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United States Senate

WASHINGTON, DC 20510-3204

December 3, 2007

The Honorable Henry M. Paulson, Jr.
Secretary
United States Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Mr. Secretary:

I am encouraged by news accounts that Treasury officials are negotiating an agreement with the mortgage industry to curb the foreclosure crisis. Reports of this agreement indicate that it will allow homeowners to apply to quickly refinance their mortgages or temporarily stop their adjustable rate mortgages from resetting at higher levels.

An effort to end the foreclosure crisis is long overdue. 1.8 million foreclosure notices have been sent out this year, an increase of 74% from last year. And with the monthly payments set to rise on more than 1 million subprime loans next year, the situation is likely to worsen. Experts now say that the foreclosure crisis is weakening the economic outlook, hurting industries from construction to autos, and making banks reluctant to lend companies the capital they need to expand and create jobs. Cities face the prospect of vacant properties marring neighborhoods, cutting tax receipts, and dragging down property values.

It is critical that we address this crisis. The Administration and the mortgage industry must reach an agreement that matches the scale of the problem. If you produce an inadequate agreement, or fail outright, the cost to our economy will be incalculable. A satisfactory agreement must do at least the following: impose a moratorium on foreclosures, freeze mortgage rates before they escalate, and require that the mortgage industry report its progress on loan modifications:

- **Impose a foreclosure moratorium of at least 90 days on subprime, owner-occupied homes**. The moratorium will stop foreclosures until lenders and servicers have an opportunity to implement the freeze in mortgage rates. Servicers have complained that they do not have the systems in place to quickly contact the large numbers of at-risk borrowers. Servicers can certainly expect that during the moratorium at-risk borrowers will contact them. The moratorium will also give state and city organizations as well as community groups the necessary time to provide financial counseling to at-risk homeowners. The moratorium only applies to owner-occupied houses, and therefore excludes real estate speculators.

- **Freeze the monthly rate on subprime adjustable rate mortgages, with the freeze lasting at least 5 years or until the mortgages have been converted into affordable, fixed-rate loans**. After the moratorium, there should be a long freeze in rates on adjustable rate mortgages. The overwhelming majority of subprime mortgages have adjustable rates. The long rate-freeze will give the housing market time to stabilize. It will give families an opportunity to rebuild equity in their homes. It also gives the mortgage industry time, and incentive, to convert mortgages that were designed to fail into loans that are actually affordable. The rate freeze and loan modification must be extended not only to borrowers who are current but to some who have fallen behind. After all, it is indisputable that brokers and mortgage companies lured families into mortgages which were designed to end in foreclosure. This was only possible because regulators were asleep at the switch. A rate freeze is critical. An average of $30 billion in loans will reset monthly next year. One study indicates that the average reset increases monthly payments by 40%. It is no surprise that rate resets are the major driver of the foreclosure crisis. The rate freeze and loan modification would only apply to owner-occupied houses.

- **Require the mortgage industry to provide status reports on the number of mortgages it has modified.** Resolution of the foreclosure crisis will require that large numbers of unworkable mortgages be converted to more stable loans. To date, however, despite pressure from Congress and the press, lenders and servicers have modified only about 1% of subprime mortgages. This obviously has to change. We cannot take the industry at its words that it will follow through on an agreement to convert loans expeditiously. Accordingly, the agreement must impose on lenders and servicers an obligation to regularly report their modifications.

Mr. Secretary, if you produce an agreement that lacks these provisions, I will pursue another course to end the crisis:

- **I will consider legislation that enables lenders to convert unworkable mortgages into stable, affordable loans without the permission of investors.** Protection from lawsuits will remove the obstacle that keeps lenders, servicers and others from turning mortgages that were designed to fail into mortgages families can afford. Right now, servicers who process monthly loan payments and interface with homeowners have flexibility to modify loans. However, they are reluctant to fully exercise this discretion in part because they fear investor lawsuits. Investors who own the securities into which the mortgages have been packaged may assert that they are harmed when servicers help at-risk borrowers. Protection from lawsuits could enable the servicers to help homeowners avoid foreclosures, help investors avoid the losses they would otherwise suffer, and help the economy.

I also propose to provide financial assistance to communities on the frontlines of the crisis:

- **A fund of up to $5 billion to help hard-hit communities and distressed homeowners weather the foreclosure crisis.** The fund will support initiatives by states, cities, and community groups to reduce foreclosures, and to help cities cope with the financial and social costs associated with an increase in vacant properties. The fund will provide a much-needed boost to communities already feeling the effects of the economic downturn. States are already piloting programs to stem foreclosures. Many of the programs provide financial counseling to at-risk homeowners, help borrowers work out solutions with lenders and educate homeowners about predatory lending. Studies demonstrate that the overwhelming majority of families that receive financial counseling ultimately avoid foreclosures. Financial counseling can cost as little as $3,000 per household, while each foreclosure costs a local community $227,000 when the harm to surrounding property values is included. Foreclosure prevention is more critical than ever. The concentration of foreclosures in particular neighborhoods has a negative ripple effect on communities. It leads to higher rates of crime, lower tax revenues, and lower property values. Low-income communities are especially at risk. Risky subprime loans are three times more likely in low-income neighborhoods than in high-income ones. Minority communities are also disproportionately at risk because subprime loans are five times more likely in predominantly black neighborhoods than in predominantly white neighborhoods. The Center for Responsible Lending estimates that 55% of African-Americans and 46% of Latinos who purchased homes in 2005 received subprime mortgages. Those loans were mostly adjustable rate mortgages, and most of them will experience escalations in the monthly payments either this year or next. The foreclosure crisis threatens to undo the gains in minority homeownership rates. Lawsuits have been filed against mortgage lenders alleging discriminatory practices. Regulators should be especially attentive to these concerns.

In March I called on the mortgage industry to observe a "foreclosure timeout" so that lenders and borrowers could work out solutions. I also wrote to Federal Reserve Chairman Ben Bernanke urging him to act swiftly to curb abusive and irresponsible lending practices. Just two weeks later, however, you told Congress that the subprime problem was "contained." Unfortunately it was not. While you and others in the Administration misdiagnosed the problem, over 1 million additional foreclosure notices were sent out. Later, I called on the Administration to convene a "crisis conference" that gathered the housing stakeholders—lenders, investors, mortgage servicers, regulators, representatives of homeowners, and others—to devise a way of modifying the large number of unworkable mortgages. I am glad that the Administration has at least heeded this call.

Now that you have gathered the housing stakeholders, it is imperative that you negotiate an agreement appropriate to the scale of the problem. The proposals I have outlined provide the framework for a comprehensive workout, not a bailout. This is a moment of shared responsibility. Investors, lenders, and homeowners all have a part to play and sacrifices to make.

While we work to solve the immediate problem, I call on the Administration, the regulators, and the mortgage industry to ensure that the abuses of recent years never recur. There must be a commitment to tightening underwriting standards and disclosure obligations. Federal prohibitions against abusive lending must be vigorously enforced. Prepayment penalties must be eliminated. Brokers must be subject to federal registration. Mortgage servicing fraud and foreclosure rescue fraud must be prosecuted. Homeowners and homebuyers must have greater access to financial counseling. I have already announced proposals to accomplish many of these things.

It is unfortunate that the Administration has been so slow to act. But now that you and others are engaged, I urge you to make the bold decisions that the situation warrants. Thank you for your attention to this critical issue.

Sincerely,

Hillary Rodham Clinton

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