ability to repay the loan, a ban on certain prepayment penalties, greater disclosure of yield spread premiums, and the right of an individual consumer to initiate private rights of action to enforce the provisions of the law.

While I remain committed to passing legislation that protects borrowers and seeks to address some of the problems that have been the subject of extensive coverage in the media, I hope that we can do so in a thoughtful and deliberative manner. The last thing we need at this point is ill-conceived legislation that dries up credit availability to ordinary Americans while worsening the current market downturn. This is an important issue and we need to get it right.

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