SETTING THE RECORD STRAIGHT – THE HOUSING CRISIS

Allegations are circulating that Democrats are responsible for the economic fallout from the subprime housing crisis because of their support for affordable housing, including the Community Reinvestment Act (CRA) and Fannie Mae and Freddie Mac (the "GSEs"). In fact, Democrats repeatedly pushed for stronger action to address predatory lending practices that led to the subprime crisis, while Republicans promoted financial deregulation and failed to rein in Fannie and Freddie during their long period in power.

- **Housing Crisis Cause.** The crisis was not caused by a Democratic emphasis on affordable housing. In fact, during the Clinton Administration, homeownership rates surged and the homeownership gap between whites and minorities narrowed, without widespread subprime abuses or loan losses. In contrast during the Bush Administration, the homeownership rate stagnated and the homeownership gap between whites and African-Americans grew by 5%, while subprime lending escalated. The current economic crisis was caused by a housing crisis caused in large part by the proliferation of risky subprime loans originated by deregulated lenders, sold off by securities firms into subprime mortgage pools, and abetted by rating agencies that failed to do their job.

  Republicans were slow to even acknowledge there was a problem. Democrats took the first step to identify high cost loan problems by passing legislation in 1994 (HOPEA), and escalated warnings during the Bush years about subprime abuses. Yet, President Bush admitted that he did not start working on the problem until August 2007.

- **Response.** Republicans failed to pass predatory legislation in the 12 years of control of Congress. Democrats took over and passed a House bill curbing predatory lending by a vote of 291-127, but the Bush Administration opposed and killed the bill. Democrats support prudent banking and securities regulation to address risky loans - while the Bush Administration failed to use its regulatory authority over lenders, investment banks, and securities markets to rein in excesses and even e*xpanded* deregulation.

- **Fannie Mae/Freddie Mac.** Fannie and Freddie are not the cause of the housing crisis, they merely participated in it by purchasing risky subprime securities that resulted in huge losses. Moreover, the claim that Democrats were responsible for blocking needed reforms to Fannie and Freddie is false. Republicans controlled Congress from 1995 to 2006 and the White House starting in 2000, and failed to enact a reform bill in that period. Within 5 months of taking office in 2006, Democrats passed a reform bill in the House. In January 2008, Treasury Secretary Paulsen turned down Chairman Frank's offer to put a reform bill into the stimulus bill, delaying final passage until July.

- **CRA.** Claims that CRA forces banks to lend to unqualified borrowers and is therefore a major cause of the mortgage crisis are contradicted by facts. CRA does not require banks to make loans to risky borrowers, only to serve their communities and qualified low income borrowers. In fact, the great percentage of troubled, subprime loans were made by lenders <u>not</u> subject to CRA. Default rates on loans by CRA lenders are much lower than default rates on subprime loans, and are comparable to prime loans. Studies have shown that CRA has actually increased the volume of responsible lending to low- and moderate income borrowers. Finally, any claim that Clinton-era CRA changes caused loan losses is belied by the fact the riskiest subprime lending which created the crisis did not take off until 2003, the very time when Bush Administration regulators were *decreasing* both the number of institutions subject to comprehensive CRA exams and CRA data reporting requirements.

Housing Crisis Cause

- **Risky Subprime Lending Cause of Housing Crisis.** The housing crisis was caused in large part by a proliferation of risky subprime loans to unqualified borrowers that were originated by deregulated lenders, sold off by securities firms into subprime mortgage pools, and abetted by rating agencies that failed to do their job. The problem was exacerbated by exotic loan terms with attractive introductory rates that reset at unaffordable rate levels, leaving borrowers with little or no equity in the properties. Foreclosures and declining housing prices led to huge mortgage losses for banks and other investors, which escalated into a broader credit crisis and economic dislocations.

- **Emphasis on Affordable Housing Did <u>not</u> Cause the Housing Crisis.** Democrats have never supported lending to unqualified homebuyers, and in fact have led the way in emphasizing that homeownership must be sustainable and that affordable rental housing is a critical component of housing policy. In fact, the Clinton Administration succeeded in raising the national homeownership rate from 64% to 68% and narrowed the minority homeownership gap, without widespread subprime abuses or loan losses.

- **Bush Administration Neglect of Affordable Rental Housing Exacerbated the Problem.** The Bush Administration took office in 2001 touting a homeownership agenda, with a goal of 5.5 million new homebuyers – but it neglected to address affordable rental housing needs. In fact, the Bush Administration repeatedly tried to slash HUD affordable rental housing programs, touting homeownership as the answer for almost all families. This led to an environment in which families who were not ready or qualified for homeownership were improperly encouraged to buy a home.

- **The Bush Administration Was Slow to Recognize There was even a problem.** Supbrime lending began to escalate in 2003, with default and foreclosure levels building over the ensuing years. Yet, on December 4, 2007, asked about whether the Administration was slow to recognize the subprime problem, President Bush said, *"We've been working on this since August."* This failure to acknowledge the problem was compounded by a failure to take decisive steps to address the growing credit problems that this subprime crisis posed for the broader housing market, for institutions holding mortgage backed securities, and ultimately, for the economy as a whole.

Response to the Housing Crisis

Predatory Lending

- **Democrats Enacted First Bill Dealing with Predatory Lending and Subprime Loans.** While in control of Congress in 1994, Democrats passed into law the Home Ownership and Equity Protection Act" (HOPEA), which identified high cost loans, and established enhanced disclosures for those potentially problematic loans.

- **Republicans Took No Action As Predatory Lending Escalated.** As predatory lending began to escalate and explode after the Bush Administration took office, Democrats repeatedly called on the Bush Administration to take action. Democrats introduced numerous bills and pushed for adoption of legislation to strengthen protections against predatory lending beginning in 2001, but were repeatedly blocked by Congressional Republicans from acting on such legislation.

- **Democrats Take Action when they take over Congress in 2007. W**hen Democrats took over and passed a House bill curbing predatory lending by a vote of 291 to 127, in November 2007, the Bush Administration opposed and thereby killed that bill. That bill would have required lenders to extend loans only to those with a demonstrated ability to repay, outlawed many abusive mortgage practices, required the licensing of mortgage brokers, and held Wall Street accountable when they bought securitizations containing predatory loans.

- **Democrats Pressed for Stronger Regulatory Protections against Predatory Lending.** During the Bush Administration, Democrats repeatedly urged the Federal Reserve and Bush Administration-appointed regulators to adopt guidance and regulations to protect borrowers against abusive predatory lending. Although HOPEA authorized the Federal Reserve to prohibit acts and practices in connection with mortgage loans that it finds to be unfair and deceptive, the Federal Reserve refused to act for more than 12 years while the Republicans controlled Congress. After the Democrats regained Congress in 2007, they continued to urge the Fed to act, and finally the Federal Reserve issued proposed regulations defining certain practices as unfair and deceptive.

Deregulation

- **Democrats Support Sound Financial Regulation.** Democrats support prudent financial regulation and pushed for better regulation of risky mortgage products as they proliferated.

- **Bush Administration Financial Regulators Failed to Do Their Job.** The Bush Administration has failed to use existing regulatory authority over lenders, investment banks, and securities markets to rein in excesses, and in fact actually e*xpanded* de-regulation.

Enhanced Regulation of Fannie Mae and Freddie Mac

CLAIM: The claim is being made that Democrats, as supporters of Fannie Mae and Freddie Mac (the "GSEs), blocked enactment of comprehensive legislation to improve financial regulation of these two GSEs, thus permitting their collapse in recent months.

THE FACTS:

- Democrats have historically supported the mission of Fannie Mae and Freddie, particularly their purchase of affordable mortgage loans for low- and moderate-income homebuyers, But Democrats have for many years supported and worked for passage of legislation strengthening financial regulation of these two GSEs – including passing in 1992 the bill that established the Office of Federal Housing Enterprise Oversight, which has provided GSE financial regulation since then.

- **Republican Inaction.** Republicans controlled Congress from 1995 through 2006, with the Bush Administration in charge from January, 2001. *Republicans failed to pass any major legislation strengthening regulation of the GSEs in that time.*

- **2003/2004.** In October, 2003, House Republicans on the Financial Services Committee scheduled a markup of comprehensive GSE reform, and had worked with Democrats on a bi-partisan bill. At the last moment, the markup was called off, because the Administration did not support the bill. The House took no further action for the rest of the 108th Congress on this legislation.

- **2005/2006.** House Democrats and Republicans worked together on major GSE reform legislation and reported a bill out of committee (H.R. 1461) on May 25, 2005 by a vote of 65 to 5 ***(****all 5 no votes were Republicans).* *Republican Chairman Mike Oxley, commenting about this, said they had received "a 1-finger salute" from the Bush Administration.* On October 26th, the House adopted this bill by a vote of 331 to 90. *The Bush Administration opposed this bill, through its Statement of Administration Policy*. Earlier, on July 28, Senate Republicans took a more partisan approach, passing a bill on a party line 11 to 10 vote out of committee. No further action was taken in 2005 or 2006.

- **2007.** Democrats take over Congress and Chairman Frank formally organizes the Financial Services Committee on January 31st. On March 28th, the Committee reports out a comprehensive GSE reform bill (H.R. 1427) by a bipartisan vote of 49 to 15 *(once again, all no votes were Republicans)*. On May 22, the full House approves the bill on a vote of 313 to 104 *(all 104 no votes were Republicans)***.**

- **2008.** In January, in the middle of negotiations between the Bush Administration and Congress, Chairman Frank offers to insert the GSE reform bill into the stimulus bill that was enacted shortly thereafter, and Secretary Paulsen says no. On May 8th, the House sent a major housing bill (H.R. 3221) back to the Senate, adding GSE reform legislation. Subsequently, the Senate Banking Committee reported their own bill, and after reconciling House and Senate differences, the President signed the bill into law as part of the broader housing bill. P.L. 110-289.

The Community Reinvestment Act (CRA)

CLAIM: The claim is being made that CRA requires banks and thrifts to make loans to unqualified low-income and minority borrowers, and that this has been a major cause of the subprime mortgage crisis, and ensuring housing and economic problems.

THE FACTS:

- CRA does not require banks or thrifts to make loans that are unsafe or unprofitable – the law states that CRA lending must be done consistent with safe and sound banking practices. In fact, studies by the Department of Treasury and the Federal Reserve have shown that CRA has significantly improved the availability of fair and affordable credit and services without negatively affecting safety and soundness.

- There is no evidence that CRA caused lenders to make risky subprime loans that contributed to the current housing crisis. In fact, studies indicate that CRA obligations helped deter insured depositories from engaging in lending practices that fueled foreclosures and the subsequent financial crisis, and that that CRA-covered banks and thrifts were significantly less likely than other lenders to make high-cost loans:

    - Non-CRA lenders made a disproportionate number (84.3%) of high-cost loans in the 15 largest metropolitan areas [per 2006 HMDA data].

    - The Federal Reserve found that in 2005, 34.3% of home purchase loans issued by non-CRA mortgage companies were high-cost loans, while the number for CRA-covered institutions was just 5.1%.

    - Only a few of the top 25 subprime lenders in 2006 were federally regulated depository institutions with CRA obligations and the vast majority of the top 20 producers of risky interest-only and option ARM loans were not covered by CRA [*Inside B&C Lending* and *Inside Mortgage Finance]*

    - A 2000 CRA study found that defaults on CRA mortgage loans were not appreciably higher than defaults on prime mortgage loans (and more than 70% of CRA banks reported default rates equal to or lower than prime default rates). By comparison, losses on subprime loans have much higher default rates than default rates on prime loans.

    - Most subprime loans are not made to minorities or low-income borrowers. Between 2005 and 2007, 58% of higher cost loans were made to white borrowers, and fewer than 30% of subprime loans in 2006 were made to low- and moderate-income borrowers (Source: HMDA data analysis by Compliance Tech and the Center for Responsible Lending).

    - The timing of the foreclosure crisis also reinforces that CRA was not responsible for the mortgage market meltdown. CRA regulations were strengthened in 1995 and contributed to a significant increase in <u>prime</u> lending to low- and moderate-income borrowers in the ensuing years. The riskiest subprime lending was most prevalent, however, between 2003 and 2006, a period in which federal banking regulators *decreased* the number of banks and thrifts subject to comprehensive CRA exams and *reduced* CRA data reporting requirements for these financial institutions.