U.S. COMMISSION ON CIVIL RIGHTS

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BRIEFING

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FRIDAY, MARCH 20, 2009

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The Commission convened in Room 540 at 624 Ninth Street, Northwest, Washington, D.C. at 9:00 a.m., Peter N. Kirsanow, Commissioner, Acting Chair, presiding.

PRESENT:

PETER N. KIRSANOW, Commissioner, Acting Chair
GERALD A. REYNOLDS, Chairman (via telephone)
TODD F. GAZIANO, Commissioner
GAIL L. HERIOT, Commissioner
ARLAN D. MELENDEZ, Commissioner
ASHLEY L. TAYLOR, JR., Commissioner
MICHAEL YAKI, Commissioner

MARTIN DANNENFELSER, Staff Director
STAFF PRESENT:

DAVID BLACKWOOD, General Counsel
MARGARET BUTLER
DEMITRIA DEAS
PAMELA A. DUNSTON, Chief, Administrative Services and Clearinghouse Division
LATRICE FOSHEE
MAHA JWEIED
ROBERT LERNER, Assistant Staff Director
SOCK-FOON MacDOUGALL
TINALOUISE MARTIN, Director of Management
EMMA MONROIG, Solicitor
LENORE OSTROWSKY
KIMBERLY TOLHURST
AUDREY WRIGHT
MICHELE YORKMAN

COMMISSIONER ASSISTANTS PRESENT:

TIM FAY
DOMINIQUE LUDVIGSON
KIMBERLY SCHULD
RICHARD SCHEMCHEL
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I. INTRODUCTORY REMARKS BY CHAIRMAN

ACTING CHAIRMAN KIRSANOW: The meeting will come to order. We have got approximately 17 witnesses today. So we are going to try to move very rapidly and with some degree of precision, which is something that is a little bit of an anomaly here at the Commission.

I am Commissioner Kirsanow. I am presiding because I have staged a coup over Commissioner Reynolds. I have appointed Commissioner Yaki as my lieutenant. And Commissioner Taylor is going to be my sergeant-at-arms.

In reality, Chairman Reynolds is participating by phone. He couldn't make it today. And Vice Chair Thernstrom extends her regrets. She has some issues to take care of. She would much like to be here today but can't do so.

On behalf of the Civil Rights Commission, I want to welcome all of our witnesses today. We have a very distinguished panel or group of panels, frankly. As usual, our staff has done a splendid job in securing some really outstanding witnesses on a
very timely and important topic. That topic is civil
directives issues with respect to the mortgage crisis.

This is the U.S. Commission on Civil
Rights. We are convening at 9:30 on March 19th
Eastern Standard Time. And, again, this has to do
with the mortgage crisis. Many of you are probably
asking yourselves, what does the Civil Rights
Commission have to do with the mortgage crisis or the
housing market or anything like that? Well, there are
a number of different perspectives in which you can
examine this overall issue.

The issue in which we have some authority
is the enforcement of federal legislation or
regulation or policies intended to prevent
discrimination in housing and mortgage lending that
may have contributed to weakening credit standards,
lending standards, creating pools of risk, borrowers
unable to meet their financial obligations, and
anything else we can get our hands on. We will take
authority over everything and jurisdiction over
everything we can.

(Laughter.)

ACTING CHAIRMAN KIRSANOW: We are also
going to examine very closely any evidence that
minority homeowners were somehow unfairly targeted or
otherwise treated in a discriminatory fashion by lenders in terms of their own lending policy.

Typically what we do is after we have a hearing such as this, we keep the record open for a period of 30 days so that supplemental comments can be submitted to the Commission. If someone has supplemental comments to submit to the Commission, send them to the Office of the General Counsel here at the U.S. Civil Rights Commission, 624 9th Street, Northwest, Washington, D.C. 20425.

As I said, we have got a number of witnesses today. They will consist of three panels, but, in fact, those panels will be bifurcated in panels 1 and 2. There are going to be various facets of this particular issue that we are going to cover today.

Given the fact that we have got a number of people who have got travel commitments and this will probably prove to be a fairly lengthy hearing, I am going to Draconianly enforce the speakers' time restraints and also that of the commissioners when we ask questions. I know that we will be able to have a very informative presentation and done so in an efficient fashion if we do so. And please forgive me
if I act arbitrarily, capriciously. That is my nature.

So, if you could, if you could keep your comments to just ten minutes, please?

COMMISSIONER YAKI: The Chair has a present theory that life is nasty, brutish, and short.

ACTING CHAIRMAN KIRSANOW: Absolutely, very Hobbesian. If we can keep the comments to ten minutes and possibly even less than that, that would be greatly appreciated. Again, we will have the opportunity for follow-up questions, have the opportunity to submit supplemental comments.

And also with respect to commissioners, if each commissioner could limit their comments or questions to no more than a total of five minutes per panel, that would be greatly appreciated so that we can get everybody out of here on time.

What we are going to do also given the fact that we have got essentially five panels, we are going to take a 5-minute break after the first panel and then a 20-minute break after the second panel so people can tend to whatever e-mail business they may have and maybe get a cup of coffee or something to eat.

II. SPEAKERS' PRESENTATIONS
PANEL 1 -

THE EFFECTS OF THE COMMUNITY REINVESTMENT ACT AND
ITS ALLEGED EFFECTS ON THE MORTGAGE CRISIS

ACTING CHAIRMAN KIRSANOW: So the first panel we have has to do with the Community Reinvestment Act and whether or not it has had any effect on the mortgage crisis. The Community Reinvestment Act is designed to encourage home ownership in low and moderate-income neighborhoods by encouraging banks to invest in those communities.

Now, as I stated before, the panels will be bifurcated given the limited amount of seating that we have and the fact that our panel number 1 actually consists of more than just the three individuals currently seated there.

So we are going to hold our questions until both panels of the first panel testify. And then we will recall the first set of panelists currently seated at the table so that they can participate in questioning.

I am going to introduce the first panel in seriatim. And then after I introduce each of you, then we will begin with Mr. Wides. And then we will proceed in order.
Now, I know many of you have contributed biographies that are really spectacular. And I apologize for not being able to read publicly all of them. Otherwise we would be here all day long. We have got, as I said, really distinguished panelists who have done a lot of work in these areas. And I think we will be presenting very interesting testimony.

On the first panel, our first witness will be Mr. Wides, Barry Wides, who is Deputy Comptroller for Community Affairs at the Office of Comptroller of the Currency. Prior to joining the OCC in 1991, he was Director of Affordable Housing Sales at Freddie Mac and Deputy Director of the Resolution Trust Corporation's Affordable Housing Program.

Our second panelist is Mr. Luke Brown. He is Associate Director at the FDIC and directs the Compliance Policy Branch and serves as Chair of the FDIC's representative to the Federal Financial Institution's Examination Council's Consumer Compliance Task Force.

Wow. Do you have a button? And how big is it?

(Laughter.)
ACTING CHAIRMAN KIRSANOW: Before joining the FDIC, Mr. Brown headed the Regulatory Affairs Group at Fannie Mae.

And our third witness on this particular panel is Glenn Canner, Ph.D., Senior Adviser in the Division of Research and Statistics of the Board of Directors of the Federal Reserve. His current areas of specialization are home mortgage and consumer lending with a strong focus on fair lending laws and community reinvestment issues. Whereupon, BARRY WIDES, LUKE BROWN, and GLENN CANNER were called as a panel of witnesses by the United States Civil Rights Commission and, having been first duly sworn, was examined and testified as follows:

ACTING CHAIRMAN KIRSANOW: Thank you very much.

Now, as I said before, we are going to try to keep it to ten minutes each. And then we will wait until each one of the panelists currently seated has completed their testimony before we open it up to questions.

So, Mr. Wides, if you could begin, we would appreciate it.
MR. WIDES: Okay. Thank you. Members of the Commission, we appreciate the opportunity to participate in today's briefing on the subprime mortgage crisis.

My name is Barry Wides. I serve as Deputy Comptroller for Community Affairs at the OCC. The OCC is a bureau within the U.S. Treasury Department which is charged with chartering, regulating, and supervising the national banking system. The OCC regulates approximately 1,600 national banks as well as 50 branches of foreign banks operating in the United States representing about two-thirds of the total assets in U.S. commercial banks as of the end of 2008.

Given the OCC's jurisdiction over national banks subject to CRA, I will focus my remarks on the erroneous connection some have made between CRA and the current mortgage crisis.

Let me start off by saying unequivocally that CRA is not the culprit behind the abuses in the subprime mortgage lending nor the broader credit quality issues in the marketplace, as some have suggested.

CRA lending and investment have been responsibly underwritten and conducted in a safe and
sound manner. The CRA was enacted by Congress in 1977 to encourage banks and thrifts to increase their lending and services to low and moderate-income persons and areas in their communities consistent with safe and sound banking.

It also requires the federal financial supervisory agencies to assess the record of each covered institution in helping to meet the credit needs of its entire community, including low and moderate-income individuals and neighborhoods.

The CRA applies only to banks and savings associations whose deposits are insured by the FDIC. Affiliates of insured depositories that are not themselves insured depository institutions are not directly subject to the CRA, nor are credit unions or independent mortgage companies.

Under regulations implementing CRA, financial supervisory agencies take into account a bank's performance under CRA when deciding whether to approve an application by a depository institution to establish a branch, relocate a branch or main office, merge with or acquire another insured depository institution or convert an insured depository institution to a national charter.
Neither the CRA nor its implementing regulations provides specific thresholds and ratios applicable to the examination or application processes I just referred to. Rather, the rules contemplate an evaluation of each lender's record, taking into consideration individual institutions' business model and the environment in which it operates. An institution's capacity to help meet community credit needs is influenced by many factors, including its financial condition and size, resource constraints, legal impediments, and local economic conditions that could affect the demand and supply of credit.

Examiners must consider these factors when evaluating an institution's performance under CRA. The CRA regulations prescribe different evaluation methods tailored to respond to differences in institutional size, structure, and operations.

However, the majority of assets in the national banking system or in banks governed by what is called the large bank examination procedures, these procedures apply to institutions with assets over $1.109 billion and include 3 tests: the lending test, the investment test, and the service test.

The lending test performance criteria focus on the number and amount of home mortgages,
small businesses, small farm, and community
development loans originated and purchased in the
bank's assessment areas; two, the distribution of the
bank's lending to individuals of different income
levels and businesses and farms of different sizes;
and, three, the bank's performance and lending to
geographies within its assessment areas.

The investment test is used to evaluate a
bank's record in helping to meet the credit needs of
its assessments areas to investments with the primary
purpose of community development while the service
test considers the retail and community development
services that the bank has provided.

Generally OCC examiners evaluate each
large bank's CRA performance every three years. Upon
conclusion of the CRA examination, the OCC provides
the bank with a written performance evaluation, which
is a public document, all of which are published on
the OCC's Web site.

By statute, the ratings that a bank
receives are either outstanding, satisfactory, needs
to improve, or substantial noncompliance. There has
been much public discussion over the past several
months concerning whether CRA may have contributed to
the mortgage crisis.
The discussion has focused on the connection between CRA-related lending to low and moderate-income borrowers and what some allege to be a disproportionate representation in failing subprime loans.

The OCC and the other federal bank and regulatory agencies have been looking at this question in some detail. And all four agencies have concluded that the CRA is not responsible for the mortgage crisis. In analyzing independent studies and comprehensive home lending data sets, we have concluded that only a small portion of subprime mortgage originations are related to CRA.

CRA-related loans appear to perform comparable to or better than other types of subprime loans. For example, single family CRA-related mortgages offered in conjunction with NeighborWorks organizations have performed on par with standard conventional mortgages.

Foreclosure rates within the NeighborWorks network were just 0.21 percent in the second quarter of 2008 compared to 4.26 percent of subprime loans and 0.61 percent for conventional conforming mortgages.

Similar conclusions were reached in a study by the University of North Carolina's Center for
Community Capital, which indicates that the high-cost subprime mortgage borrowers default at much higher rates than those who take out loans for CRA purposes.

Overwhelmingly, CRA lending has been safe and sound. The Federal Reserve Board has reported extensively on these findings for all CRA loans. Federal Reserve Board study of 2005-2006 Home Mortgage Disclosure Act data show that banks subject to CRA and their affiliates originated or purchased only six percent of the recorded higher-price loans made to lower-income borrowers within their CRA assessment areas.

The Federal Reserve also found that less than two percent of higher-priced and CRA-eligible mortgage originations sold by independent mortgage companies in 2006 were purchased by CRA-covered institutions.

Federal Reserve loan data analysis also found that 60 percent of higher-priced loan originations went to middle or higher-income borrowers or neighborhoods and, further, that more than 20 percent of the higher-priced loans extended to lower-income borrowers or borrowers in lower-income areas were made by independent non-bank institutions that are not covered by CRA.
OCC's analysis of lending by banks that we regulate also confirms that the vast majority of subprime loans were not originated by national banks supervised by the OCC. In 2006, subprime lending by national banks amounted to roughly ten percent of total subprime mortgage originations by all lenders.

Further, our analysis shows that subprime and alt-A loans originated by national banks defaulted at lower rate than those originated by non-bank lenders.

Our analysis compared the foreclosure start rates for loans originated between 2005 and 2007 that were placed in subprime or alt-A securities. These loans originated by OCC-regulated institutions defaulted at roughly two-thirds the rate of comparable loans originated by non-bank lenders.

In conclusion, I want to reiterate my belief that the CRA has made a positive contribution to community revitalization across the country and generally encouraged sound community development lending, investment, and services initiatives by regulated banking institutions. Only a small percentage of higher-priced loans were originated by CRA-regulated lenders to either lower-income borrowers or neighborhoods in bank CRA assessment areas.
Similarly, banks purchased only a small percentage of higher-priced CRA-eligible loans originated by independent mortgage companies.

And, finally, the performance of higher-cost loans originated by national banks is markedly better than loans originated by non-bank institutions.

Thank you for the opportunity to appear today. And I will be pleased to respond to your questions at the appropriate time.

ACTING CHAIRMAN KIRSANOW: Thank you, Mr. Wides.

Mr. Brown, you are up.

MR. BROWN: Thank you. Members of the Commission, good morning to you. And thank you for inviting me here to speak about the FDIC's role in evaluating Community Reinvestment Act and our involvement in looking at CRA in the midst of the mortgage crisis.

The FDIC has three main missions. We serve as federal supervisor of non-Federal Reserve member banks. We serve as deposit account insurer for financial institutions and receiver of closed banks.

The CRA was signed into law 30 years ago, on October 12th, 1977. The purpose of the CRA is to
encourage banks to serve the credit needs of their entire communities, including low and moderate-income neighborhoods, consistent with safe and sound lending practices. I emphasize consistent with safe and sound lending practices.

At the time CRA was enacted, there was a severe shortage of credit available to low and moderate-income neighborhoods and concern about racial redlining and discrimination.

Studies have pointed to increases in lending to low and moderate-income customers and minorities in the decade since the CRA’s passage. For example, a study by the Joint Center for Housing Studies at Harvard University reported that HMDA data from 1993 through 2000 shows that home purchase lending to low and moderate-income people living in low and moderate-income neighborhoods grew by 94 percent, more than in any other income category. However, the success has been overshadowed in recent months by critics asserting that CRA caused the financial crisis.

A complex interplay of risky behaviors by lenders, borrowers, and investors led to the current financial storm. As we all know, there is plenty of
blame to go around, but when it comes to laying the blame on CRA, we disagree.

Studies have shown that only about one in four higher-priced first mortgage loans were made by CRA-covered banks during the peak years of subprime mortgage lending. The rest were made by private, independent mortgage companies and large bank affiliates not covered by CRA rules.

Recently, some commentators have alleged that the government told banks they had to make loans to people who were bad credit risks who could not afford to repay just to prove that they were making loans to low and moderate-income people. That is simply wrong.

The CRA affirmatively states that banks must make loans consistent with safe and sound lending practices. The FDIC believes the lending practices that are causing problems today were driven by a desire for market share and revenue growth.

CRA encourages FDIC-insured banks to lend in low and moderate-income areas. The CRA regulations always recognize that there are limitations on the potential volume of lending in low-income areas due to safety and soundness considerations.
It also recognizes that a bank's capacity and opportunity for safe and sound lending in lower-income communities may be limited. That is why CRA never set lending target or goal amounts. CRA was intended to expand access to credit and reduce discriminatory credit practices.

Consistent with safe and sound operations, CRA assigns regulated financial institutions a continuing and affirmative obligation to help meet the entire credit needs of their communities, including the needs of low and moderate-income neighborhoods.

The CRA evaluation process. FDIC examiners evaluate the CRA performance of approximately 5,200 institutions under the corporation's supervision. For most institutions, this performance is evaluated under tests that draw distinctions among institutions based on their size and business strategies.

When conducting CRA evaluations, examiners consider factors such as the business opportunities available as well as the size and financial condition of institutions.

Upon the consideration of each examination, the examiner prepares a written examination of the institution's record of meeting the
credit needs of the entire community, including low and moderate-income neighborhoods.

The written evaluation must have a section available for public disclosure. The FDIC and other financial institution regulatory agencies facilitate public review of CRA evaluations by posting them on their Web sites.

The nature and effect of CRA ratings. The agencies assign each institution one of four performance ratings: outstanding, satisfactory, needs to improve, and substantial noncompliance.

Determining the CRA rating for an institution involves an assessment of a number of qualitative and quantitative factors against a backdrop of the institution's performance context.

To foster consistency in this process, the agencies rely upon a matrix which sets forth a description of the elements of the various tasks and what performance level is required of the rating. Unlike fair lending or other regulatory violations, which can be addressed through mandatory corrective action and financial penalty, CRA is enforced through the application process and the public disclosure of ratings. Instead, it essentially incentivizes financial institutions to act.
The FDIC takes an institution’s CRA performance into account when evaluating its applications for deposit facilities. Such applications must be submitted when an institution proposes to open a branch, relocate a home office, merge, or acquire another institution.

In evaluating these applications, the FDIC must take into account the applications’, applicant institutions’, CRA performance, as well as the views expressed by any interested parties about institutions’ CRA performance. The FDIC can deny or conditionally approve applications based on CRA concerns, the effect of fair lending violations on CRA ratings.

Consistent with the 2005 amendments to the interagency CRA regulations, illegal credit practices, including violations of fair lending laws, are considered when evaluating CRA performance and may result in lower CRA ratings.

Evidence of discriminatory or other illegal credit practices considered as part of CRA evaluation includes but is not limited to discrimination against applicants on a prohibited basis in violation of ECOA, violations of HOEPA,
violations of section 5 of the FDI Act, violations of section 8 of RESPA, and violations of TILA.

The 2005 amendments strengthen CRA regulations in several respects. First, they expressly incorporate into the regulation the specific statutory example cited above. Second, the amendments clarify the illegal credit practices carried out in any geography could have negative impact on an institution's CRA rating.

This part of the amendment made clear that the agencies could consider lending discrimination that had occurred outside of financial institutions' CRA assessment area.

Finally, the amendments added express coverage of illegal credit practices by an affiliate within the institution's assessment area if the relevant lending were considered as part of the institution's CRA performance evaluation.

The effect of an illegal credit practice by an institution is determined in the overall context of the institution's CRA performance. The FDIC's regulation states that in determining the effect of evidence of such practices on the bank's assigned rating, the FDIC considers the nature, extent, and strength of the evidence of the practice, the
policies, and procedures that the bank has in place, preventive practices, any corrective action that the bank has taken or committed, including voluntary correction action resulting from self-assessment, and any other relevant information.

The role of CRA in addressing current challenges. CRA provides flexibility because it contains broad goals without detailed requirements. With its focus on the needs of the community, as opposed to specific products or services, it allows bankers to change their business activities in response to changing credit demands.

It also allows federal financial institution regulatory agencies to address emerging issues and respond quickly to local and national crises. For example, we extended CRA consideration for activities that benefitted the Gulf Coast during that period.

Today the FDIC is promoting the use of CRA to encourage solutions to several key consumer financial concerns, specifically encourage alternatives for homeowners facing mortgage foreclosures, addressing the demand for affordable small credit, and the need for basic banking services in many under-served areas. Those are issues that
Chairman Bair has championed and is aggressively pursuing.

Foreclosure prevention. As you know, the FDIC strongly supports sustainable loan modifications for at-risk homeowners that appropriately balance the interests of homeowners, servicers, and investors.

In April 2007, the banking agencies issued guidance encouraging financial institutions to consider prudent workout arrangements to keep borrowers in their homes and made clear that there may be able CRA considerations for programs to transition low and moderate-income borrowers from high-cost to lower-cost loans provided the loans are made in a safe and sound manner.

However, the agency stated in a recent release to interagency guidance that such loan programs again should result in long-term affordable sustainable homeowners because the last thing that we want is for the problem to be kicked down the road.

Because Congress wrote CRA in a way that allows for adaption to changing conditions, CRA-implementing regulations allows flexibility. The FDIC is prepared to work with partners consistent with CRA's statutory requirements to resolve many of the issues that we are facing today.
I am prepared to answer the Commission's questions. Thank you for your time.

ACTING CHAIRMAN KIRSANOW: Thank you, Mr. Brown.

And, finally, at least with respect to this bifurcated panel, we have got Mr. Canner.

DR. CANNER: Members of the Commission, I am pleased to be here today to present the results of research conducted by the Federal Reserve staff on the role of the CRA in the subprime mortgage crisis.

As the current mortgage market difficulties have unfolded, an argument that the CRA is at its root has gained a foothold. The argument draws on the fact that the CRA encourages banking institutions to help meet the credit needs of lower-income borrowers and neighborhoods.

Critics of the CRA contend the law pushed banking institutions to undertake high-risk mortgage lending and defaults on these loans and spark their current mortgage market difficulties.

To my knowledge, the critics of the CRA have basic contention on lines of reasoning, rather than analysis of relevant data. In my remarks, I will discuss key features of the CRA and results from the
analysis of data that we have been doing to address this issue.

On balance, the findings from available data run counter to the contention that the CRA lies at the root of or otherwise contributed in any substantive way to the current mortgage crisis.

The CRA directs the banking agencies to use their authority to encourage these institutions to help meet the credit needs of all segments of their local communities, including low and moderate-income areas.

For the purposes of the CRA, the local communities are the areas where banking institutions have their branch offices and take deposits. The banking agencies periodically assess the performance of those institutions and then take those performance evaluations into considerations when they are dealing with applications.

I want to emphasize that the CRA instructs banking institutions to fulfill their obligations within the framework of safe and sound lending. The CRA does not stipulate minimum targets or even goals for the volume of loans, services, or investments banking institutions must provide.
Over the years, the Federal Reserve has prepared two reports for the Congress to provide information on the performance and lending to lower-income borrowers and neighborhoods, the populations that are the focus of the CRA.

These studies have found that lending to lower-income populations has been nearly as profitable and performed similarly to other types of lending done by CRA-covered lenders.

Before I turn to our recent analysis of the data, I want to make two general comments regarding the CRA and its possible connection to the mortgage crisis. The first point relates to timing.

The current crisis is rooted in the poor performance of mortgage loans made primarily over the period of 2005 to 2007. If the CRA did indeed spur the recent expansion of the subprime mortgage market and subsequent turmoil, it would be reasonable to assume that some change had occurred in the rules during 2002, '03, '04, or '05.

In fact, nothing happened in that regard. However, the CRA rules, as I said, had nothing happen in that regard.

Second, considering the potential role of the CRA in the current mortgage crisis, it is
important to account for the originating party. In particular, mortgage companies not affiliated with banking institutions originated a substantial share of subprime mortgages. But they're not subject to the CRA and has not directly been influenced by CRA obligations.

I want to turn to the data analysis in order to assess the merits of the claims that the CRA was a principal cause of the current problems. The analysis focuses on two basic questions. First, what share of subprime originations are reasonably related to the CRA? And, second, how have CRA-related loans performed? The answers to these two questions shed considerable light on the role of the CRA in the subprime crisis.

First, with respect to the question regarding loan originations, we determined what types of lending institutions made subprime loans, to whom the loans were made, into what types of neighborhoods the loans were extended. The analysis, therefore, depicts the fraction of subprime mortgages that could be reasonably related to the CRA.

Using loan origination data obtained pursuant to HMDA, we find that in 2005 and 2006, 55 percent of subprime originations were made to middle
or higher-income borrowers or neighborhoods' populations. And they're simply not the target of CRA.

Of the subprime mortgages that were extended to lower-income borrowers for borrowers in lower-income neighborhoods, independent mortgage companies; that is, institutions not covered by the CRA, originated nearly half of these loans.

In total, of all the subprime loans originated in 2005 and '06, only 6 percent were extended by CRA-regulated lenders or their affiliates to either low-income borrowers or neighborhoods within the local communities.

Having said this, it's possible that CRA might have indirectly encouraged independent mortgage companies to undertake some lending because examiners give banking institutions credit for loans they purchase.

We have looked at the HMDA data once again here. So the data suggests that the link between independent mortgage companies and banks through direct secondary market transactions is very weak.

For example, in 2006, less than two percent of all the mortgage originations sold by independent mortgage companies were subprime and made
to lower-income borrowers or neighborhoods and to banking institutions covered by the CRA.

In sum, the evidence indicates that only a very small share of subprime lending can reasonably be linked to the CRA. This suggests that unless CRA-related loans perform far worse than other loans, it is very unlikely that the CRA could have played a substantial role in the crisis.

Let me turn to the performance information. To assess the relative performance of CRA-related subprime loans, we looked at data from First American loan performance and compared delinquency rates for subprime loans in lower-income zip codes relative to those in middle and upper-income areas. The results indicate that delinquency rates for subprime loans are high in all neighborhood income categories.

In order to gauge more precisely the possible independent effect of the CRA, we examined the LP data a little more carefully and focused attention on the subset of neighborhoods that are similar except for their relationship to the CRA. Specifically, we compared the performance of loans in neighborhoods right above and right below the neighborhood-to-income threshold that CRA uses.
As such, the only major difference between these two sets of neighborhoods should be that CRA focuses on one group but not the other. This analysis indicates that subprime loans in neighborhoods that are the focus of the CRA; that is, just below the neighborhood-to-income threshold is used, performed slightly better than the loans right above and neighborhoods right above the threshold.

To gain further insight to the risks of lending to lower-income borrowers, we compared the performance of mortgages originated and held in portfolio under the nationwide affordable lending programs operated by NeighborWorks America to the performance of loans of various types as reported by the Mortgage Bankers Association of America.

Many loans originated through NeighborWorks programs are done in conjunction with banking institutions subject to the CRA. So the performance of these loans provides a basis to assess the relationship between CRA and the subprime crisis. Along any measure of loan delinquency, the loans originated through the NWA program have performed better than subprime loans.
Another way to measure the relationship between the CRA and the subprime crisis is to examine foreclosure activity across neighborhoods.

Data on foreclosure filings from RealtyTrac covering the period of January 2006 through August 2008 indicates that most filings have taken place in middle and upper-income neighborhoods.

More importantly, foreclosure filings have increased at a faster pace in middle and higher-income neighborhoods than they have in lower-income neighborhoods.

In conclusion, two basic points emerge from our analysis of the available data. First, only a small portion of subprime mortgages are related to the CRA. Second, CRA's related subprime loans appear to perform about as well and perhaps even better than other subprime loans.

Taken together, the available evidence seems to clearly run counter to the contention that the CRA contributed in any substantive way to the current mortgage crisis.

I would be pleased to answer any questions you have.

ACTING CHAIRMAN KIRSANOW: Thank you very much, Mr. Canner. And I want to thank the panelists
for being very timely in presentation of your remarks. If you could yield your seats to panel 1b and if panel 1b can come forward, I would appreciate it.

At the conclusion of this subpanel, we would ask those who have just completed their testimony to return to the table so that we can begin our questioning of the entire combined panel 1.

That is, with the first subpanel, I will introduce each speaker and give a brief recitation of their bio. And then if you could testify in order of your introduction? And then we will forward questions, as I indicated, until we have reconvened both subsets. And then we will proceed on to the next panel after that.

Let's see. I guess we have got everybody here. Okay. Our first witness in this particular subpanel is Howard Husock, who is Vice President of the Policy Research and Director of Manhattan Institute's Social Entrepreneurship Initiative. He was formerly Director of Case Studies in Public Policy Management at Harvard University's Kennedy School of Government.

Mr. Stan Liebowitz is Professor of Managerial Economics, University of Texas-Dallas and
Director of the Center for the Economic Analysis of Property Rights and Innovation.

Ms. Marsha Courchane is Vice President of Financial Economics Practice for Charles River Associates. Her work focuses on issues in primary and secondary mortgage markets, including fair lending, affordable housing, credit scoring, origination, pricing, securitization of mortgages.

Previously she was Director of Financial Strategy and Research at Freddie Mac. Prior to that, she was Senior Financial Economist at the Office of Comptroller of the Currency.

And, finally, on this subpanel we have got David Berenbaum, who is the National Community Reinvestment Coalition’s Executive Vice President. The coalition is an association of more than 600 organizations. And they have no access to basic banking services for America's working families. Whereupon,

HOWARD Husock, STAN LIEBOWITZ,
MARSHA COURCHANE, AND DAVID BERENBAUM were called as a panel of witnesses by the United States Civil Rights Commission and, having been first duly sworn, was examined and testified as follows:
ACTING CHAIRMAN KIRSANOW: Thank you very much. Good. We will start with Mr. Husock.

MR. HUSOCK: Thank you very much, Mr. Chairman.

PANEL 1B

MR. HUSOCK: I should stress that I really speak to you today as a policy journalist who has following this issue for some decades, not as a technical expert. But I hope, nonetheless, that I will help you be able to engage these issues.

Almost nine years ago, writing for Forbes magazine, I offered the following observations. Hardworking upwardly mobile families don’t need easy credit. They desperately need tough credit standards in order to have some assurance that they and their neighbors can afford their investment and are likely to maintain their properties. This is how neighborhoods have built and preserved.

I was writing about the Community Reinvestment Act and expressing the concern that it risked undermining low-income communities by giving lenders the incentive to make loans for reasons other than or in addition to the best and time-honored one: the ability of borrowers to repay. I continue to have these fears.
This is not to assert, I should hasten to add, that I believe that the CRA is the precipitant of the mortgage crisis that we face now. I do not believe that. However, I do believe that the current situation provides an important moment to reflect on the ongoing appropriateness of the CRA and the companion standards known as the affordable housing mandates for Fannie Mae and Freddie Mac. So there is a philosophical connection, I believe, between our present situation and these twin requirements. Let me try to connect the dots.

Let's start by saying that it is not my view that at the time of the original passage of the act, the CRA, in 1978, that there was no justification for it. But I do believe that these factors which gave rise to it were an artifact of a regulatory structure no longer in existence, not an inherent problem with the U.S. banking system.

As many of you know, before the 1980s, mortgage lending was largely the province of just one sector of the banking industry, the so-called thrift or savings and loan institutions. And they had a kind of a deal with the government. They would pay relatively low rates of interest in exchange for
charging relatively low interest rates for home
mortgage loans.

This limited spread strongly discouraged
risk and, combined with the lack of bank competition
at that time, undoubtedly led many low-income
neighborhoods in which house values were declining or
not increasing as fast as others to have limited
access to credit, the term "redlining," aptly
developed to describe the situation and caused many,
including myself at the time, to conclude that only a
legislative mandate can guarantee that those of modest
means struggling in urban areas would have access to
credit.

Until the Clinton administration, this
kind of CRA compliance was not a significant matter,
what amounted to an A for effort for outreach in
neighborhood newspapers and things like that. But the
Clinton Treasury Department's 1995 regulations did
change matters, requiring banks which wanted
outstanding CRA ratings to demonstrate numerically
that they were lending both in poor neighborhoods and
to lower-income households.

In my view, this new era of strict
enforcement was in response to conditions which no
longer existed. The bank deregulation of the 1980s,
begun, by the way, not by Republicans, by the Carter administration's Federal Depository Institutions Deregulation and Monetary Control Act, has put us on the road to seeing sharp competition among mortgage lenders.

A paper by the Dallas Federal Reserve Bank published in 1999 and entitled "Redlining or Red Herring," put it this way, "The CRA may not be needed in today's financial environment to ensure all segments of our economy enjoy access to credit."

The ramped-up enforcement had powerful effects, however, in no small part because banks were engaged in a series of mergers and acquisitions in order to obtain provision for such deals, outstanding CRA regulations were required.

What is more, nonprofit advocacy groups came forward to demand successfully that banks seeking regulatory approvals commit large pools of mortgage money to them; in effect, outsourcing the underwriting function to groups which viewed such loans as a matter of social justice, if you will, rather than due diligence.

As the leader of one such group told me eight years ago, our job is to push the envelope. He specified that he would use his so-called delegated
lending authority to make loans to households with limited savings, significant debt, and poor credit histories. So it is that we begin to see a connection between CRA and our present troubles.

Quite sizeable pools of capital began to be allocated in an entirely new way. Rather than lending on the basis of an individual household's demonstrated ability to repay, regulators were pushing for lending to occur on the basis of additional criteria.

Bank examiners began to use federal home loan data broken down by neighborhood, income, and race to rate banks on their CRA performance. In my view, this stands traditional lending on its head.

They key difference, in sharp contrast should the traditional regulatory emphasis solely on safety and soundness, banks were now being judged not on how their loans perform but on how many they made. I am not even aware of banks having to report specifically on how their CRA loans as a succinct group performed.

As one former Vice President of Chicago's Harris Bank once told me, you just had to make sure you didn't turn anyone down. If anyone applies for a
loan, better to give it to them. A high denial rate
is what gets you in trouble.

It is no surprise that as early as 1999,
the Federal Reserve found that only 29 percent of
loans in bank lending programs established especially
for CRA compliance purposes could be classified as
profitable.

The White House observes today that the
impact of lax underwriting is felt most by
lower-income households who pay their bills on time
and find themselves living next to a house on which
foreclosure has occurred. Poor neighborhoods in order
to build both social and economic capital must rely on
the frugality and prudence of their residents.

As Congressional Budget Office analysts
Charles Capone and Albert Metz put it presently in
their 2003 study, "Mortgage Default and Default
Resolutions, Their Impact on Communities," once
neighborhood foreclosures start to rise, the
foreclosure cycle starts" --

ACTING CHAIRMAN KIRSANOW: Try saying that
three times.

MR. HUSOCK: I did it. Two is the magic.
It becomes progressively harder for other households
to sell their homes. Abandoned properties and blight
can destroy neighborhoods where low down payment affordable housing programs are prevalent. This is true, to be sure, whether the loans are made by regulated lenders or unregulated mortgage companies. But all were facilitated in some way by the extension of CRA-type thinking and regulation to the secondary mortgage markets through the government-sponsored enterprises: Fannie Mae, Freddie Mac. I think their activities are much more important for our present situation than the CRA narrowly considered.

Beginning in 1992, the Department of Housing and Urban Development pushed Fannie and Freddie to buy loans based on criteria, in addition to their creditworthiness.

The affordable housing goals and subgoals authorized, ironically, by the Federal Housing Enterprise's Financial Safety and Soundness Act became ever more demanding and by 2005, required that Fannie and Freddie strive to buy 45 percent of all loans from those in low and moderate-income, including 32 percent from central cities and 22 percent to very low-income families.

As one former Fannie official told me, both HUD and many advocates in the early 2000s were anxious for the GSEs to extend credit to borrowers
with blemished credit. How will such goals met? Crucially, subprime loans sold to Fannie and Freddie could help the secondary mortgage giants meet their affordable housing goals.

This is not to say that all or even a majority of subprime loans were made for CRA purposes. Clearly, the combination of cheap money, imprudent borrowers made for a tremendous bubble.

But such loans, bundled into asset-backed securities, could be and were purchased according to the June 2007 HUD report, the GSE's funding of affordable loans, especially by Freddie Mac, to help fulfill its affordable housing goals.

Indeed, as recently as April of this past year, Fannie actually boasted about, "mortgage products and options," which included "reduced requirements for down payment and closing costs, choices for borrowers with less than perfect credit, and flexibility to provide loans to home buyers with no traditional credit history."

By insisting that such under-qualifiers buyers be dealt into home ownership, we helped create our present crisis. How many of the troubled Freddie Mac/Fannie Mae loans were also used for CRA regulation
purposes, by those who originated them? That is impossible to know.

Nor did CRA advocates, who have long insisted that such loans were profitable, if not as profitable as other mortgages, push for performance tracking at the time of the lending. But they were clearly implicated in our present situation.

The Bank of America, for instance, reported in the third quarter of the year past the non-performing CRA-eligible loans were a significant drag on its 2008 income to that point, representing on an annualized basis 29 percent of its residential mortgage net losses.

I understand that looking at small programs, like NeighborWorks, and the Small Sample of North Carolina, are useful comparisons, but the big bank reporting has not been analyzed in that same kind of way. It is a long way from making loans which are profitable, just less profitable than standard mortgages, as CRA advocates have always claimed would be the case, to 29 percent of net losses.

It undermines more the assertion that traditional underwriting standards failed to capture the likelihood of defaults by low-income buyers, a view which has held since such buyers were especially
likely not to default because of the importance of home ownership to them.

Whatever the extent of housing mandates in increasing home mortgage delinquency and foreclosure, it is most important at this point to look ahead. How should we think about our financial system as it relates to Americans of modest means?

It seems clear in retrospect that we have, as a matter of policy, pushed too many households towards home ownership using subsidies to do so. This turned out to be a disservice to them.

We have in place the tools for a fair and effective housing policy. Fair housing anti-discrimination laws must be enforced to ensure that prospective borrowers are not turned away for non-financial reasons.

Credit scoring, which did not really exist at the time of the original CRA passage, allows lenders to differentiate among households of similar incomes but different levels of frugality and thrift, rather than through such illegitimate proxies as race.

We have the tools, in other words, to judge those seeking credit as individuals, not as residents of zip codes, census tracts, or income groups.
In the wake of the current high levels of default, delinquency, and foreclosure, it is in my view incumbent upon proponents of all manner of affordable housing mandates and renewal of the CRA and its extension to specify what the problem is to what such mandates continue to be the answer.

Why would the financial system deny credit to households with good credit rating? If minority households confront different terms than others with equivalent qualifications, fair lending laws provide a way to punish lenders engaging in such practice.

If more broadly we come to the conclusion collectively that a long history of discrimination has led to a situation in which members of minority groups lag others in the accumulation of assets, there are other ways to address that problem, rather than distorting housing markets in the way that puts neighborhoods at risk. Let us cease, then, to rely on regulatory housing mandates and the political risk they introduce into financial markets.

Thank you very much.

ACTING CHAIRMAN KIRSANOW: Thank you.

Mr. Liebowitz?

MR. LIEBOWITZ: Thank you.
Ladies and gentlemen, members of the Commission, thanks for having me here and allowing me to express my views on the mortgage meltdown. I am going to go back to the beginning.

In the early 1990s, the banking industry was under attack for presumably discriminating against minority and poor applicants. The yearly publicity surrounding the release of the HMDA data, which showed the projection rates were related to race, was enormous, but no conclusion was capable of really being drawn from that data.

Thereupon, after creating what appeared to be a data set that could allow analysts to determine whether or not banks were discriminating, researchers at the Boston Fed using that data that they constructed did come to the conclusion that banks discriminated.

Yet, when a colleague and I examined the data used by the Boston Fed, we found hundreds of obvious errors in a data set with only about 3,000 observations. Anyone who examined the minimum and maximum values of the variables in the data set would quickly have discovered some of these mistakes.

We found mortgages with implied negative interest rates, mortgages that were sold in the
secondary market but had been supposedly rejected by
the mortgage lender, mortgages that didn't match up
with the original data, the HMDA data, that the Boston
Fed used as its starting point, and so on.

My colleague Ted Day and I concluded after
examining the possible impact of the errors on the
coefficient measuring discrimination that the Boston
Fed data set did not and could not provide evidence
that banks discriminated.

Our most fundamental point was that the
data set was so plagued by transcription errors, most
of which could not be checked for internal
consistency, that no conclusions could really be drawn
from that data set.

All the other researchers of whom I am
aware except the original Fed researchers agreed that
the data had serious problems, although these latter
researchers came to disparate conclusions about what
the results looked like after cleansing the data. The
over-arching point that the data itself could not be
trusted was largely ignored in the later studies.

Nevertheless, the Boston Fed results when
first announced were reported with great fanfare in
which was described as a landmark study. The Boston
Fed result was heralded by government officials in the
media as if the results had been written on stone tablets and brought down from Mount Sinai.

It was suggested the day the results of the study were made public, that no further research on the subject was even necessary. This rush to judgment by the regulatory and political community appeared to be the order of the day. And later criticisms of the study were largely disregarded.

The government then embarked on a multi-faceted program to fix the problem that it was so intent on finding. First, the government decided to increase the home ownership rate, particularly for poor and minority individuals.

Second, the government tried to weaken the mortgage underwriting standards, beginning with a booklet put out by the Boston Fed shortly after the ink on their study had dried. By changing the underwriting standards, the government was able to pursue its policy without using its own money.

The new underwriting standards came to be known as "Innovations in Mortgage Lending" or "Flexible Underwriting Standards" by the supporters of those standards, who apparently believe that there were no costs in weakening the lending standards.
The CRA, which is the topic that seems to be most heavily discussed today, was given some of the credit by proponents of the weak underwriting standards in helping to achieve those underwriting standards.

But I want to make the point it's those underwriting standards that were the problem, not the CRA. Not everyone thought that the weakened underwriting standards were a good idea. My co-author and I thought, among others, that it was a dangerous idea. And we said so.

When our paper was published, we warned that the attempts to lower mortgage underwriting standards would lead to a large increase in foreclosures.

In a letter to the Fed's Board of Governors, I warned that lowering the standards combined with pouring trillions of dollars into low-quality loans, would be a disaster -- that was the actual word I used -- for the country. But the home ownership trend had its own seemingly unstoppable political momentum and the results from that much worse than I imagined.

We all know the impact of the policy. First, home ownership began to increase in the mid
1990s, which, predictably, led to an increase in the housing prices a year or two later. Lax underwriting standards enhanced speculative returns and eventually led to an enormous bubble in housing prices.

Of course, the bubble burst. And many individuals were left in houses they either couldn't afford or didn't want. We are all familiar with the current state of our financial system as a result of what happened with the housing bubble.

Now, the last few months, as blame has begun to be assigned for the current financial problems, there has been an attempt to discredit a bowdlerized version of the general thesis that I just presented.

To put things in perspective, it is helpful to use a simple analogy. Let's assume that some owners of high-performance cars form a coalition with the goal of eliminating traffic lights and speed limits. Let's also assume that they represent only a small portion of drivers but, nevertheless, are successful at changing the laws. We could say, in other words, that driving standards had been weakened.

Then, with no traffic lights and no traffic speed limits, all hell breaks loose on the
roads. Traffic jams are everywhere. Accidents occur, and injuries skyrocket.

Let's assume the economy is going to a standstill by the dysfunctional transportation system. Naturally the government would attempt to figure out who caused this problem.

The owners of the high-performance vehicles can point out, those who belong to that group, that their vehicles make up only a small proportion of all the vehicles stuck in traffic jams. And, therefore, it can't be that the traffic jams are due to them or their vehicles.

Further, they can point out that their members incur fatalities at no higher rates than other drivers of high-performance cars that do not belong to their coalition. They can claim, therefore, that their group has nothing to do with the traffic problems that have befallen the country.

This is essentially the argument that has been made by those who are trying to deflect attention away from the true problem, which is the reduction in lending standards, and, instead, saying it has to do with just the CRA.

The problem was the decline in underwriting standards. The most important cause of
that problem, which is almost never addressed, was the
propaganda that was put out by a small army of housing
analysts and community activists claiming that not
only that the weakened underwriting standards were
required from bankers to avoid engaging in
unintentional discrimination but, more importantly,
that such weak lending standards were actually sound.

Propaganda when officially blessed and
sanctioned can be very powerful. Once the propaganda
had been accepted as being correct, all mortgages
became potential outlets for flexible underwriting
standards.

Once the propaganda had been given the
stamp of approval by the academic and regulatory
community, rating analysts felt secure in providing
AAA ratings. And investors were happy to purchase
mortgage-backed securities.

The propaganda received positive
reinforcement when loans based on relaxed lending
standards seemed to be doing fine because the
continued increase in home prices kept the
foreclosures hidden from view.

But, instead of focusing on the claims and
causes for the relaxed underwriting standards, the
defenders of the status quo are trying to deflect
attention away from the standards and, instead, focus solely on the CRA. Even then, their arguments are often misleading.

Sometimes these defenders of the CRA point out that many subprime loans were made by institutions not covered by the CRA. This is true, but it's also irrelevant because the CRA did cover most lenders back in the early and mid 1990s when the underwriting standards were first being weakened and the CRA could be used as a cudgel on recalcitrant lenders.

Some defenders of the CRA claim that the CRA loans were only a small percentage of all defaults. This is also true and also irrelevant. As my traffic analogy should make clear, once the standards have been changed, everyone tends to be affected in a similar manner.

Now that the general public sees the folly of weak lending standards, most of the analysts who were so strongly supportive of weakening the lending standards are silent on the benefit of mortgage innovations.

They are silent about allowing the possibility of people to get mortgages with no money down, no possibility of being able to make the monthly payments at market interest rates. The housing
regulatory establishment failed to see or warn of the foreclosures engendered by those policies. They should be embarrassed by their performance, which hurt poor and minority homeowners as well as everyone else. Thank you.

ACTING CHAIRMAN KIRSANOW: Thank you, Mr. Liebowitz.

Ms. Courchane?

DR. COURCHANE: Good morning, Commissioners. I am Marsha Courchane, Vice President of Charles River Associates. I want to thank you very much for inviting me to testify today on the Community Reinvestment Act.

The hearing today actually covers three topics, not just the Community Reinvestment Act. And I think all three of these topics are important for understanding the current and potential impacts of the crisis the U.S. is now facing in our mortgage markets.

Clearly a long-term goal of policy-makers in the U.S. has been the reduction of financial barriers to home ownership; for example, through implementation of CRA and also through the affordable housing goals set by HUD for the GSEs.

Both CRA and HUD's affordable lending goals were implemented, in part, to address perceived
contemporaneous problems with mortgage markets. As envisioned in 1977 and also today in 2009, CRA does encourage federally insured banking institutions to meet the credit needs of their communities while maintaining a safe and sound operation.

The act was originally in response to the perception that depository institutions had failed to meet the credit needs of their neighborhoods and that the failure encouraged urban flight and deterioration of cities.

Reasons espoused for the limited access to credit faced by borrowers included social reasons, such as discrimination in lending; economic reasons, including limited information on credit and limited access to capital; regulatory reasons, such as prohibitions on interstate branching and mergers and interest rate ceilings.

The passage of the GSE Act of 1992 reflected an additional public policy focus on mortgage and credit market. The GSEs were required to provide liquidity, stability, and affordability to mortgage markets.

And, as part of the GSE Act, HUD established housing goals that were specifically meant to help improve and increase the opportunities for
housing for low and moderate-income and other
under-served borrowers in neighborhoods.

Both CRA and the GSE Act were meant to
courage financial institution participants in both
primary and secondary mortgage markets to meet the
housing needs of these borrowers in safe and sound
ways.

It was also meant to provide through
supervision and examination of the financial
institutions that meeting these needs not come at the
cost of predatory or discriminatory practices. The
current mortgage crisis has, however, forced the
consideration of not just access to credit for
homeowners but, rather, access to credit that is
compatible with sustainable home ownership, keeping
borrowers in the homes they purchased. Lessons
learned from the past decade will contribute, I hope,
to achieving that sustainability.

Rapidly changing credit and housing market
conditions in the past 15 years have markedly impacted
home ownership rates. Home ownership rates in the
U.S. increased steadily and significantly from 1995 to
2004 from 64 to 69 percent overall for the U.S.

Notably, however, no additional increase
in home ownership in the aggregate occurred with the
expansion of non-prime lending after 2004. By 2009, in fact, the overall U.S. home ownership rate has fallen to a level below what we saw in 2002.

As delinquencies and foreclosures mount, putting the nation's homeowners and the economy at risk, home ownership rates continue to decline. How do we explain this reversal of fortune?

There has been a lot of recent research on this topic by many. And they have emphasized the role of structural changes in mortgage markets, characterized by the extension of non-prime credit; the progressive weakening of layered credit standards; mispriced risks in both the primary and second markets; and possibly misaligned incentives, which have led to the meltdown.

Many have questioned whether the uneven coverage of the financial regulatory system contributed to the collapse. Some have questioned whether CRA's or HUD's affordable lending goals were responsible for the mortgage meltdown.

I am not of that view. In fact, CRA loans, as has been pointed up by many here, were not generally subprime, nor were the bulk of the affordable loan purchases by the GSEs comprised of risky subprime loans.
However, today specifically I want to focus on CRA in light of the changing financial landscape and address the role of regulation and supporting responsible mortgage lending that could encourage sustainable home ownership.

CRA has evolved considerably over the past three decades. It continues to meet some of the goals that were originally intended for CRA. As was mentioned by others earlier today, CRA did not contribute much to the subprime crisis in terms of the percentage of loans. The number given to you earlier today by Glenn Canner was about six percent.

This does not mean, however, that CRA's reach and effectiveness have not been impacted by the surge of subprime lending. In recent research that I conducted with Bob Avery at the Federal Reserve Board and Peter Zorn at Freddie Mac, we specifically looked at CRA in the context of the changing financial landscape.

Since the passage of CRA back in 1977, the financial markets evolved in several ways that have potentially important implications for CRA. First, the share of overall financial activity covered under CRA has declined substantially for two key reasons. One is the growth of financial institutions not
covered by CRA and the reduction in the within
assessment area activity by the largest of the
CRA-regulated institutions.

Second, the footprint of those financial
institutions has increased dramatically. And
financial activity is no longer largely locally based.
Instead, the institutions operate across several
states and have nationally based operations. And they
conduct most of the financial activity.

Third, there has been an increase in LMI
lending, although much of it occurs outside the CRA
assessment areas. And that increase is observed for
both CRA-regulated and non-CRA-regulated institutions.

Finally, we do observe, again as has been
pointed out by others this morning, that CRA-regulated
institutions and particularly the top 25, which is
what we focused on in our research, disproportionately
get outstanding CRA ratings and do not get
unsatisfactory ratings.

At this time, however, we are, arguably,
in the midst of the most dramatic financial changes of
the past several decades. And some of those changes
will impact CRA and CRA regulations going forward.

What we have seen over the last 30 years
has been a dramatic increase in the market share
measured in dollars of single-family home mortgages held by the top 25 regulated institutions.

Their share back in 1977 was only 20 percent, and it's grown to over 60 percent by 2007. The share of mortgages in dollars held by small CRA-regulated institutions fell from 40 percent back in 1977 to only 15 percent now.

The increasing share of the mortgage originations for the top 25 has also been quite evident. Mortgages are increasingly originated by depositories with a large and often national footprint.

We have also seen a dramatic increase in the share of originations by non-CRA-regulated institutions from 17 percent in 1990 to a high of 40 percent in 1993. Since then the share of originations by these non-CRA-regulated institutions has trended downward a bit, but generally it's remained above 30 percent.

This rise in mortgage originations was coincident with the rise in the importance of securitization and the increasing role of subprime lending as independent mortgage companies were not subject to CRA regulations.
We also observed that the share of LMI low and moderate-income CRA lending increased. In my written testimony, I present the actual shares of LMI mortgage originations over time, but they show a fairly consistent trend across all types of institutions with a general upward trend at the CRA-regulated institutions up through 1996.

By 2004, that trend has leveled off, but roughly the share of low and moderate-income mortgage loans exceeded 30 percent for all sizes of CRA-regulated institutions. So they were in this measure meeting the goals that were set out for them.

As a consequence, low and moderate-income borrowers and tracts were receiving a greater share of the mortgage activity of the CRA-regulated institutions. Moreover, these trends began when LMI customers were, arguably, under-served.

For example, in 1990, if you look at census data, 16 percent of owner-occupied single-family homes were in LMI tracts, but the LMI tract share for lending was only 10 percent of the CRA-regulated institutions.

By 2007, the average CRA-regulated lender share of loans in LMI tract has increased to 70 percent, a share equal to the 2000 census number for
the percent of owner-occupied single-family homes. So there has actually been an increase in performance of CRA over the past 15 years in reaching out to LMI neighborhoods.

However, there also appears to be strong evidence that LMI mortgage customers have enjoyed an improvement in service from others than CRA-regulated lenders.

While the CRA-regulated lenders increased the share of mortgages from 26 to 34 percent in 2007, those unregulated by CRA also increased their share from 29 to 35 percent over the same period of time. So the low/mod-income lending was coming about not only from CRA-regulated but also from other institutions.

The similarity of changes in the share might be because lenders face different regulatory environments. It can suggest either that the growth of LMI lending comes from CRA or from something else. And, for example, one of the other things that might have prompted this increased share for everybody was the enactment of the affordable housing goals for Fannie and Freddie back in the mid 1990s.

But, due to several recent changes in mortgage markets, we actually believe it is quite
likely we will see the CRA-regulated institutions regain further market share.

The criticisms concerning the uneven coverage of were they or were they not subject to CRA will matter less because non-CRA-regulated institutions are ceasing to exist. The subprime lenders are mostly out of business. And the investment banks have merged with the CRA-regulated institutions.

We also expect to see further increases in concentrations of the top lenders that are CRA-covered will continue to have a larger share of the business. We also believe that because the underwriting standards have tightened significantly, there will be a reduced share of high-priced originations.

What I am worried about is that this may mean less access to credit for exactly those borrowers CRA was meant to reach. And what we hope to see is that that access to credit does not diminish as we look at the impact of the subprime crisis on the mortgage meltdown. Thank you very much.

ACTING CHAIRMAN KIRSANOW: Thank you, Ms. Courchane.

Mr. Berenbaum?

MR. BERENBAUM: Thank you.
Good morning, Commissioner Kirsanow and members of the Commission. My name is David Berenbaum. I serve as the Executive Vice President of the National Community Reinvestment Coalition.

NCRC is an association of more than 600 community-based organizations that promotes equal access to banking services, including credit and savings, to create and sustain affordable housing, job development in vibrant communities for America's working families.

The United States economy is unraveling at a pace not seen in decades. The more than 600,000 jobs lost last month has contributed to a growing concern that the unemployment rate could rise to 10 percent or higher before the economy rebounds.

At the center of the economy's instability is the foreclosure crisis that has claimed 3.5 million homes in the last year alone and threatens the loss of an additional 8 to 10 million homes to foreclosure over the next 5 years. The loss of wealth associated with the collapse of the housing market is staggering.

More than $5 trillion in housing equity has virtually evaporated since the foreclosure crisis began. Major stock indexes have also been cut in half, further contributing to decreased consumer
confidence, substantially reduced spending, lower productivity, rising unemployment, and additional foreclosures.

The magnitude of the economic decline has led many observers to conclude that the current crisis is "an equal opportunity financial nightmare." But reality paints a different picture.

While few have been able to escape the financial pain completely, African Americans, Latinos, Native Americans, and many Asian subpopulations are bearing the brunt of this national epidemic.

Even before the crisis, the unemployment rate for African Americans was nearly double that for non-Hispanic white workers. Today, as the national unemployment rate rests at 8.1 percent, African Americans and Latinos are mired in double-digit job losses.

The unemployment rate for African Americans is just under 14 percent, Latinos more than 11 percent, and non-Hispanic whites at a little over 7 percent. For young African American males, the rate is 25 percent and climbing.

Before the crisis, African Americans and Latinos held on an average a mere $10 and $12 of net worth, respectively, for every $100 of saving for the
This disproportionate impact of the foreclosure crisis on African American/Hispanics forms a wider expansion of a racial and ethnic wealth gap.

African Americans and Latinos were the disproportionate target for unfair, deceptive, and reckless lending practices that triggered the foreclosure collapse and imploded the credit markets.

The situation is so dire in the African American community that United For a Fair Economy, a Boston-based policy group, estimates that African Americans could experience the greatest loss of wealth since reconstruction.

This morning I will focus my remarks on the Community Reinvestment Act and the new CRA Modernization Act of 2009 introduced in Congress last week by Representatives Johnson and Gutierrez.

Later this morning, my colleague Jim Carr, COO of the National Community Reinvestment Coalition, will focus his remarks on the role of Wall Street, related predatory and fair lending issues and recommend solutions for your consideration.

Relative to CRA and the mortgage crisis, it is important to note that CRA is one of the most important laws for building wealth and revitalizing
neighborhoods, period. CRA provides incentives for safe and sound lending, period, and should be more broadly applied throughout the financial services industry.

Had CRA been applied more broadly to non-bank financial institutions and independent mortgage providers, it is arguable that the foreclosure crisis would not have occurred.

Current anti-predatory lending law is weak and lacks adequate enforcement at the federal level. In response to this, NCRC hopes to also work in the 111th Congress to enact comprehensive anti-predatory lending laws in conjunction with CRA modernization.

To put it simply, option ARMs, toxic loan products, no income verification loans, despite representatives from panelists here, economists here on this panel, were never CRA-related products.

CRA, simply put, is the antidote to the current crisis in the housing and credit markets. I am not going to go over how CRA works. I feel that was presented already quite effectively in the benefits of CRA.

A number, a number, of studies have already, reports have been, presented by other panelists on how CRA has leveraged substantial amounts
of loans and investments in low and moderate-income communities and how that has a positive boarder impact, both locally and nationally, on our economy.

To quote Sandra Browenstein, Director of the Division of Consumer and Community Affairs, at her congressional testimony last week before a consumer credit subcommittee of the Financial Services Committee, "I can state very definitively from the research we have done that the Community Reinvestment Act is not one of the causes of the current crisis.

"We have run the data on CRA lending and where loans are located. And we have found that only six percent of all higher-cost loans that were made by CRA-covered institutions and neighborhoods targeted, which would be low and moderate-income neighborhoods covered by CRA. So I can tell you that is where you are going." And this was to a Republican questioner.

"That CRA was not the cause of the loan crisis."

Additionally, Mr. Michael Milken, President and COO of the Community Bank of Tri-County Maryland, in testimony representing the American Bankers Association before the same subcommittee noted, "We really find CRA is a tool, not an obstacle. And I mentioned that of all of our affordable housing
loans, that they are all current. And none of them are in default."

From these reports, it should be noted that CRA-covered depository institutions also do other work beyond mortgage lending. Small business lending, community development lending, access to quality banking services are all critically important as we move to a financially inclusive society.

CRA, as noted also in earlier testimony, works to preclude foreclosure. Foreclosure prevention is a very important element of what regulated institutions are now doing.

And now to move to my conclusion with regard to the CRA Modernization Act of 2009. NCRC and our members have worked very closely with moderates from both sides of the aisle in both the House and the Senate to see the introduction of the CRA Modernization Act of 2009.

This legislation will require CRA exams in the great majority of geographical areas, banks served. Currently CRA exam banks are in areas where they have branches and not in other areas where they lend for brokers, for example.

We will address racial disparities in lending by requiring CRA exams to explicitly consider
lending and services to minorities, in addition to low and moderate-income communities.

   It will require that small business loan data, including race and gender of small business owner, be recorded. The Home Mortgage Disclosure Act would also be linked to a new loan performance database tracking foreclosures and loan modifications. We do want that accountability. We have always wanted that accountability, despite the representation of another testimony today.

   Insurance companies would also be required to submit data similar to HMDA data in the future. And, last and most significantly, as we look to the role of the rating agencies, we look to the role of financial service corporations, and we look to the role of Wall Street, in fact, facilitating the entire financial meltdown, we would apply CRA to a variety of non-bank institutions, including independent mortgage companies, mainstream credit unions, insurance companies, and securities firms to promote responsible lending and eliminate disparities in lending and equal access to credit issues.

   Inadequate regulatory oversight and outdated consumer protection laws underscore the need for a strong civil rights enforcement program,
anti-predatory lending legislation, and CRA modernization.

We look forward to the dialogue that you have done today and to working with the U.S. Commission on Civil Rights. And I look forward to answering any questions that you may have.

ACTING CHAIRMAN KIRSANOW: Thank you, Mr. Berenbaum.

At this time, I would like to ask the other three panelists who testified on the first subpanel to come forward. Logistically it's maybe a bit of a challenge.

Again, thank you very much. We will begin the questioning. And, again, in consideration of the fact that a number of panelists and/or commissioners have got flight arrangements and we would like to get out of here so that we can make those flights, I am going to limit our questions to a total of one-half hour. And if, in fact, we could terminate them prior to that, that would be helpful.

Nonetheless, if there is something of a great concern and usefulness, I will extend that, obviously, but we are going to try to shoot for that time frame.
So also logistically because you are kind of arranged in a fashion that is a little haphazard, if you could prior to beginning any response to any questioning state your name so that the Court Reporter can transcribe who it is who is responding? Okay? Thank you very much.

Commissioners have any questions?

Commissioner Melendez?

III. QUESTIONS BY COMMISSIONERS AND STAFF DIRECTOR

COMMISSIONER MELENDEZ: Yes. First of all, I want to thank all of the panelists for a meaningful first panel. I would like to know and basically have you comment on how you think the CRA is working right now.

I know Mr. Brown mentioned that they assisted in Katrina, in the Gulf. Could you comment on what you think we're doing right now as far as people, the situation?

MR. BROWN: Sure. The FDIC sees it as an effective mechanism to incentify financial institutions to invest in low-income areas and low-income individuals, be sure that they are receiving credit.

The example that I used essentially was focused on the flexibility of CRA. And we can use it
in many ways. I mentioned the Gulf Coast. Another example is we are in the midst of this foreclosure crisis.

So CRA consideration can be used when examiners are looking at a financial institution if they have invested in foreclosure prevention programs and even foreclosure counseling, for example.

So not only does CRA incentify lending in certain areas, but it also can be used as events change and regulators have been using that in interpreting CRA to help provide credit to those areas.

ACTING CHAIRMAN KIRSANOW: Commissioner Taylor?

COMMISSIONER TAYLOR: Thank you.

This is a question which is a follow-up to Commissioner Melendez's question. I practice in the regulatory area generally. So I want you all to know my bias and my perspective on this issue.

The CRA is not designed to address active discrimination. It's designed to incentivize lending. Translation: It's a regulation designed to change corporate behavior. Correct?
Isn't the corporate behavior impacting the underwriting standards? Isn't that the corporate behavior the CRA is designed to impact and change?

MR. BERENBAUM: If I may, this is David Berenbaum. I will start the topic, and then others can jump in there.

You are absolutely right in pointing out that CRA is not a punitive statute. It is an incentivizing statute and safety and soundness is critical to that.

And, frankly, I think if you speak with any regulated institution, they will tell you that the audits by the regulators are quite extensive looking at safety and soundness issues, but the flip side of that is that it has been an amazing law to promote creativity in the open marketplace, develop new and innovative products or housing developments, business opportunities that meet community needs.

And that side of it has, frankly, never really been celebrated enough.

COMMISSIONER TAYLOR: That sounds like a yes to my question because none of those new creative products can be created unless you change the "traditional" underwriting standards and approaches.
MR. BERENBAUM: Yes, right. I mean, for example, there are products developed for areas of the colonials of Texas or New Mexico or other areas that are quite unique for those areas. But the underwriting review, especially for regulated banking institutions, has been very, very strong.

You will never hear a regulated banking institution describe an option ARM product as a CRA-related product, even in areas of high-cost housing, for example, because that would not meet the test. Community advocates historically have not supported non-prime or some of these toxic products.

So there is a very important distinction there: creativity in the non-regulated areas of industry versus regulated.

MR. LIEBOWITZ: If I could say something? This is Stan Liebowitz.

From my understanding -- and I don't claim to be an expert on the CRA -- there was a change in 1995 which was an important change. We said, "Instead of looking at your behavior," the "you" being the lenders, "we want to actually take a look at the performance."

That was a big change, and I think it was the wrong type of change. I think, in fact, looking
at behavior is, in fact, the type of thing you want to look at or do banks appear to be trying to be fair in your lending because once you start going beyond that and say, "Well, we want to see the results," then you start getting closer to quotas on we want to compare the numbers here. And then it becomes very difficult to know whether or not the difference in rejection rates is due to discrimination or something else. And you do tend to force change.

Now, as far as the reduced underwriting standards, the fact is that the groups that were pushing that in the mid 1990s were very much the community activists. The groups that were supportive of the Boston Fed manual on how not to discriminate in your lending, where they were saying, "You shouldn't be looking at those old standards of 28 percent and 36 percent affordability, and you shouldn't be looking at having to come up with down payments and a whole lot of these other reasons."

They were very supportive of weakening them. And they argued that, in fact, particular types of lenders didn't have -- those were not good markers of whether or not they were going to be able to repay their loans. All right?
So they were in favor of reducing the traditional 20 percent down. And then if you don't have it, you have to pay mortgage insurance and having to have 28 percent and 36 percent of the monthly income devoted to the mortgage.

There was a very serious attempt to weaken those. And when they were weakened, you could find papers. I have some that I referenced in a paper that I wrote on this recently.

We are very happy that the people who were pushing those changes were very happy with the results. They were crowing about the great results they were getting with the reduced underwriting standards, but, in fact, it was those reduced underwriting standards with large changes spread out all over the place that led to the really bad loans that has caused the problems that we have.

And so I think it is misleading to say that oh, "everyone is in favor of soundness." And everyone is in favor of loans that are good." But everybody has a different idea of how you measure that.

And it turns out that a lot of people thought that it was perfectly safe to have these loans
with these very weak underwriting standards. And they were wrong, but they won't say so.

ACTING CHAIRMAN KIRSANOW: Mr. Husock?

MR. HUSOCK: Nothing for me.

ACTING CHAIRMAN KIRSANOW: Okay. Ms. Courchane?

DR. COURCHANE: I am just going to respond to two things that Stan said. First of all, I often work with the banks on the bank side and sometimes in matters on the opposite side of David, but I would say that back in the late 1990s, when I was still at the OCC, we did not see community activists coming to us pushing us to weaken lending standards.

I am also a little concerned about throwing out the baby with the bath water, so to speak. It was not just allowing people to have lower down payments that led to the mortgage crisis. There was responsible lending done with higher LTV ratio loans.

In my mind, it's not like I want to advocate for the toxic loans we have seen lately, but it was a combination of weakening many, many standards simultaneously, 500 credit scores, and 100 percent LTV loans, and no verification of employment and income.
And it is the layering of those risks that I believe led to the toxic loans.

So I actually still believe that we can have responsible higher LTV lending. And that's essential if we actually want to reach out to low and moderate-income borrowers in minority neighborhoods.

So I do not believe it was the community activists pushing for the weakened standards. I do believe that public policy in general pushed us to try to erase home ownership gaps between white non-Hispanic in minority neighborhoods and a variety of innovative products, some of which were toxic, were developed to try to do that.

Also, the motivation may have been profit, market share, and a lot of other things, but I don't think changing standards one at a time would necessarily have led us to where we are today.

ACTING CHAIRMAN KIRSANOW: Mr. Husock?

MR. HUSOCK: Okay. I just continue to wonder. And now we have heard a reiteration of a defense of the lower underwriting standards that were not being defended supposedly, but I don't understand why tough underwriting standards are not a friend to those who are trying to struggle and get ahead.
The risk that foreclosures will occur because underwriting standards are flexible puts those with relatively small accumulated wealth at the greatest risk. They lose everything because of foreclosures.

Just, really, my mouth is open to hear things in the name of expanding home ownership. And, by the way, let's be careful about setting that out as our public policy goal to say, "Well, we went from 64 percent to 69 percent." Was that good or bad?

Maybe it was actually not good. Maybe we pushed through a variety of instruments to extend home ownership beyond the actual rate of wealth. And maybe gradual accumulation of wealth over time is sustainable wealth, rather than changing corporate behavior, right, not mandating underwriting standards, changing corporate behavior, absent the accumulation of wealth that really gives people a sustained chance to keep that wealth.

MR. BERENBAUM: Mr. Kirsanow, since community groups were represented and in response to a question, I would like to jump in. I know time is limited.

First, I can tell you with authority that the membership of the National Community Reinvestment
Coalition had never, never called for home ownership for anyone who cannot afford that home through a responsibly underwritten loan product. It's as simple as that in our entire history.

With regard to the representations being made about low to moderate-income consumers here or potential homeowners, I think there are two issues. One, the data is ripe with smoke and mirrors. And, two, it's replete with isms that continue to exist in our society.

Frankly, the majority of homeowners facing foreclosure now are middle-income white folk who have received toxic products from Wall Street due to regulatory failure.

The problem initiated in urban and core areas, initiated because of discrimination targeted against African Americans, Latinos, Asians, and others, but, frankly, the failure on a regulatory and underwriting level is so extreme that it has gone beyond even all fair housing issues.

The impact is stealing more wealth, though, from protected classes and constituents whom the Commission is concerned about. But I strongly disagree with the representations that continue to be made by those funded by industry or representing
industry that CRA or community advocates were in any way responsible for this.

ACTING CHAIRMAN KIRSANOW: Mr. Husock?

MR. HUSOCK: I was just wondering who the gentleman is referring to as funded by industry because I just wonder who he is talking about here.

MR. BERENBAUM: I think it is self-explanatory, sir,

MR. BROWN: This is Brown from the FDIC.

I do want to mention that this issue is a little more settled than is being discussed here. Safety and soundness should be connected with CRA for comments.

And it's not just about underwriting. It's also about going into a financial institution and encouraging them, for example, to have a marketing plan or a strategy to reach out to under-served areas, under-served people. That's not necessarily about lowering any standards in terms of underwriting.

So another example would be the borrower who has decent credit, decent job, can get an affordable loan, but they are steered to the wrong loans. Maybe they would have access to the right loans. So it's not all about underwriting.
CRA also identifies people that are a good credit risk at the normal credit standards.

ACTING CHAIRMAN KIRSANOW: Commissioner Gaziano?

COMMISSIONER GAZIANO: Yes. Thank you, all. I wish I could ask you all questions. But since I am limited to five minutes, I wanted to try to probe Mr. Liebowitz on two matters regarding the Boston Fed's manual, lending manual, whether it was community activists who convinced them to do really silly things or they decided to do really silly things on their own.

I just want to understand, first, if you could confirm for me or explain the theory that underlaid it. As I understand it, they said that these profit-maximizing lenders were really stupid because they only were getting the cream of the profit. We know better than the entire market where the profit line is.

And, you know, these particular loan-to-value ratios that they have established, you know, they have drawn their line. And they think they are getting every dollar of profit they can. But we know better.
And if they just move the line here in these five, is that kind of a necessary explanation for -- you know, our study supports this theory. Can you explain that?

MR. LIEBOWITZ: Yes. That would have to be, in fact, the case that they were essentially arguing that these would be good loans if you changed the underwriting standards in particular ways. And, therefore, if they were going to be good loans and profitable loans, they were loans that were not being caught.

The market hadn't previously realized that they could get those good loans. And the Boston Fed was doing them a favor by telling them, "Look, this is how you can, number one, not discriminate, but at the same time, you will actually increase your profits.

The thing that would be the really unfortunate part about it is in the late '90s is when they began the really private securitizing of these loans.

And the increasing house prices already went on the way at that point. And it looked like they might have been right because those loans were performing well. And, you know, common sense was sort of thrown out the window.
So there was this quote that the Wall Street Journal had with somebody who was from one of the rating agencies. And he said, "Well, we were looking at piggyback loans."

And all common sense said the piggyback loans were where you get a first mortgage and any percent down payment, but you get a second mortgage for the 20 percent to make the first.

All common sense says those loans won't perform as well as people who actually put down just the one, 20 percent, put the real money down. But we can't go with our gut. We have to go with the numbers. And at that point, the numbers were saying there's very little difference between them.

So they gave the same ratings, very same ratings, to the two types of loans. It was ridiculous. They should have gone with their gut because their gut was not just common sense, but simple economic understanding of the way markets work.

So there was a lot of thinking that people understood how the markets work better than the market participants early on. And they worked very seriously to try to change the market.

And I should mention one other thing. Since the people in Texas are the ones who are paying
me, I get paid by them, therefore, obviously what I am
about to say is very biased. The academics who are
writing very positively about the reduced underwriting
standards in the early 2000 period were giving some
credit to CRA for helping to lead to those reduced
underwriting standards.

Now, maybe they were wrong or maybe they
wanted to give CRA credit just because they like CRA
so much and it really had nothing to do with it. But
they were giving it credit back in the days when
they're not ashamed to give CRA credit for doing that.
So I do think that CRA --

COMMISSIONER GAZIANO: The second question
I would like to ask -- and then others can join in.
But to you since you talked about the importance of
the Boston Fed's manual and the study that supposedly
backed it up that you and others have questioned, why
did anyone care about this Boston Fed manual? To what
extent did it kind of take a life of their own?

And you have already testified, and I have
read some of your other articles about some of the
effects and how that fed a little bit back into the
CRA.

You know, I imagine or at least think that
one of the partial effects where there are these HUD
lending goals to Fannie/Freddie to buy up and some lenders who may have thought the Fed manual was bunk became convinced by it, became convinced by it. Maybe someone said, "Well, there is no risk to us if our loans are going to be bought back up." That is my hypothesis.

Why was it that anyone believed this crap besides what you just told me previously about the conditions?

MR. LIEBOWITZ: I think that the bankers who disbelieved it strongly enough and were willing to say it lost their jobs is what I think happened to a large extent.

I mean, if you work in the university administration and I bring up a different topic and you say, "I don't believe diversity is a good idea," you're not going to be working for that university administration very long.

So I presume the same thing was true for the bankers back then. They had to basically at least say that they were going to go along with this because that was the way it was. It was very strong stuff as far as I could tell.

The Boston Fed study, I don't think people pay a lot of attention to the details. When I say,
"people," I mean the regulators and the industry. I think it was largely a fig leaf. They wanted something to which they could say, "Ah. We finally have proof of something that they wanted to act on."

Whether it was true or not, they wanted to act on it. They believed it was true perhaps or they thought it was politically useful, but whatever it is, they wanted to act on it.

The Boston Fed study gave them a chance to do that, which is why the day it came out as a pure study, people were saying, "We don't need anything more. We don't need any more studies like this."

That's what the head of the Boston Fed said. The OCC made a comment that said "This is definitive. This is it. We don't need any." That's not a way you study and find out what the truth is. That's a way that you go ahead and do your politics.

COMMISSIONER GAZIANO: Sure, but the lending manual itself, was it symptomatic or was the manual itself relied on?

MR. LIEBOWITZ: I don't know whether or not the manual was relied on. I think it was put out there to tell banks, "Look, these are the marching orders. And you should follow in line." That's what I think.
COMMISSIONER GAZIANO: Anyone else?

ACTING CHAIRMAN KIRSANOW: Commissioner Yaki? I'm sorry. Mr. Berenbaum wanted to respond.

MR. BERENBAUM: Well, first, I am not quite sure which manual we are talking about, but if we are talking about a policy that expands home ownership for qualified homeowners, particularly in areas that or communities that have had unequal access to credit and not had equal quality to services, not only is that realizing the American dream. That is helping the tax base.

You know, again, there are a lot of references today in others here. I have no problem saying that home ownership remains, even in this difficult time, a very critical part of sound communities, of strong communities, of vibrant communities, and American values. I don't think we should step away from that. We need a correction.

And in deference to my colleagues, I do believe my remark was taken out of context. I have been on several different panels over the past two weeks, including congressional testimony, where remarks have been made that I really take strong exception to, about members of the African American, Latino community, low and moderate-income consumers.
I stand by what I said, but I wasn't intending it to be taken personally or professionally by my colleagues here.

ACTING CHAIRMAN KIRSANOW: Thank you.

Commissioner Yaki?

COMMISSIONER YAKI: Thank you. Thank you very much, Commissioner Kirsanow.

One, I wanted to say I am pleasantly surprised by the first panel. Usually I am one of the people who says we have panelists of three people, and we seem to draw conclusions from that. Here we have a large number of people from different walks of life, by different disciplines, and I am very pleased to see that here.

I just had a quick question to ask for a response on. I am someone who delves in civil rights and in the past has done work, full disclosure, with the groups who have worked on our CRA in California, especially with the groups like Greenlining Institute with Abby.

I would just like to get a response from maybe Mr. Canner or others about the sort of ad hominem attacks on the Boston Fed study that had been made during this hearing.
DR. CANNER: So I am quite well-aware of the Boston Fed study. Actually, I helped consult when they were designing the questionnaire that was used in the study. And I've done quite a bit of analysis using that data over the years.

I would like to step back for a second and start by trying to distinguish between what I would call flexible underwriting and loose underwriting. And the concerns expressed here are all of loose underwriting, which I think demonstrably are related to the problems we are having.

I think flexible underwriting is a little different. I don't think there was any reason to believe that the underwriting standards established in the '30s, '40s, and '50s, when technologies were different and information available was quite different, including credit reference and credit scoring, should be the only standards that are consistent with safe and secure credit extensions. And things change over time.

One of the things that the CRA I think did contribute to was the notion that we ought to look beyond the tight constraints of the underwriting standards of the past to see if loans could be done safely using flexibilities.
And so there has been and there was over the course of the '80s and '90s some experimentation in the layering of risks, if you will, but with offsets, whether it was counseling or a higher credit score being required when you allowed a lower down payment.

The studies that the Federal Reserve conducted for the Congress in 1993 and 2000, where we interviewed organizations or questioned them, demonstrated pretty amply that CRA-related loans perform about as well as other loans and are about as profitable. That's the first point.

The second point, this is a little more subtle. And that is all the discussions here tend to focus on any loan that is lower-income to a low-income borrower or a low-income neighborhood as being caused by or related to CRA. I think that is not true.

As an economist, what I think about the effects of a law -- I don't want to measure what occurs because of the law -- you are looking for the marginal effect. And in this case, you would be asking yourself the question, is all low-income lending only because of the CRA or if CRA disappeared tomorrow, would low-income lending disappear? The answer is quite clearly no. There was actually
low-income lending going on before the CRA was enacted.

So when we actually did our report to Congress on the profitability and performance of CRA lending, we did look at a section of the data that we tried to capture that focused, really, on what was driven by CRA, as opposed to what regulators routinely count, which is all low-income lending. And it's a very, very small part of the market. But, even in that segment of the data, the lending for most of the institutions was at least marginally profitable.

So all of that is to say flexible underwriting I believe can be done safely and soundly and can expand opportunities for people. And that is different than the experience over the last few years, which was, by the way, driven mostly, I think, by independent mortgage companies that were clearly driven by profits and market shares and are not regulated by the CRA.

ACTING CHAIRMAN KIRSANOW: Okay. I do have a couple of questions. The first is -- and I think maybe this would be to Professor Liebowitz -- there was some testimony that it would be a good thing to apply CRA more broadly; that is, to institutions not currently covered, and that it would, frankly, be
MR. LIEBOWITZ: Well, I'm not sure how it would be an antidote to the current problem. I mean, I am all in favor of having regulations that you think are worthwhile so that, for example, the borrower knows exactly the deals of the loan that he is purchasing. And if there is a belief that that is not the case, then you make it as clear as possible.

Maybe you make the guy write 20 times in a row the way you help kids in school, you know, "I understand that in 5 years, the interest rate is going to go up by" X percent, have them do it. And then you could say they definitely knew it.

And so to the extent that there are regulations that inform it for the borrower, I think that's fine. And to be national, instead of statewide, I think that is fine as well. As far as the CRA in general somehow helping the current problem, I don't see how that would happen.

The claim that is made by those who want to say that it's not just the underwriting standards, I agree with Glenn that there are probably some amount
of changes to underwriting standards compared to the ones that have been in place, that might have been reasonable.

Once you start loosening them, though, where is the dividing line between the flexible underwriting standards and the loose underwriting standards?

I am well-aware of the people who are doing the research. And Glenn does lots of good research. Where were they when the line was crossed saying, "Stop. Stop. Stop. Stop" because it really only took a bully pulpit to stop a lot of that to warn people because warned off the secondary market to be careful. None of that was done.

So when we crossed that line, wherever that line was, no one seemed to know we crossed that line. No one was stating we were crossing that line. And it's not clear we really know where that line is or that much study has really been done on exactly where that line is relative to where the old underwriting standards happened to be.

So I don't know offhand that, you know, making the CRA cover more banks than it currently covers would do much of -- the subprime originators seem to have disappeared.
And the other thing is it's not just subprime. The people who were in here who have a certain point of view who were saying, "It's all CRA. This is about the CRA. And it's all subprime," it's not all subprime. Right now there are more prime loans that are in foreclosure than there are subprimes.

Now it's very close to 50/50, but the fact is it's not just a subprime problem. And to say it is is misleading. It's a prime problem as well. If you include the alt-A's, those are usually lumped in with the primes. And so when they say, "subprime A," do they mean subprime and alt-A's?

We need to be sort of careful. It's not just subprime. It's not just high interest rates. Only 15 percent of the houses in foreclosure had an increase in the interest rate on their mortgage from when they first took it out. Eighty-five percent of them had the same interest rate that they got originally. So it's not "Oh, the interest rate is going to go up" and then it did and they got caught. They went to foreclosure before their interest rate went up.
I see there is a lot of misinformation in the way this tends to be discussed. So we need to be careful about that as well.

ACTING CHAIRMAN KIRSANOW: Mr. Wides?

MR. WIDES: I would just add that I think when you get to the panel talking about the Fannie Mae and Freddie Mac, that that would provide a very good opportunity to learn more about the changes in underwriting standards over a particular time period, let's say roughly 1990 through 2005, because their underwriting stance is a matter of public record. They published guides that were in the public domain that they were driving a very considerable portion of the market. And you can delve in with the next panel about what percentage of the market, but I think you can look at the standards over that period of time.

And then the movement by the GSEs from manual underwriting to automated underwriting and how those models were is a way of really looking at this question of how underwriting standards change over time.

And in terms of the impact of underwriting standards on housing prices, perhaps that was a factor during the period when we saw the explosion of prices.
with the explosion of the secondary market, the unregulated sector, in terms of the subprime, the payment option ARM, the interest-only, no-doc, low-doc type of lending.

But I think you also have to look at the changes in the Tax Code over a period of time and the impact that that has perhaps had on housing price appreciation. And there have been a number of studies looking at that.

As you look at federal tax policy towards home ownership over a period of time, you will see that that has changed significantly and be more favorable to home ownership in terms of excluding capital gains and the like.

So I think there may be a number of factors that contribute to home price appreciation, which does I think then lead into the question of what the ratings agencies assume with regard to home price appreciation and the models that they use to model low-doc, no-doc subprime loans that were payment option ARMs.

MR. BERENBAUM: If I could quickly jump in?

ACTING CHAIRMAN KIRSANOW: Sure.
MR. BERENBAUM: You know, unfortunately, fair lending and equal access to credit is an issue that we need to pay constant attention to. I agree with Glenn's point that, in fact, there was lending to low-income communities before CRA, but I need to bring the point out that over the past three years, NCRC has filed ten complaints against lenders, non-CRA-regulated lenders, who are, in fact, redlining communities.

Now, we are not talking 1960s. We are talking 2000s, where if a home is less than a certain value, they will not lend. If it's a rowhouse, they will not lend. If it's a tribal community, they will not lend. There was no regulator to ensure enforcement with the most basic of "Thou shalt not redline."

So there is a purpose behind CRA. And, again, these were safe and sound loans. There is no business defense in these cases. And a number of the lenders quickly said, "Oh, then they are now lending to their credit." So there is an ongoing issue here.

ACTING CHAIRMAN KIRSANOW: Let me follow up on that. I think there has been testimony that the CRA acts as an incentive. Maybe it was Commissioner Taylor's question that characterized it in that way.
As you indicated, this is not 1974, 1964, but I would tend to think that in 2009, there was probably less discrimination than there was in 1964 if, in fact, that is the case. And I don't know if that is the case, but I think that is a reasonable presumption.

If the CRA acts as an incentive, why wouldn't it be the case that the market itself would cause lenders if it were profitable to loan to low-income individuals on the same basis? And why doesn't the market drive what the interest rates that are charged or other costs of lending would be as rationally or as effectively as, say, a CRA-driven rate would be or lending practice would be, open to anybody?

MR. HUSOCK: Asked and answered, I would say.

MR. BERENBAUM: I think that it gets to where we are going as a nation in the coming decade with regard to our national civil rights commitment and how we partner with industry and Wall Street to get beyond this current mortgage crisis right now.

We have a wonderful opportunity, you know, out of the difficulties we are facing to engineer a solution that will, in fact, celebrate community, the
individual, treat all Americans equally based on their qualifications.

If we fail to do that, Mr. Carr later will speak to how, frankly, that will -- we are going to be on a very uncompetitive basis economically as the middle class continues to shrink, there is more pressure on low and moderate-income consumers.

We won't be able to compete globally if we do not clean up within our own house here locally. We must address the civil rights issues to move ahead economically.

ACTING CHAIRMAN KIRSANOW: We are actually beyond the 30 minutes I have prescribed by about 2 minutes.

CHAIRMAN REYNOLDS: Commissioner Kirsanow, can I get in a question? This is Reynolds.

ACTING CHAIRMAN KIRSANOW: No, you may not.

(Laughter.)

ACTING CHAIRMAN KIRSANOW: This is Chairman Reynolds who is speaking in a disembodied fashion. Go ahead.

CHAIRMAN REYNOLDS: I will make it quick. My question is, in the absence of discrimination, is there a reason for the government to issue policies
that affect the underwriting standards? I mean, shouldn't the underwriting standards be determined by the businesses themselves in the absence of discrimination?

MR. HUSOCK: If I might?

ACTING CHAIRMAN KIRSANOW: Mr. Husock?

MR. HUSOCK: I am Howard Husock.

I think it is important to distinguish between underwriting standards. CRA does not speak to underwriting standards specifically.

CHAIRMAN REYNOLDS: It affects them, though.

MR. HUSOCK: It does. I agree. But I think what we really ought to focus on is its ultimate goal might be called the allocation of credit. And CRA advocates believe that in reference to Mr. Kirsanow's question previously that the market fundamentally is in ways unjust, unfair, unequal in the way it will allocate credit.

And if you believe that, then you should believe that you want the CRA to be extended to other areas. If you believe -- I am really trying to be as fair as I can in characterizing this. If you believe that there are flaws in the market, that there will not be competition, that the rowhouse owner who is
turned down won't be able to turn to another mortgage lender, and that, actually, the person who turned down the rowhouse will be penalized for not understanding the profitability of that rowhouse, if you believe that all of those flaws are there, then you believe in allocation of credit.

The danger, of course, in allocation of credit is that the government gets it wrong. And the highest and best use of that capital to benefit those of low and moderate-income over time will be subverted. That's the kind of choice that we really face, I think.

ACTING CHAIRMAN KIRSANOW: Mr. Chairman?

CHAIRMAN REYNOLDS: Yes. But with credit scoring, it seems to me that a lot of the issues that we dealt with prior to 1977, a lot of the issues regarding race, regarding neighborhoods, a lot of these considerations, we can sweep them aside.

Is that truly our concern to ensure that low-income people who have good credit and who are in a position to service the debt are able to get loans? Aren't there vehicles that we can use to ensure that low-income individuals would have access to credit?

MR. BROWN: One thing -- this is Luke Brown speaking from the FDIC -- the majority of our
banks that at the FDIC we supervise are
community-based banks, very small institutions.

So, you know, I just want to say that
banking is not always big. It's still in communities.
It's still about being interested in communities and
looking at certain under-served areas and focusing
your resources in those areas.

So although it was said earlier that the
market now maybe does not discriminate as much as it
has in the past, as we have seen, one of the big
pieces of why we are where we are today is the market
is about money. It's about chasing money. It's about
your bottom line.

So at the end of the day, if that is the
big motivation, a lot of lenders are not going to be
focused on certain communities. So the good thing
about CRA is it focuses them and incentivizes them to
start thinking about those areas.

ACTING CHAIRMAN KIRSANOW: Again, I will
leave this open for a couple of more minutes because,
as you know, your testimony will probably be
instrumental in whatever recommendations are sent by
this Commission to Congress or the White House related
to this particular subject.
And given that we are talking about the CRA, I am wondering if -- and I think this was raised nominally, at least, in someone's testimony. I can't recall whose it was. What, if any, changes should be made to CRA going forward if any changes need to be made?

COMMISSIONER TAYLOR: Mr. Chairman?

ACTING CHAIRMAN KIRSANOW: Yes?

COMMISSIONER TAYLOR: Along those lines, can we get agreement from everyone on the panel that in the discussion that we have had today? And in making the changes and modernizing the act, there has been little attention on what I like as a paradigm for flexible versus loose standards or creative products.

Could we all agree that that is the problem? We failed to draw the line, we failed to identify where the line was. And when it was crossed, we failed to call it.

MR. BERENBAUM: Relative to the Community Reinvestment Act?

COMMISSIONER TAYLOR: Yes.

MR. BERENBAUM: I would respectfully -- I think I am going to disagree --

COMMISSIONER TAYLOR: Okay.
MR. BERENBAUM: -- because I believe that the underwriting standards of CRA-regulated institutions, as demonstrated by all of the reports discussed today by the regulators and presented by NCRC as well as by Marsha, document that they were, in fact, a stronger underwriting, not loose.

COMMISSIONER TAYLOR: Which goes to your point of expanding the CRA --

MR. BERENBAUM: Exactly.

COMMISSIONER TAYLOR: -- to encompass those unregulated institutions.

MR. BERENBAUM: So if we're talking a broader discussion about the marketplace, I think it's a very effective way of capturing the types of loan products.

COMMISSIONER TAYLOR: Okay.

ACTING CHAIRMAN KIRSANOW: Okay.

MR. WIDES: This is Barry Wides with OCC. I would also agree with David that it may be true with respect to the independent mortgage companies, but that line was clearly crossed. I would argue that with respect to the banks that we supervise and the other federally supervised banking agencies, whose regulators are at this table, we put out considerable guidance during
the period 1999 to 2007, which was provided in a letter that was sent by Julie Williams, our chief counsel, to the Commission several weeks ago, which delineates in a great deal of detail the guidance that we put out to banks, making very clear to them what type of underwriting that is credit quality-deteriorated was acceptable for national banks and what wasn't.

And testimony that Comptroller Dugan has given to Congress yesterday and many other cases made very clear that what is needed are standards that apply across the industry and not to just federally supervised entities but to all independent mortgage companies and players in the marketplace.

I think that is where the issue really lies in terms of where that line led. And it was not really clearly delineated.

ACTING CHAIRMAN KIRSANOW: Mr. Husock?

MR. HUSOCK: Howard Husock, Manhattan Institute, once again.

In answer to the question about going forward, I think it has been pretty clear that I am not a big fan of the CRA. But if it is going to be with us and if it were to be extended, I think the most important modernization would be transparency.
And that would be ongoing timely reporting of the performance of CRA-qualified loans by lenders.

I would expect that the NCRC would favor that. The assertion has always been made that these are profitable but maybe slightly less profitable. Of course, that is a form of non-profitability because capital is being used in a less profitable way, but okay.

If you are not a strong free market guy, let's at least find out how those loans are performing in a timely way to make sure going forward that we're not inviting a new problem.

ACTING CHAIRMAN KIRSANOW: I have to limit this to two more minutes. Ms. Courchane?

DR. COURCHANE: I should be 30 seconds. Two things that came up in the research we did, one is that the biggest banks are the ones who are making many of the CRA loans if you are focusing on mortgage lending.

I think we could revisit the definition of in and out an assessment area. When you have nationally based lenders, how will you define that footprint? And what gets covered under CRA could be addressed.
The second thing I would say -- and, again, we also noticed this in the data that we looked at -- is that you have this voluntary reporting of the lending activity by the affiliates that might be subs of the banks.

And you could make mandatory all of that coverage as well, which would bring in the coverage fairly simply beyond the points that David raised earlier about going to the independent mortgage companies, credit unions, et cetera.

But, even as it stands, changing the assessment and changing the reporting and for the affiliates are some of the things that could be done to broaden coverage.

ACTING CHAIRMAN KIRSANOW: Mr. Liebowitz?

MR. LIEBOWITZ: Yes. I just wanted to say that, with all due respect to my colleagues from the agencies that do the regulating, I think when we go through this with a fine-toothed comb in the later years, we are going to find that all of the banks, all the groups of banks, all of the regulated banks, all the different types of regulated, that all went over the line. Okay? We're not going to just find it's some small little group of unregulated or lightly
regulated mortgage brokers that went over the line in terms of the loose lending standards.

ACTING CHAIRMAN KIRSANOW: Okay. That being the conclusion of panel number 1, I want to thank all of the witnesses for their splendid testimony. This has been highly informative. I think this is the first comprehensive hearing on all of these matters. And it has been very useful to all of us. Thank you very much.

We will take a five-minute break. And then we will reconvene to talk to panel 2 about HUD lending goals and their effects, if any, on Freddie Mac and Fannie Mae.

(Whereupon, the panel was excused.)

(Whereupon, the foregoing matter went off the record at 11:36 a.m. and resumed at 11:45 a.m.)

PANEL 2 -

THE HUD LENDING GOALS AND THEIR EFFECTS ON

FANNIE MAE AND FREDDIE MAC

ACTING CHAIRMAN KIRSANOW: I think we are prepared to go forward at this particular point on HUD lending goals and their effects, if any, on Fannie Mae and Freddie Mac.

Just a few statements with respect to the outlook on this particular briefing and panel. When
Fannie Mae was chartered as a GSE in 1968, Congress assigned regulatory authority over the entity to the Department of Housing and Urban Development.

HUD was authorized to require that a reasonable portion of Fannie Mae's mortgage purchases be related to the national goal of providing adequate housing for low and moderate-income families. Similar housing goals were authorized for Freddie Mac, as the panel will examine the impact of lending goals, as I have stated, on the effects of Fannie Mae, Freddie Mac.

As I understand it, the Department of Housing and Urban Development had intended to send the former Director of HUD's Office of Governmental-Sponsored Enterprises Oversight, which had the responsibility for setting housing goals, but, unfortunately, the director is out on medical leave, not expected to return until sometime in late March.

And, due to the transfer of HUD's staff who worked on the housing goals to the FHFA and retirements, HUD related to us that they did not believe they had any other officials with sufficient knowledge to provide testimony as to the establishment of the goals but that they are prepared to make the
former director available to the Commission upon her return from medical leave.

Again we will follow the same procedures we did in the previous panel. And I will introduce each of you. And again forgive me for not citing all of your accomplishments.

We have on our first panel -- and also forgive me if I mispronounce your name -- John Wiecher, Ph.D. and Director of the Hudson Institute's Center for Housing and Financial Markets.

From 2001 to 2005, Mr. Wiecher served as Assistant Secretary for Housing and Federal Housing Commissioner for the Department of Housing and Urban Development with responsibility for FHA mortgage insurance. His major initiatives included promoting minority ownership, regulatory reform of the real estate summit process and mission regulation of Fannie Mae and Freddie Mac.

Mr. Alfred Pollard is General Counsel of the Federal Housing Finance Agency, which has been appointed conservator of Fannie Mae and Freddie Mac. His work focuses on regulatory matters affecting Fannie Mae and Freddie Mac and the 12 Federal Home Loan Banks, including regulations governing capital, corporate governance, internal controls, affordable
housing and accounting, as well as on legal developments affecting mortgage markets and legal representation of FHFA.

Mr. Pollard has worked on a major interagency report on mortgage-backed securities markets and currently serves on the President's corporate fraud task force and Justice Department's bank fraud working group and mortgage fraud working group. You have a lot on your portfolio there.

He has had a leadership role in major investigations and enforcement actions and in the conservatorships imposed on Fannie Mae and Freddie Mac in 2008.

And, again, as though they will not be formal presentations, the officials from Fannie Mae and Freddie Mac have joined us at the table. They will be available to answer questions.

MR. POLLARD: Can I take the liberty of introducing them?

ACTING CHAIRMAN KIRSANOW: Yes. If you could, I would appreciate that.

MR. POLLARD: Bill Senhauser, to my immediate left, is the Senior Vice President and Chief Compliance Officer at Fannie Mae. And Bob Tsien is
the Senior Vice President for Mission Oversight and Development at Freddie Mac.

Both of these gentlemen, if I could, I want to say I appreciate their coming. They are intimately involved in the new loan modification and refinance programs, and we were able to get them to come. I do appreciate their joining me today with their factual expertise.

ACTING CHAIRMAN KIRSANOW: And we appreciate that also, especially on relatively short notice. Whereupon,

JOHN WIECHER and ALFRED POLLARD were called as a panel of witnesses by the United States Civil Rights Commission and, having been first duly sworn, was examined and testified as follows:

ACTING CHAIRMAN KIRSANOW: Thank you very much. So we will begin with Mr. Wiecher.

MR. WIECHER: Thank you, Mr. Kirsanow. And I want to thank the Commission for the opportunity to discuss civil rights issues and concerns arising from the mortgage and housing market crises of the last two years. This is a panel on the affordable housing goals, and I will limit my remarks to that subject.
The Department of Housing and Urban Development is charged by statute, was charged by statute, with formulating the affordable housing goals for the government-sponsored enterprises for the GSEs in 1992.

As Assistant Secretary for Housing at HUD, 2001-2005, I held the authority for those activities under delegation from the Secretary of HUD. If that authority had been delegated to the Assistant Secretary for Housing since 1993, it has now, of course, been transferred to the Federal Housing Finance Agency and the Housing and Economic Recovery Act of 2008.

In my written statement, I discuss the nature of the goals and how they were established. I will skip over that in the interest of time and look at two factual questions: first, the extent to which the GSEs have served minority homeowners; and, second, the effect of the 2005 housing goals on GSE purchases of subprime mortgages.

The affordable housing goals are not set in terms of the race or ethnicity of the borrower, nor are they set with respect to whether the borrower is buying a first home or refinancing a mortgage or buying a home for the second or third time. But there
is always interest in the extent to which borrowers
are first-time home buyers and the extent to which
they are members of minority groups.

In the policy discussions and analysis
prior to the promulgation of the 2005 affordable
housing goals, HUD analyzed the extent to which the
GSEs were serving first-time home-buyers. A summary
of the analysis appears as table 2 in my statement.

As the table shows, the GSEs did not serve
first-time home buyers very well. During 1999 to 2003
-- and this is the latest data that has been publicly
available -- about 39 percent of mortgages to home
buyers in the overall conventional conforming market
were to families buying their first home. Only about
26 percent of mortgages to home buyers who were
purchased by the GSEs were to first-time home buyers.

The GSEs did a particularly poor job in
serving minority first-time home buyers. About 12
percent of mortgages to home buyers in the
conventional conforming market were to first-time
minority home buyers compared to only about 7 percent
of GSE purchases.

Now, the conventional conforming market is
the market in which the GSEs do make loans. It
excludes the lower half of the subprime market known
in the trade as the B and C loans. It includes the higher-quality subprime loans, the A-loans, and has since the mid 1990s.

It also excludes loans that are government-guaranteed. It excludes FHA loans and VA loans. Those are not part of the conventional conforming market. And should the GSEs buy them, they're not counted in evaluating goals performance.

What this means is that lenders other than the GSEs, lenders without the various special privileges that were given the GSEs agency status and the ability to borrow preferential rates in the capital markets, lenders other than the GSEs did a better job of serving first-time home buyers and minority home buyers than the GSEs actually did.

By contrast, the GSEs did much better in serving homeowners who were buying a home for the second time and the third time before trading up, both white and minority homeowners. And they did a better job of serving borrowers who are refinancing.

The second issue is the extent to which the GSEs were buying subprime mortgages, both before and after the 2005 rule went into effect. The evidence indicates that the affordable housing goals had little, if any, impact on GSE activities in these
Instead, it appears that the GSEs were responding to the same factors in the mortgage markets as other lenders.

In my statement, table 3 reports the dollar values of subprime mortgage purchases by the GSEs during 2001 to 2006. As I mentioned, the GSEs had been buying A-loans since the later 1990s, but they began buying subprime mortgage-backed securities heavily in 2002. Their subprime mortgage-backed securities purchases doubled between 2002 and 2003, doubled again in 2004, from 38 billion to 81 billion to 176 billion.

After the new goals went into effect, their subprime mortgage-backed securities purchases actually declined slightly to 169 billion in 2005 and then dropped sharply to 110 billion in 2006.

Their share of the subprime MBS market rose from 31 percent in 2002 to 49 percent in 2003. Then it declined slightly to 44 percent in 2004 and much more sharply after the new goals to 33 percent in 2005 and 20 percent in 2006.

Essentially what happened was that the market for subprime mortgage-backed securities took off in the early years of this decade. And the GSEs
became active in that market for a couple of years. And then the GSEs began pulling back.

The data I have quoted come from a series of annual reports by the Office of Federal Housing Enterprise Oversight, which has been the GSE safety and soundness regulator until last summer. The reports are entitled annually "Mortgage Markets and the Enterprises in" whatever year it might be.

It appears that OFHEO did not think that these purchases posed a risk. In each year's report, the discussion of subprime purchases was followed immediately by a section on overall single family mortgage credit risk in which OFHEO concluded that the risk was not great.

In the 2006 report, for example, the discussion of subprime purchases is followed by a section titled "Enterprise Single Family Credit Risk Remains Low." Similar discussions appeared in earlier reports.

Further evidence on GSE behavior comes from a recent analysis by HUD staff economists published in the August 2008 issue of HUD's periodical "U.S. Housing Market Conditions."

The study reports the distribution of mortgage/income ratios for the GSEs and other lenders
from 2001 to 2006. Higher ratios indicate greater risk of default, mortgage payment burdens that will be a particularly large share of the borrower's income.

The data are shown in table 4 for loans that were in the 90th percentile of the mortgage-to-income ratio, close to the most risky loans being made, close to the loans which posed the highest burden on incomes of the borrowers.

What we have in that study is evidence that beginning in 2002, the GSEs began taking more risks. And they increased their risk through about 2004. And then their appetite for risk remained about the same. The ratio remained about the same. But they did not choose to take less risk after 2004 but chose to take about the same amount of risk. Of course, when the new goals went into effect in 2005, there wasn't a change in the GSE behavior.

Other lenders were taking more risks at the same time. If you look at the portfolio lenders, their appetite for risk increased beginning in about 2002. If you look at the private issuers of mortgage pools, who tend to be the subprime lenders, their appetite for risk increased at about 2002. And their appetite for risk will continue to grow until 2005-2006.
I think the GSEs were reacting to the same factors that other lenders were reacting to, a relaxed monetary policy, especially in the aftermath of 9-11, when everyone was persuaded that we were about to see a major recession and the Fed took action to prevent that. Everybody saw an opportunity to profit in the mortgage market, and everyone took advantage of it.

The GSEs were acting like other lenders. And their experience was a lot like other lenders. They were by no means the first lenders to run into the problem of excessive risk. It's just over two years ago the first HSBC and then New Century were reporting major problems with their subprime mortgage portfolios.

The GSEs' problems surfaced later, surfaced in the Summer of 2008. But the GSEs are the largest lenders in the mortgage market. They have been traditionally and by statute the least well-capitalized, certainly among the portfolio lenders, and their problems when they hit attracted much more serious for the economy.

Thank you very much.

ACTING CHAIRMAN KIRSANOW: Thank you, Mr. Wiecher.

Mr. Pollard?
MR. POLLARD: I first heard of the Civil Rights Commission in 1972, which shows my age, when I was an intern on the Hill and there was a hearing about the Civil Rights Commission. That is the first time there, but this is my first time in attendance. I appreciate the opportunity today.

We have met with your staff and hope we provided some useful information and hope that has contributed to the work of the Commission. And we will be happy to continue that.

The staff made one mistake when they spoke to me. They said, "We're going to get you up to talk about affordable housing. But if you would like to comment on some of the other issues, go ahead." So I will be the fastest-speaking Georgian you have heard from and cover a few topics.

It is great to be on a second panel. You get to either agree with what everybody else has said or you can disagree with what everybody else has said. I will maybe take the former and say there is a little bit of what everybody said that has some good kernels of truth.

Let me give you, if I could, a few seconds about my view of this market. This is not 1957. This is not '67, '77, '87, '97. It's today and what has
happened. And I will just hit some themes for you because I think they are useful. I hope they are.

First, complexity. This is not an S&L and a borrower and maybe Fannie and Freddie. That world is gone. This is investors in China, bond insurers, rating agencies, securities firms. None of these people were participating in 1987. I mean, there was some securitization going on in '87-'89, but it is a new world in terms of its complexity and the number of players.

So that's number one. Number two, you all remember what went on in the 1990s. We had rapid growth, a technology boom. So three things came about: a technology boon, which increased immigration; a baby boom, which increased migration; and speculation. We had some lower interest rates, as Mr. Wiecher said.

All of this got concentrated in a new area: housing. People are moving in. People are moving up. A lot of housing got built. There was a great deal of pressure to accommodate that.

So where do you come down? What is new in this new system that is different? First, the government has continued to call for housing. The government has never called for poor underwriting.
Number two, we took on perhaps a new view of risk spurred by some of our new technologies and new devices. The theory sort of was if it was just an S&L with 100 percent of the risk and someone on Wall Street is willing to buy part of the risk and someone in Europe is trying to buy part of the risk and we have mortgage brokers who are just helping getting mortgages in the system who have very little risk, then we have spread the risk.

Unfortunately, there took to be an element from that that there was no risk, no risk for me, or I just got a percentage of the risk. But, remember, we have this complex interconnected system.

So to say that I have a half a percent of the risk but I am connected to you is different than saying I have 100 percent of the risk and I am over here. That to me is one of the major fundamental changes.

And we did this through things called hedging and derivatives and insurance. People get insurance. But they forget that they have deductibles and put-backs. And insurance doesn't pay if there is fraud. So all of this risk transfer that people entered into did not eliminate risk. We still have risk.
And, to be candid, they are moved into the housing world a different attitude. My dad told me when I started to buy my first house. He said, "Buy a house you can afford to live in. You may have to." I kind of always took that pretty seriously.

Housing became a method of wealth accumulation in many people's mind. As prices inflated in certain markets, people began to see, well, if I get in and everybody is a part of this, the media, everyone was get in, get part of this -- and some of your prior speakers said, you know, there's an emphasis on housing, there is.

But it wasn't just housing for residents. It became housing for speculation and then what we call layering, where people get into the house, barely get in, and then borrowed again to furnish the house and get the big TV and get the rest of what they needed. So a lot of this came about with low-risk, no-risk attitudes and speculation.

Two final things before I get to my statement. There is a good statistic I thought the realtors put out a few years ago, which was -- I forgot the time frame. Let's say a five-year time frame. Housing prices went up 50 percent. Income went up 13 percent. People were getting in houses
with mortgages that were going up a lot, going up a lot faster than their incomes were.

And, finally, -- and I'll turn to subprime -- I don't know that subprime is the only reason we're in a housing crisis. Inflated housing prices could have burst on their own, not people being unable to default. Perhaps in certain markets we simply built so many homes. The builders would have gone down. It turned out it happened to be in subprime. Investors may have just been going too far. But the short of it is we will focus on subprime, and that's where we were.

So with those sort of -- and I am not an economist, but I will call those economic views that are my own. Let me turn to my quick remarks for you.

The mortgage crisis that began in '07 and '08 has many causes. In my mind, it is a systemic event. The crisis and its repercussions for the broader economy should be viewed from a systemic perspective, not merely one sector.

As regulators and others consider the future beyond our immediate challenge of resolving current market conditions, we need to look at all elements and all elements at the same time. That is at least my view.
Financial panics in the Nineteenth Century were frequent, about every 20 years. In the Twentieth Century, we created the Federal Reserve, the FDIC, the Securities and Exchange Commission. We have had technological advances. This promised prosperity, greater access to credit.

After the second world war is when people really begin buying homes. Before the second world war, mortgages were five years. It's not a very popular product.

Still, here at the beginning of the Twenty-First Century, we meet at the Commission to discuss what has transpired and how one of those parts of this system has had an impact.

Our agency, the Federal Housing Finance Agency, prior to July 30th this year was the safety and soundness regulator for Fannie Mae and Freddie Mac. On that date, we became both the safety, soundness, and mission, which includes affordable housing goals, regulator as well as overseer for the 12 Federal Home Loan Banks.

I would tell you at this time we are preparing a draft for comment on affordable housing goals for the coming year. Clearly these goals will be important, particularly in light of current market
conditions, but should reflect the ongoing commitment of the enterprises to their core missions, as established by Congress.

We have to address 2009 under the existing rules. We will promulgate our first rule of housing goals for the year 2010, as Congress placed it in position in our statute.

Now, what is the role of Fannie Mae and Freddie Mac? I think it is important to note that. They buy or guarantee mortgages or mortgage securities. They issue thousands of mortgage-backed securities a year. They hold $1.6 trillion in portfolio of mortgage loans and guarantee in one fashion or another $4 trillion of securities.

The fundamental purpose is a secondary market function to buy and provide liquidity and stability to the system. The core banking laws to protect consumers from discrimination and unfair marketing practice apply at the point of origination. Fannie Mae and Freddie Mac are prohibited from originating mortgages.

I would tell you it is a complex system having worked in the banking industry. There are over 35 separate retail banking laws. And many of these do affect mortgages.
Indeed, if not conflicting with federal law, state laws are relevant in jurisdictions, deceptive advertising, things like this.

The retail delivery system, not the secondary market, is the major point of contact with borrowers. Let me pause to say immediately I am not here to tell you that Fannie and Freddie don't have a role. I am not here to tell you let's talk about somebody else.

Fannie Mae and Freddie Mac do undertake steps and have undertaken steps to support federal laws across the board. The major method they employ is called a rep and a warranty, a representation and a warranty, which is that their seller/servicers, many of whom are unregulated, which is one of the benefits when Fannie and Freddie set a standard, will comply with applicable federal and state laws or face having their mortgages returned to them and the enterprises reimbursed. This is a very powerful incentive.

Further, their seller/servicer guides, which have been referenced, provide instructions on how to conform standards and avoid law violations. For example, there are specific requirements to meet anti-predatory lending statutes and rules.
Now let's talk about the affordable housing goals very quickly. I won't go over the entire history. I think Mr. Wiecher has done a good job in that.

What I would note is that in 2004, there was a sizeable increase in the housing goals pressing Fannie and Freddie to match or exceed the market; in effect, to lead the market.

In 1996, the percentage for low-income was 40 percent. In 2003, it was 50 percent. And it was to be 56 percent by 2008. And there is a chart attached showing this growth.

In sum, the goals address income levels and geographic delineations. They provide various targets to be set by the government. They support all forms of housing, including multi-family, rental, manufactured housing, and under-served areas.

The goals do not go directly to underwriting criteria in the primary market, but the enterprises do take actions to try and limit the threats to their safe and sound operations.

The current market, in many ways Fannie's and Freddie's market share, which is reflected in one of the charts, demonstrates that many mortgages were being made outside of the Fannie and Freddie Mac
channel; in part, because of their underwriting criteria.

These were being made and purchased by firms on Wall Street and became known as private label securities. They were, in fact, creating a secondary market. What you had was Fannie and Freddie going from about 55 percent of the market to about under 44 percent of the market.

With the housing goals, these ambitious goals, announced, it is clear that the enterprises did increase their purchases in the subprime market. Indeed, the HUD guidance at the time mentioned looking into the subprime market as a place for potential targeting to find these housing goals.

The share of loans, however, was less than one percent of their portfolios. They were significant purchasers of private label securities that had subprime. They did take the higher quality of these. They are divided into tranches and frequently had a good deal of credit enhancements for these loans, where they had insurance and other things.

So while they were buying subprime, they were focusing, trying to get on the higher level of
the quality spectrum. And there is some information in my chart, in my testimony, regarding it.

And the delinquency rates, which is also a chart, it reflects this, that their delinquencies are aggregate two to two and a half percent. The regular market in these loans is as high as 23 and 34 percent for subprime loans.

During this time, the bank regulators, who had begun as early as 1999 issuing statements -- they issued statements in '99, 2001, 2002, 2005, 2006, and 2007 regarding subprime lending and concerns for the financial community. These guidances were put out.

Our predecessor agency, OFHEO, in 2007 on its own initiative applied these to Fannie and Freddie. In other words, the guidance by the bank regulators in a spirit of working together and making sure this was being done properly, we applied them to Fannie and Freddie.

Now, what this did was to add not only that a bank dealing with Fannie and Freddie had to abide by these guidances but unregulated firms that wanted to sell products to Fannie and Freddie had to as well. And we believe that was helpful to pulling down this market in these products.
Let me digress one second as well. Not to defend the products, but there is a situation. And this is a complex situation where many products that were created were created for a particular type of borrower.

If you are a well-to-do borrower and you want to borrow money and you borrowed money from a bank quickly, maybe the bank doesn't want to have to get as much paperwork and take as much time. They're willing to take a risk. This is a sophisticated person.

Maybe that type of credit is okay. I am not saying it is or it isn't, but it clearly would not be okay for someone who is a first-time home buyer with modest means to get into a loan where, as we talked about today, they really didn't qualify.

Now, let's talk about initiatives. And I will quickly finish. I do want to let you know what is going on and what we are trying to do.

Before the crisis, I would note that the enterprises have had anti-predatory loan provisions as early as 2000 on their loan purchases. And for private label securities, they have required, where possible, due diligence by the sellers and that the sellers do anti-predatory lending reviews of their
portfolios, where possible. There are some securities
laws issues.

Since the crisis, the enterprises have
begun a refi program for people in danger, not there
yet, of not being able to meet their mortgages. They
are part of a Treasury-directed with us loan
modification program to help people who are crossing
the line, in imminent default, or who are delinquent
on their loans.

They have put in foreclosure forbearance
programs with modified payments. They have put in
foreclosure preventions programs. They have put in
rental continuation programs, where landlords have
been the subject of foreclosure and where the
enterprises own the properties.

They have put in place new appraisal rules
-- appraisals contributed to this house price
inflation -- to protect appraisers from undue
coercion. And they have enhanced their mortgage fraud
efforts, which our agency began about 2004 and 2005.

I personally have spent the last five
years with a great deal of time on those task forces
trying to get mortgage funds which prey on all
communities but particularly on low and
moderate-income families.
ACTING CHAIRMAN KIRSANOW: Mr. Pollard, could you please wrap up?

MR. POLLARD: I am going to wrap up. Let me talk about the future. I think when we look at things to be done in the marketplace, there are various ideas out there. Affordable rentals, are we doing enough there? Licensing of mortgage brokers, mortgage originators; regulation of key players at the state level as well as the federal level; ID numbering for mortgages and individuals who touch mortgages so we can find out who is doing what; enhanced mortgage fraud prevention, not just detection; and, finally, a return to that traditional underwriting, which may mean some more time and in some cases some increased costs. But, as some of your other speakers said, the benefit would be greater assurance that a homeowner that buys the home stays in the home.

ACTING CHAIRMAN KIRSANOW: Thank you very much.

We will proceed to questions from the commissioners. Commissioner Melendez?

III. QUESTIONS BY COMMISSIONERS AND STAFF DIRECTOR

COMMISSIONER MELENDIZ: Yes. Thank you very much. Yes. First of all, thank you all for being here this morning.
I would like to ask Mr. Wiecher. I am trying to understand the claim by some that affordable housing goals cause Fannie Mae and Freddie Mac to acquire loans made for low and moderate-income households that basically went bad. So I have two questions.

Were there any rules or regulations about affordable housing that required expansion into the subprime and alt-A markets? If not, then how exactly do you think the decisions of Fannie and Freddie to increase their share of the subprime and alt-A markets were influenced by affordable housing goals?

MR. WIECHER: Commissioner Melendez, there is no requirement that either GSE buy loans that are rated below prime. There is a legal requirement that loans of the type they had been making should be considered as part of the market that they are serving in establishing housing goals and, indeed, in the 1992 statute, the Federal Housing Enterprise's Financial Safety and Soundness Act, there is a specific provision that grandfathers in the kinds of mortgage products they had been making prior to that statute. They are not subject to review by either HUD or OFHEO other than on safety and soundness grounds or down the road.
So there is no requirement there. They were buying A- and alt-A loans as of the mid 1990s. And so those were counted by HUD in the affordable housing goal in defining the market that they were serving in order to determine what would be the appropriate targets under the goals. Those were included as loans that they were buying and could presumably be expected to continue to buy.

The data that I was quoting in my testimony I think shows that the decision to increase their activity in A- and alt-A was a decision undertaken in the interest of profit maximization in the same way that that decision was undertaken by other types of lenders. And they increased their activity sharply in 2002, '03, '04, and then pulled back, making whatever prudential judgments they thought were appropriate. And I think that is fairly clear from the data.

ACTING CHAIRMAN KIRSANOW: Any other questions? Commissioner Taylor?

COMMISSIONER TAYLOR: No, no questions.

ACTING CHAIRMAN KIRSANOW: Chairman Reynolds?

CHAIRMAN REYNOLDS: Yes?

ACTING CHAIRMAN KIRSANOW: Any questions?
CHAIRMAM REYNOLDS: No.

ACTING CHAIRMAN KIRSANOW: Mr. Staff Director?

STAFF DIRECTOR DANNENFELSER: Yes. Thank you.

We talked earlier about relaxation of underwriting standards in the first panel. And I believe it was Marsha Courchane said that she thought the affordable lending goals for Fannie and Freddie probably had more to do with more lending to low and moderate-income homeowners.

Was there a separation in terms of the risk that the loans being made by community banks could then be passed on to someone else and that once they sold to someone else, that there was no longer the risk?

Was there a situation where people were making many loans and that there was a great deal of pressure to have more loans made but without the risk of the people who originally made the loans? And to what extent were Freddie and Fannie involved in that situation?

MR. POLLARD: I guess I would answer that, again, in this market, as mortgages were seen as the safest investment across the board by everyone, there
became an increasing demand for mortgages. The market that developed outside of the enterprises was showing mortgages with higher yields because they were charging more. And that made those attractive investments.

So that builds a cycle of people saying, "Well, we would like to buy some more." That then says to a lender, "I can go out and try and market some more of these loans." And, of course, I am a big believer that a percentage of this is also fraud, but that they would go out and market and get a broker or their own people to go out and have programs saying, "Come on in. And let's see."

So I don't know. You can say that sometimes a lot of people view it it's the people at the front who start the motivation. There's also the people at the back who are buying securities and want to invest who say, "Gee, there is money available for this."

I would note that at some point rates are actually going down in the prime market. And some of the rates for the subprime were somewhat lower, but they were still higher than the prime, obviously, because people knew there was a risk.
In fact, when you buy a mortgage-backed security, private label security, from the Wall Street firms, that's why they had tranches. There's BBB and all the way up to the AAA because they're breaking it down by FICO score and the risk.

So everybody knew there was some risk in these. The enterprises in working even with us as safety and soundness were saying, "We're getting the higher part of this that seems to have less risk, not no risk. It's not prime. It's clearly not prime."

And so in terms of what drives it, again, I am hard-pressed to pick X. That is going to be my problem. I think you could tell from my beginning remarks.

I think it's a function of people wanting to buy paper in global markets and domestic markets, people prepared to underwrite it outside of the Fannie and Freddie system, Fannie and Freddie then coming in and saying, be it for affordable housing, be it for market share, be it for some of these, like decent securities -- they were rated AAA -- you know, whatever, a mix of motivations that Fannie and Freddie get into.

What prompted this market, it's hard for me to pick that. This drove it. This got everybody
doing subprime and everybody getting into it. Homeowners were desperate to get into homes before they got completely out of their reach.

Unscrupulous people came to them and good people came to them, perhaps trying to do a good deed for them, getting a home, "We'll put a little bit of extra on your income. You're in. Don't worry. The price goes up. If there's any problem, you can sell."

This was the dynamic.

And I am talking common knowledge. I am not giving you any secret here today. But it's the reality. So it's hard for me to say that -- I would rather say and I think I said in my statement I think everything is part of this. Affordable housing goals were there.

HUD recognized at the time in 2004 that "You might have to look at" -- they didn't say, "Go get bad things." They said, "You may have to look at to get to these higher levels subprime, new types of products, whatever it is, to try and reach the communities."

But neither HUD nor Fannie and Freddie told people to go out and make fraudulent loans, inflate people's income, prepare forms that were fake
and bad. So I'm not saying fraud is everything, but to me there is a huge factor.

So, Mr. Dannenfelser, I'm not sure I am answering your question completely, but it's hard for me to pick the driver. The driver was this. The driver was that. It was a society that looked at mortgages, the safest of investments. And that is where I get to that risk comment I made earlier.

So everybody is making money. Rates are going up. Yields are going up. Buy these. They are easy to buy. They are quick. Technology. You know, bankers don't work in the banks. You don't know your customer. They're doing this over the internet. You have to go to your closing.

In the old days, it took two or three weeks not to go to closing, to get the mortgage, to go sit down and talk to somebody and show them all the paper and bring them this and bring them that. Then they told you when the closing was going to be.

And, you know, there are benefits for technology. We don't want to get rid of it. Now it's 15 seconds or I don't know how to do it myself, but, you know, 2 minutes. You're applying. We'll get you the quote. Good-bye. And they show up at the closing. And someone else is there with you.
So there's a lot of benefits to what has happened in our society. And I mean they are benefits. We should not lose them. As we look going forward, there have also been some negatives to it.

MR. WIECHER: This is John Wiecher. Just a couple of thoughts. One is that the GSEs typically devoted a smaller share of their portfolio to the loans that were in the goals category than other lenders were devoting to their lending activity.

This was true of all of the affordable housing goal categories. I mentioned this in the context of first-time home buyers, not first-time home buyers, but it is true in all of the goals categories. The GSEs were, in the jargon that we used, lagging the market. And the statute required them to provide leadership to the market.

I think the other lenders, the portfolio lenders, perhaps the CRA lenders, other lenders, who were not portfolio lenders and not subject to CRA, were, in fact, making more loans to low and moderate-income people and more loans to under-served areas than the GSEs were as a share of their business.

So I think it's hard in that environment to talk about the affordable housing goals as a
problem for generating the problem, generating the situation that developed in 2006 and '07.

Beyond that, I think you can see. If you go back -- Mr. Pollard talked in terms of the last few years. But you go back. The home ownership rate in this country turned up beginning in 1994, which is long before any of this problem, this phenomenon that we have been talking about. It started turning up in 1994. It went up from 1994 to 2004, from 64 percent of the households in America to 69 percent. That is huge. That is a huge change.

We had been a little bit higher than 64 percent in the midst of the unprecedented peacetime inflation that we experienced between the mid '60s and 1980, when the only hedge you had against inflation for most people was buying a home, owning your own home, thanks to the tax treatment of home ownership. That was the best investment you had.

If you knew something about collectibles, if you knew something about objet d'art or Oriental rugs, those were good investments. But most people didn't. And houses were something that most people knew.

Even in that environment, the home ownership rate moved up from 62 percent to 64 percent
and then came back down again. Beginning in 1994, we
had a sea change. And it lasted for a decade. And to
my mind, what happened is that is the technology
revolution, information revolution, coming to the
mortgage market.

I was at HUD 20 years ago running a
research program. At that point, the best information
we had about risk in mortgages was information about
the original loan-to-value ratio.

If you took out a mortgage with very
little equity in the home, there was a better chance
that you would default on the mortgage. It was no
sure thing or anything along that line. But if you
put down 20 percent or more, you were much less likely
to default than if you put down 5 percent or less.

We didn't know anything about credit
scores. FICO didn't exist 20 years ago. Automated
underwriting did not exist 20 years ago. It became
possible to make better judgements about people's risk
based on their actual behavior, rather than based on
the initial loan-to-value ratio.

It became possible to evaluate a mortgage
application much more quickly than it was when you did
it by hand. And so you had automated underwriting
systems. You had FICO scores. And it became
possible, as Mr. Pollard said, to make a decision more quickly.

If you were operating by rules, there will be special cases where the rule will put somebody on the wrong side of the dividing line between approval and not approval compared to where they would be if you sat down and went through all of the factors by hand.

NFHA, in fact, there was always manual underwriting. It alone was denied on the basis of any kind of automated underwriting system. So there was always that. There was always that risk.

That decade, that process of increasing home ownership impact of technology came to the end about the end of 2004. And you can see at that point the home ownership rate beginning to turn down, the number of renters beginning to rise.

And you can also see if you go back and look at the mortgages that lenders were issuing, look at the performance, in the first year or so, after a loan was originated, when you would think that the loan was not likely to default, you knew what the borrower's income was, you knew what the market was like.
If you look at first-year defaults, they were low in 2002, loans originated in 2002. They were a little higher in loans originated in 2003. They were a little higher than that in loans originated in 2004. They were more than a bit higher than that on loans originated in 2005 and a lot more than a bit higher than that on loans originated in 2006.

Lenders across the board had started to take more risks. The effect of the major change in the ability to assess risk, that had run its course. But lenders were still looking to make the same kind of profits that they had been seeing, do the same volume of business they had seen in the decade before. And they overshot.

I don't see that as systemic. This may be a question about terminology. I see this as an effort to make money and misreading the situation when the situation had changed.

ACTING CHAIRMAN KIRSANOW: Commissioner Gaziano?

COMMISSIONER GAZIANO: Yes. I thank you all, too.

I am going to focus maybe on a philosophical question that was raised in the last panel. Mr. Husock said that it is really not a good
thing for low-income families to be induced, whether it's societal pressure or not, into home ownership. And then there are, as we know, countervailing sort of social arguments about home ownership.

And so I want to make probe that a little bit with a hypothetical, to what extent we should socialize loan risk a little bit on the margin, you know, with flexible, more flexible loan standards, to increase slightly at least low-income home borrowers.

My hypothetical is simply this. We all learned of the more sophisticated tools of FICO scoring and such that allows us to maybe determine better who is going to be able to repay the loan or not.

If we could imagine whatever and we profit maximize or draw the line, we could imagine that they make their best effort at drawing the line, should the government help socialize the risk so that, at least some people a little below that imaginary profit-maximizing line can get into a home or are we really better off and society and potential home buyers really better off not getting home mortgages and waiting a little while maybe until they're more mature and they've built up a little bit more income? What is your all's view on that?
MR. WIECHER: This is John Wiecher again.

As Mr. Kirsanow mentioned and as I mentioned, I served as FHA Commissioner from 2001 to 2005, which puts me in charge of the FHA home mortgage insurance program, among other things.

FHA is a socialization of risk or from borrowers. The mission of FHA, going back to the 1930s, has been to help families become homeowners and to do that without the federal government losing money, to take a little bit more risk than the private sector is able to take but in taking that risk, not to go too far and start losing money.

When I was at HUD in 1989, it appeared that FHA had overdone it in the 1980s in the oil patch problems. And FHA was very close to having a negative net worth.

And Congress, acting very promptly on the basis of that information, introduced a new premium structure in order to recapitalize FHA. And that worked quite well.

FHA has traditionally required a three percent down payment. That is a statutory minimum. And that has meant that FHA is taking more risk than a private lender is taking, than Fannie or Freddie is able to take or any private lender that you could
mention. And there will be more defaults. There are more defaults in FHA loans than there are in the conventional market, in the prime market.

The policy decision has been that it's worth trying to promote home ownership. It's you don't want any more defaults than you can help. Defaults are not good. They're not good for the individuals affected, the families affected. They're not good for the neighborhoods.

There are always defaults, even the best, the lowest-risk. But you have a system where the risk is socialized. And the program has made money and steadily since it was established.

In recessions, like this recession, it does worse. And that I am sure is going to be true in this recession. It has been true in other recessions.

COMMISSIONER GAZIANO: It is not going to make a profit?

MR. WIECHER: I would not expect it to make a profit on the business that it is doing now. And the FHA defaults tend to peak in the third to fifth year after the loan is originated, before you built up much equity. But there has been time for your economic circumstances to change and for it to go
for a job loss for a family or something along that line.

And I think you will see more defaults in the loans that were underwritten a few years ago than you would have seen --

COMMISSIONER GAZIANO: If you don't mind me asking one clarification?

MR. WIECHER: Sure.

COMMISSIONER GAZIANO: It seems to me that the private market, profit maximizers, will on average aim to reach every single home buyer whom they think can add a penny of extra profit.

What I think you are saying -- I just want to make sure I understand it -- is that FHA or other government enterprises is willing to reach a little bit lower and perhaps take risks where they know on average there might be a loss but they can take some of their profit from some of the creamier home buyers. And that is how they still, you believe, on average turn a net profit over time. Is that how it works?

MR. WIECHER: Up to a point. Nobody who borrows from FHA is creamy as a borrower. The --

COMMISSIONER GAZIANO: Slightly creamier, a few pennies taken here.
MR. WIECHER: Two percent is on average, it's two percent, and sometimes it's one percent. It's not quite skim.

But I think that nothing protects FHA's market share. There has been a limit on the maximum mortgage amount under FHA mortgage. But that doesn't stop anybody, Fannie, Freddie, anybody, from making a loan that would be eligible for FHA if they think it is profitable. And they do.

What FHA has had, what VA has had is the backing of the government, which enables it to take a little bit more risk. And the requirement that if they take that more risk, they not lose money.

And there is a little sliver of the market, sometimes a bigger sliver, sometimes a smaller one, but they consider it on that basis. And they do. And that's the purpose. And that's where the risk has been socialized.

And that seems to me to be an appropriate public policy answer to the question you asked.

ACTING CHAIRMAN KIRSANOW: Is there anyone else who wants to --

MR. POLLARD: I was going to say as counsel is in charge of helping my agency meet the policies set by Congress, I probably won't comment on
that, maybe from one of my classes at Georgetown or UVA.

I think one of the things you should note is that in the affordable housing program, people think of this as just stand-alone houses. It does look to manufactured housing. It does look for rental. We look at multi-family programs that the enterprises have.

I am not answering your question, but what I am trying to say is there is interest already in that. The second thing I would say is that, as I noted, we are going to be undertaking a rulemaking.

And if the Commission has views that it would like to put in for our consideration, that would be fine. But, I mean, our policies, we are operating with the laws that are set.

MR. SENHAUSER: Can we speak?

ACTING CHAIRMAN KIRSANOW: You can speak.

MR. SENHAUSER: All right. Bill Senhauser, speaking for myself because the conservator speaks for Fannie Mae.

I look at this as sort of there are two buckets here. I think one is a terms and conditions bucket and that we have been talking a lot about price, but, you know, the touchstone going forward, I
think, needs to be suitability and sustainability. Someone has to be incented to pay very close attention to the facts and circumstances of the consumer and needs to have a federal or state or local or all three incentive to care.

And so the most important thing going forward in terms of the federal role, it seems to me, is setting some standards through Fannie Mae and Freddie Mac or otherwise, that are totally focused, like a laser beam, on sustainability and suitability of home ownership.

Now, the price question I think you can say either you're going to through CRA say because you have a bank charter you are going to have to give away a little money to get more people in homes or you can make it explicit, like the Treasury Department has done with the HASP program, which is to take people's DTI down. The Treasury is going to pay some money.

So that is my answer as a human to the question that you posed. Is that responsive?

COMMISSIONER GAZIANO: It is. It is.

MR. SENHAUSER: Okay.

ACTING CHAIRMAN KIRSANOW: Commissioner Yaki?

COMMISSIONER YAKI: Thank you.
Actually, I am looking at the time. And I really want to listen to the third panel. But I just want to say there is some kind of a very interesting irony here of when we talk about FHA and sort of the social spreading or government policy spreading risk in terms of FHA-underwritten mortgages.

And, yet, you must look at what we are doing right now on Wall Street and think to yourself, "Well, now we are taking a big risk in terms of our taxpayer funds on extremely toxic securities right now."

So I just wanted to make that point that I hope we move on to the next panel.

ACTING CHAIRMAN KIRSANOW: Mr. Tsien?

MR. TSIEN: I just wanted to give an update on the facts on some data that Secretary Wiecher used. He had mentioned the first-time home buyer rate for the GSEs in 2003 range was about 20 or 25 percent of government and the minority participation rate for home purchase loans was 13 to 14.

We had a change of leadership in 2004. It was clear part of that message was we had to change our performance on those dimensions. So I would say we just filed our annual housing report for 2008. I
would be happy to send you a copy. I think we sent
2007 because it wasn't available yet.

Our first-time home buyer rate is 35
percent. And our minority participation is 25. So
progress has been made. More progress obviously needs
to be done. We have to rethink some of the tools we
have used because things that we thought were
progressive and innovative in an upring house price
environment have proved to be riskier than we had
anticipated, not just for us as investors or companies
but also for owners. So there needs to be progress
made. We need to pause and think about the kinds of
tools we're going to get into in the next plateau.

I just want to be clear that, Mr.
Secretary, we have made progress. We took that
guidance to heart.

MR. WIECHER: Thanks. But may I say one
thing in response?

ACTING CHAIRMAN KIRSANOW: Sure. Go ahead.

MR. WIECHER: I am glad to hear that, Bob.
I am no longer a secretary, and I speak even less for
anybody than Bob and Bill do. I speak only for
myself.

(Laughter.)
MR. WIECHER: I am glad to hear that because that was the first time the annual housing activity's report will have reported first-time home buyers and minority first-time home buyers. The data has not been -- they are public. And we did the work in 2004. We put it together partly from GSE data and partly from HMDA data.

So it's good to have that information. I am delighted to hear that. I look forward to seeing the report.

ACTING CHAIRMAN KIRSANOW: Commissioner Taylor?

COMMISSIONER TAYLOR: A quick question. It sounds like the goals were articulated. And it sounds like we now have reports breaking down the data by race and ethnicity. Are the goals connected to race and ethnicity at all?

MR. WIECHER: No.

MR. SENHAUSER: That would be unlawful.

MR. WIECHER: One point to make. This is John Wiecher again.

There is a goal that is based on geography, the under-served area goal. And that is based partly on the minority composition of the census.
tract, but it is not based on the race of the borrower. It is based on the location of the loan.

There have been cases and, indeed, at one point there was a story with a lovely picture of a mansion in Cincinnati, a story in the Post about a million-dollar home that counted toward the under-served area goal because it happened to be in the census tract that the boundaries as drawn by the Census Bureau included a small area of very nice homes with a much lower-income area adjacent to it.

And the locational goal of anything can happen, but there are no goals based on the race or ethnicity of the borrower and no goals based on whether the borrower is a first-time home buyer, repeat home buyer, or whether you are making a loan to a rental property or a refi.

ACTING CHAIRMAN KIRSANOW: Well, this has been highly informative. I, in fact, had a couple of questions. But, again, in sensitivity to the time, I think I am going to have to defer them.

I want to thank the panelists very much. The record remains open for 30 days, as I mentioned at the outset. If you have anything else you would like to contribute, feel free to do so at the address we
provided earlier; that is, this address, 64 9th Street, to the Office of General Counsel.

And, with that, we will close out this panel.

(Whereupon, the panel was excused.)

ACTING CHAIRMAN KIRSANOW: Take a 20-minute break and convene the third panel on predatory lending.

(Whereupon, a luncheon recess was taken at 12:47 p.m.)
ACTING CHAIRMAN KIRSANOW: I think we are all set. Okay. Good enough. Again, I apologize for being late. I am ten minutes late.

PANEL 3 - PREDATORY LENDING AND THE MORTGAGE CRISIS

ACTING CHAIRMAN KIRSANOW: This is the predatory lending panel. And we are going to be examining whether or not minority homeowners have been unfairly targeted or otherwise treated in a discriminatory fashion by way of any lender or lending policy.

Due to the size of the panel, we are again going to subdivide it into two panels. Follow the same protocol we had in the past. That is, we will have this panel testify and the next panel come up and testify.

We will hold questions until the completion of testimonies of both subpanels. Try to keep your testimony, if possible, to ten minutes or less. And the questioning from commissioners will be about five minutes apiece.

I will recite your biographies. As I mentioned previously, many of you have impressive biographies. So if I were to read them all, we would
be here until 3:00 or 4:00 o'clock before we begin testimony. So I am just going to talk about the salient features of your biographies as pertains to your testimony here today.

On the first subpanel -- in fact, we have got some recidivists here, at least one -- our first witness will be Eileen Harrington, who is Acting Director of the FTC's Bureau of Consumer Protection.

The bureau's mandate is to protect consumers from deceptive, unfair, or fraudulent practices. Its actions include individual company and industry-wide investigations, administrative and federal court litigation, rulemaking proceedings, and consumer and business education.

Mr. Barry Wides was supposed to be here. I don't see him here yet. He had testified in the previous panel. So I will skip his bio.

And also Mr. Brown is here. I will skip his bio.

But we also have Mr. Leonard Chanin. He is the Associate Director of the Division of Consumer and Community Affairs at the Fed. He is responsible for implementing and interpreting several consumer protection laws, including the Truth in Lending Act, Equal Credit Opportunity Act, Home Mortgage Disclosure
Welcome to everybody. And we will begin with Ms. Harrington.

MS. HARRINGTON: Thank you, Mr. Chairman and members of the Commission.

PANEL 3A

MS. HARRINGTON: As the Chairman said, I am Eileen Harrington. I am the Acting Director of the Bureau of Consumer Protection at the FTC. And I am very appreciative of the opportunity to talk with you this afternoon about the FTC's role with respect to predatory lending and related issues.

I first want to remind you that the commission has submitted a written testimony for the record. My oral statement and any answers that I may give this afternoon represent my views and not necessarily those of the commission.

The Federal Trade Commission is the nation's consumer protection agency. It has broad enforcement responsibilities under the Federal Trade Commission Act.

The FTC deals with issues that touch the economic life of nearly every America. It is the only federal agency with both consumer protection and
competition jurisdiction in broad sectors of the economy.

We enforce section 5 of the Federal Trade Commission Act, which broadly prohibits unfair or deceptive acts or practices in or affecting commerce. The commission also has responsibility for enforcing statutes that address specific aspects of lending practices, including the Truth in Lending Act, the Home Ownership and Equity Protection Act, and other statutes.

And, in addition, the commission enforces a number of other consumer protection statutes that govern financial services providers, including the Fair Debt Collection Practices Act, the Fair Credit Reporting Act, the Equal Credit Opportunity Act, the Credit Repair Organizations Act, and the privacy provisions of the Gramm-Leach-Bliley Act.

Although the commission has the authority to take action against a wide array of acts and practices in the financial services arena, as we often say, practices that occur during the entire life cycle of financial transactions, the commission lacks jurisdiction over many financial service providers which are exempt from the FTC's jurisdiction. Banks, thrifts, and federal credit unions are specifically

The FTC's jurisdiction under the FTC Act extends only to non-bank financial companies, including non-bank mortgage companies, mortgage brokers, and finance companies.

The commission's actions to protect consumers of financial services are an essential part of our consumer protection work. Unfair, deceptive, discriminatory, or otherwise unlawful lending practices result in significant injury to consumers every year. These illegal practices, especially in connection with subprime lending, have a disproportionate effect on lower-income and minority communities.

To fulfill its consumer protection mission in the financial services area, the FTC engages in law enforcement, consumer education, regulatory work, and policy research.

The commission has pursued law enforcement actions focusing on all aspects of mortgage lending, including advertising and marketing, approval and pricing, and servicing by mortgage lenders, brokers, and loan servicers.
Several of these landmark cases have resulted in large monetary judgments, collectively returning approximately $345 million to consumers over the past decade.

The FTC's actions have challenged deceptive or unfair practices without regard to the race or national origin of the victims of these practices.

Nevertheless, because many minorities were subprime borrowers, the FTC's cases have provided redress to many minority borrowers who were victims of unfair or deceptive practices.

Additionally, as we have seen the recent rapid increase in mortgage delinquencies and foreclosures, the FTC has intensified its efforts to protect consumers in financial distress, including protecting them from mortgage foreclosure rescue scams.

We began a year ago by forming task forces in seven local and regional areas with our state and other federal counterparts. The FTC to date has brought eight cases. And we have many more in the pipeline.

And we have worked closely with our partners and other enforcement agencies to assign...
targets, identify targets, and make sure that the
authority with available resources and the best reach
goes after targets.

Another focus of FTC law enforcement is
discrimination in mortgage lending. Since the Equal
Credit Opportunity Act was enacted, the commission has
brought over three dozen cases against large subprime
lenders, major non-mortgage creditors, and smaller
finance companies, alleging ECOA violation.

Although most of the FTC's lending
discrimination cases have involved the unlawful denial
of credit, most recently the FTC's enforcement is
focused on the pricing of mortgage loans. And, for
example, in December of 2008, the FTC reached a
settlement with Gateway Funding Diversified Mortgage
Services and its general partner, Gateway Funding Inc.

The commission alleged that Gateway
violated the ECOA by charging African American and
Hispanic consumers higher prices for mortgage loans
than non-Hispanic white consumers. The alleged
pricing disparities were substantial, statistically
significant, and could not be explained by factors
related to underwriting risk or credit characteristics
of the applicants.
The FTC settlement bars Gateway from discriminatory lending practices and requires it to implement a fair lending training program, a comprehensive data integrity program designed to ensure accuracy and completeness of loan data, and a fair lending monitoring program.

Additionally, the settlement imposed a judgment of $2.9 million, all but $200,000 of which was suspended based on the company's inability to pay. The FTC is using this money to redress African American and Hispanic consumers who were harmed by Gateway's practices.

Law enforcement is the primary means that the commission uses to combat mortgage lending acts and practices that harm consumers. At the same time, to empower consumers to better protect themselves from potentially harmful conduct in the first instance, the FTC engages in extensive consumer education related to mortgage lending.

All of the commission's consumer protection materials, including many released in Spanish as part of the FTC's Hispanic Outreach Program, are available to the public on the FTC's Web site, by calling the FTC's Consumer Response Center, or through 10,000 partners that we have in the private
and public sector all over the country who distribute
our materials.

For example, in tandem with a recent law
enforcement action against foreclosure rescue scams,
the commission initiated a stepped-up outreach
initiative. We are involved in federal, state, and
local task forces, as I mentioned.

Our people are out giving seminars in
local communities along with our state enforcement
colleagues and others to work with consumers one on
one who are at risk of foreclosure to make sure that
they are steered in the right direction and not the
wrong direction for help.

In addition, we warn consumers about the
red flags for scams. And to inform them about
legitimate resources available to them, the commission
has undertaken a variety of other outreach
initiatives, including radio public service
announcements in English and Spanish to stations in
cities hardest hit by mortgage foreclosures and
distributing an article adapted from its mortgage
foreclosure scam consumer education brochure to a
national syndicated news service, which, in turn, sent
it to more than 10,000 community newspapers across the
nation for inclusion in publications.
Finally, the commission engages in public workshops and other research efforts so that it may better understand particular consumer protection issues in the changing marketplace and advocate for policies that promote protections for consumers, such as policies that foster better informed mortgage borrowing.

One of our more significant recent research projects was an empirical study assessing the effectiveness of mortgage disclosure documents that mortgage originators are required to provide to consumers under Truth in Lending and RESPA. That project concluded that these disclosures were not very effective.

Have you all closed on a mortgage any time recently? We are not very effective in helping consumers of subprime and prime mortgages understand the terms of mortgages. Consumers could benefit from changes in current disclosure requirements. And the FTC has been advocating aggressively for those reforms.

Lastly, the Congress just gave the Federal Trade Commission some additional regulatory authority in the Omnibus Spending Act of 2009. The FTC generally does not have authority to issue rules under
the Administrative Procedures Act but, rather, has to use quite cumbersome procedures that are in the FTC Act itself under those normal procedures in the FTC Act that takes four years or more for the FTC to issue a trade regulation rule.

We have asked for broader Administrative Procedures Act rulemaking authority for all of the financial services area. The Congress has just given us authority in the spending bill to do Administrative Procedures Act rulemaking relating to mortgage lending and mortgages.

And we will be using that authority. We should have new proposed rules out for comment within, as the statute giving us the authority requires, 90 days, probably sooner than that.

And we will be using that new authority to initially target practices that are most harmful right now. We are not going to take a backward glance at what was harmful last year and the year before that isn't happening right now yet, but we want to address the practices that are harmful right now first.

So thank you very much for the opportunity to be here. And I look forward to your questions and to hearing my colleagues.
ACTING CHAIRMAN KIRSANOW: Thank you, Ms. Harrington.

Mr. Brown is up again.

MR. BROWN: Here I am. Mr. Chairman and members of the Commission, thank you for having me back after having me here this morning, after we had some spirited conversation, which is a good thing.

I am happy to be here to talk about predatory lending and the FDIC's response. In recent years, many consumers took advantage of low-income interest rates and new mortgage products to push the home ownership rate to almost 69 percent.

Product innovation and the expansion of mortgage credit have been generally positive social developments. Yet, as we know, for a significant segment of the subprime market and an increasing percent of the prime market, we have seen a troubling trend. Many borrowers have accumulated debt obligations that put their financial health at risk, the situation exasperated by the current economic crisis and rising unemployment.

Rather than building wealth, borrowers across the nation are struggling to keep their homes. Many borrowers, particularly low and moderate-income
individuals, have little financial cushion in the event of personal emergencies or economic downturns.

In addition, many borrowers have been the target of practices that are highly troubling, if not predatory. Repeat refinances have taken equity from people’s homes. And adjustable rate features have challenged the ability to continue making payments.

In previous years, many of these borrowers could have refinanced their mortgages or sold their homes at a profit to repay their debt in full. Now, as home prices have stagnated or declined in many areas of the country, more borrowers find themselves trapped in mortgages they cannot afford to pay.

Abusive lending practices that result in home ownership that builds debt, rather than wealth, harm not only individual consumers, but they undermine important societal benefits of home ownership.

Defining predatory lending. There is no universally accepted definition of predatory lending or a simple checklist. Products and loan terms that may be appropriate to one type of borrower in a particular circumstance may be inappropriate under other circumstances.

Nonetheless, in 2001, expanded guidance for subprime lending was issued by the banking
regulators. And they identified the characteristics most often associated with predatory lending as making unaffordable loans based on the collateral of the borrower, rather than on the borrower's ability to repay, inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced, which is also referred to as loan-flipping, and engaging in fraud or deception to conceal the true nature of the loan obligation or ancillary products from an unsuspecting or unsophisticated borrower.

Additionally, over the past several years, the banking regulators have published a number of examiner and industry guidance documents worrying about the deteriorating underwriting standards. In October 2006, the agencies issued interagency guidance on nontraditional mortgage products to address concerns about offering interest-only and payment option ARMs to borrowers for whom they originally were not designed.

The MTM guidance only reminded bankers to carefully manage the risks associated with these products. It also emphasized that consumers should provide with clear and accurate information about
these products at the time they are choosing a loan or deciding which payment option to select.

In January of 2007, the FDIC issued its supervisory policy on predatory lending to reaffirm that such activities are inconsistent with safe and sound lending and undermine individual, family, and community economic well-being.

The policy describes the FDIC's supervisory response to predatory lending, including a list of policies and procedures that relate to consumer lending products.

The agencies issued a statement of subprime lending in July of 2007 also. The statement focused on certain adjustable rate mortgage products marketed to subprime borrowers. It emphasized the potential for these products to become predatory if institutions did not have strong risk management compliance programs.

The statement explained that institutions marketing these mortgage loans face an elevated risk that their conduct would violate the FTC Act's prohibition against unfair, deceptive acts or practices, which the FDIC and the other banking agencies enforce.
Examination and supervisory actions. As the federal regulator of state non-member banks, the FDIC aggressively addresses predatory lending through examinations and supervisory actions.

When examiners encounter unsafe and unsound lending practices, we take whatever supervisory action is necessary to effect correction. The FDIC employs a cadre of specialized examiners in fraud, risk management, consumer compliance, and the Bank Secrecy Act, who regularly examine insured institutions to ensure compliance with state and federal laws and regulations, including all consumer protection laws and the safe and sound operation of FDIC-supervised institutions.

The FDIC also utilizes the data provided under HMDA, devoting significant resources to analyzing data to identify differences in prices of mortgages along racial, gender, and ethnicity lines.

The FDIC investigates all circumstances of discrimination that the HMDA data or our examinations raise. We work closely with the Department of Justice, to which we refer all apparent instances of pattern or practice discrimination. The FDIC also pursues administrative enforcement actions against institutions for discrimination, where DOJ does not.
HMDA pricing data became available for the first time following collection in 2004. And we are processing a number of cases pursuant to the information that we have received.

When the FDIC finds practices that violate consumer protection, fair lending, or other laws, including the FTC Act, the FTC Act's UDAP provisions, we take action to ensure that illegal practices cease and that harm to consumers is remedied. The supervisory action taken will depend on the violation, whether consumers or institutions have been harmed and to what degree.

The FDIC will also undertake joint enforcement actions with state authorities or with other federal agencies, where appropriate. The FDIC may assess penalties and require consumer reimbursement where unfair and deceptive practices were identified. And it's been done in a number of cases.

In addition to our regular examination process, the FDIC investigates consumer complaints. The findings of such investigations may result in supervisory actions if that is warranted.

Challenges for reform. Guidelines and other supervisory standards promulgated by the bank...
regulators apply to only a portion of the market. Widespread credit distress in the subprime market with especially pronounced problems among independent mortgage lenders suggest the need for a comprehensive response that assures that all lenders are subject to a certain baseline of requirements.

Moreover, the lack of uniform standards creates negative competitive pressures on insured institutions. It is essential that there be a uniform standard for financial products, whether they are offered by banks or non-banks.

I see I am running out of time here. Chairman Bair has been an aggressive advocate of loan modifications, particularly systematic loan modifications. We think that is an important way to address some issues with respect to borrowers that have already been subject to some predatory lending.

So that is the important initiative that we are also focused on as well as Money Smart, which is a financial education program sponsored by the FDIC, where we go out, educate people of all ages in all walks of life so that they are much more sophisticated on financial issues and they are prepared to deal with, individuals, for example, abusive lenders.
So, in conclusion, the FDIC is very concerned about certain practices in the financial markets. Recent practices have often placed borrowers in products that create financial hardship, rather than building wealth.

The FDIC stands ready to work with all partners to ensure that appropriate steps are taken to strengthen supervision and regulation of all financial institutions.

Thank you for your time. And I am happy to answer your questions whenever you might have them.

ACTING CHAIRMAN KIRSANOW: Thank you, Mr. Brown.

And Mr. Chanin?

MR. CHANIN: Thank you, Mr. Chairman and commissioners. I appreciate the opportunity to discuss the Federal Reserve Board's rules that prohibit unfair and deceptive practices in the mortgage market.

In July 2008, the board adopted sweeping new regulations using its authority under the Home Ownership and Equity Protection Act, or HOEPA, to prohibit unfair and deceptive mortgage practices. The board's rules are carefully crafted to protect consumers from abusive or deceptive acts and practices.
while keeping credit available to qualified borrowers and supporting sustainable home ownership.

Today I will describe the scope of the board's rules and outline the new consumer protections. The board's rules apply to all mortgage lenders, not just to depository institutions, such as banks.

The rules are also comprehensive in their coverage of the mortgage market. One set of the rules would apply to the vast majority of mortgage loans secured by the consumer's principal dwelling. Other parts of the rules would apply to higher-priced mortgages. It is to the set of rules for the higher-priced mortgages that I will turn first.

To ensure that the protections remain robust, as loan products and lending practices change, higher-priced mortgage loans is defined broadly. The threshold is intended to cover the entire subprime mortgage market for consumer primary dwellings.

There are four practices banned or regulated by the rules. The first three are directed at risk that consumers will be unable to repay their loans.

First, to help ensure loans are affordable, lenders are prohibited from making a loan
without regard to the consumer's ability to repay the loan from income and assets other than the home's value.

A lender complies, in part, by assessing repayment ability based on the highest scheduled payment in the first seven years of the loan. For example, if a loan has a lower initial payment, the lender is required to underwrite the loan using the later higher payment.

The second rule deals with stated income loans. Lenders are prohibited from relying on income or assets that they do not verify. This rule seeks to ensure that income and other financial information lenders use to evaluate consumers is accurate.

For example, the rule prohibits making stated income loans and requires lenders to rely on third party information, such as an employer letter, W-2 form, or tax return.

The third rule deals with escrow accounts. To sustain home ownership, borrowers need to pay property taxes and homeowners' insurance, in addition to their mortgage payments. The rule requires that the lender establish an escrow account for the payment of property taxes and homeowners' insurance for first lien loans. This seeks to ensure that borrowers are
not misled by monthly payment amounts that exclude these costs. The lender may offer the borrower the opportunity cancel the escrow after the first year.

The final aspect of the board's subprime rules address prepayment penalties. The rule bans any prepayment penalty if the consumer's payment can change during the initial four years of the loan.

For other higher-priced loans, a prepayment penalty period cannot last for more than two years. This seeks to ensure that consumers are not trapped in higher-priced loans and can refinance those loans if their payments may increase.

The HOEPA rules also prohibit several practices that apply to all mortgages secured by consumers' principal dwellings. One area of risk for consumers is appraisal fraud. Inflated appraisals harm consumers who overpay for housing and may lead to further harm if consumers borrow based on the belief that they have more equity than they really do. The rule prohibits a creditor or broker from coercing or encouraging an appraiser to misrepresent the value of a home.

The rule also prohibits three servicer practices, which apply to entities that consumers make payment to and that process such payments.
Specifically, the rule prohibits a servicer from failing to credit a payment to the consumer's account as of the date the payment is received.

The rule also seeks to ensure consumers can promptly obtain payoff statements if they wish to refinance their loan by requiring servicers to provide a payoff statement within a reasonable period of time. Finally, servicers are prohibited from pyramiding late fees on a loan.

The board also made several changes to its advertising rules to ensure that lenders do not engage in deceptive and misleading practices, such as suggesting that loans are government-issued or guaranteed if they are not.

Finally, creditors are required to provide consumers with disclosures about the credit terms within three days of application for all mortgage transactions to ensure that consumers can better shop and understand the transactions.

These rules are generally effective October 1st, 2009 except for the escrow provisions, which are effective on a later date.

In conclusion, the board's rules are designed to protect consumers where they face the most risk. The rules seek to ensure that loans are
affordable and that consumers are not locked into unsustainable loans.

Thank you for the opportunity to discuss the board's rules with you today. And I look forward to answering your questions.

ACTING CHAIRMAN KIRSANOW: Thank you very much. We will now go to questioning from commissioners. I'm sorry. That's correct. I apologize for that. We will begin questioning at the conclusion of subpanel B. Everyone was up in arms about that.

So if you can give up your seats and subpanel B approach? And we will listen to your testimony and then have questions.

It appears we have got everybody seated. And I will read your bios in order. And then we will begin the testimony with Ms. Rice as soon as I have completed all of your bios. Again, these are the truncated versions of your bios.

Ms. Rice is Vice President of the National Fair Housing Alliance. She oversees the alliance's resource development, public policy, and enforcement initiatives.

Ms. Rice previously served as CEO of the Toledo Fair Housing Center, where she development and
implemented the State of Ohio's first predatory lending remediation program and worked to help pass anti-predatory lending statutes.

Next we have James Carr, who is Chief Operating Officer for the National Community Reinvestment Coalition. He is also a visiting professor at Columbia University and an advisory committee member of Federal Reserve of the San Francisco's Center for Community Development Investments.

Next is Brian Brooks, managing partner of the D.C. office of O'Melveny and Myers. Mr. Brooks' experience in the fair lending area includes defending the nation's largest automated underwriting system for disparate impact claims, representing several of the nation's largest mortgage originators and servicers in shared lending investigations and litigation brought by states' attorneys general and representing mortgage investors in administrative disputes brought before the U.S. Department of Housing and Urban Development under the Fair Housing Act.

And last we have got Ken Markison, Associate Vice President and Regulatory Counsel at the Mortgage Bankers Association, where he works on a wide variety of mortgage lending issues.
Mr. Markison joined the Mortgage Bankers in July 2004, following his retirement from a 33-year career with the federal government. At the time of his retirement, he served as Assistant General Counsel for Government-Sponsored Enterprises in the Office of General Counsel of the Department of Housing and Urban Development.

I welcome all of you, look forward to your testimony. And, as I said, we will defer questions to the conclusion of your testimony, when we will ask again. It was a logistically challenging feat of asking the previous panel to join us so that we can question you all at the same time.

Commissioner Yaki?

COMMISSIONER YAKI: Yes. Commissioner, Mr. Chair, I just wanted to say that I want to thank the staff for this. I am going to be leaving in the middle of this presentation. I will be obviously looking at the record and the testimony closely. I just want to thank the staff for this.

And it's no insult to you folks. I just have a plane to catch.

ACTING CHAIRMAN KIRSANOW: It's his private plane.

(Laughter.)
COMMISSIONER YAKI: If it were my private plane, I wouldn't have to worry about when I get there.

ACTING CHAIRMAN KIRSANOW: Ms. Rice?

PANEL 3B

MS. RICE: Mr. Chairman and members of the Commission, thank you very much for this opportunity to speak to you this morning or this afternoon now, I guess.

Bloomberg estimates that American taxpayers will spend close to $10 trillion to address this financial catastrophe that many have attributed to failures in the subprime market and, in part, to predatory lending practices.

We have seen in the media the terms "subprime" and "predatory lending" being used interchangeably. However, the two terms are not synonymous.

Subprime lending is supposed to be a market for borrowers who do not meet prime credit standards. Unfortunately, it has not been used this way. At the National Fair Housing Alliance and in my work in Ohio, we have seen predatory lending practices in all segments of the lending market: conforming, nonconforming, conventional, nonconventional, prime,
and subprime. However, in more recent years, a preponderance of the predatory lending cases that we have seen have involved the subprime market.

So what is predatory lending? You have heard a couple of speakers in the previous panel talk about some of the attributes of predatory lending. I won't go through the problem of repeating all of those, but basically predatory lending is putting the best interests of the lender before those of the borrower. And it's the practice that results in harm to the borrower.

Characteristics such as yield spread premiums, basing eligibility for the loan on the property value or equity in the home, as opposed to the ability to pay, not escrowing for taxes and insurance, and originating a loan that is unsustainable for the borrower are all characteristics of predatory lending.

Predatory lending has existed for decades and, arguably, for centuries and is largely possible because America has a bifurcated lending system. It always has, even as we look back to the Reconstruction era with the advent of the Freedman's Bank system.

Restrictive covenants and other discriminatory practices in the housing and lending
markets contributed significantly to the segregation of America's neighborhoods. Indeed, America's neighborhoods and communities are more segregated today than they were in 1920.

Lending, as it evolved, it relied on property valuation methodologies and other underwriting methodologies. These methodologies simply reflected discriminatory beliefs at the time.

I include in my statement and in my PowerPoint presentation several excerpts from real estate valuation manuals. I will quote from one, "There is one difference in people, namely race, which can result in a very rapid decline in neighborhoods. Usually such declines can be partially avoided by segregation."

Homer Hoyt and Arthur Weimer in their appraisal treatise "Principals of Urban Real Estate" warned that persons other than of the Caucasian race will negatively impact property values. They promoted and supported the use of restrictive covenants, even after the Supreme Court had ruled them unconstitutional.

The establishment of the Homeowners' Loan Corporation in the 1930s helped dramatically to make home ownership available to Americans by lessening
lending standards and making it easier for people to qualify for mortgages. But the Homeowners' Loan Corporation also practiced discrimination.

For example, it created a series of color-coded maps indicating the level of risk presented by each neighborhood. And, of course, the level of risk was correlated to the level of the presence of African Americans and Latinos in those communities.

The FHA and the VA also, of course, were programs that were sponsored by the federal government that also made home ownership more accessible by, again, lowering mortgage standards for homeowners and for borrowers.

Homer Hoyt, whom I mentioned earlier, joined the FHA as its principal housing economist. He, of course, brought his jaundiced views to the FHA.

One of the FHA's appraisal manuals states that "If a neighborhood is to retain stability, it is necessary that properties shall continue to be occupied by the same social and racial classes."

The FHA in keeping with Homer Hoyt's views also promoted the use of restrictive covenants. As a result, fewer than one percent of all African
Americans were able to obtain a loan from the FHA program from 1930 to 1960.

Ironically, in response to outcries of this discrimination that was present in the FHA program, in the 1970s and 1980s, FHA was actually used as a vehicle for predatory lending practices due to lax regulation and lax oversight. In fact, appraisal fraud was replete in FHA during that time.

Substantial lending deregulation in the 1980s greased the wheels for lending in minority communities desperate for credit because of historic redlining practices.

We have talked a lot about the loosening of underwriting standards for borrowers but have not heard a lot about the loosening of underwriting standards for lenders and, in particular, investors.

Bankruptcy remoteness, liability and asset protection, the ability to move assets off of corporate balance sheets have all contributed dramatically to the attractiveness of the subprime market to investors.

In fact, I can remember talking to lenders, one lender at the Royal Bank of Scotland, who said they would take a portfolio, a $100 million portfolio, of fully amortizing prime, fixed rate
mortgages. And they had a $100 million portfolio of exotic mortgages. And they would get much better pricing for the exotic mortgage portfolio.

So when you have investors who are willing to pay more for exotic mortgage portfolios, of course, you know what kind of loans are going to be marketed by loan originators.

When I first started working on predatory lending issues in the 1990s, the subprime market was largely funded by private investors and the junk bond market.

But since that time, trillions of dollars have pulled into this area. And, as a result, what we have seen is FHA, Freddie Mac, and Fannie Mae lending, those entities losing market share precipitously as the subprime market has grown voluminously.

Our organization has long pushed for more GSE traditional lending in under-served markets, largely because we had seen that where there were high penetration levels of traditional GSE lending, there much lower foreclosure rates.

And, indeed, in jurisdiction after jurisdiction, we see patterns, a very high correlation between the racial composition of the neighborhood and levels of subprime lending.
Simultaneously, where we see high levels of subprime lending, we also see much higher levels of foreclosures. And I have included several maps in the presentation that showed the correlation and the juxtaposition between high levels of minority residency and also high levels of subprime lending. And you also see that where there are very, very high levels of subprime lending, the foreclosure rates are much higher.

A couple of disturbing facts I would just like to highlight. African American and Latino home buyers face a statistically significant risk of receiving less favorable treatment than comparable whites when they ask mortgage lending institutions about financing options.

In fact, the National Fair Housing Alliance conducted a systemic lending testing project in the mid 1990s in which we matched African American potential borrowers to white potential borrowers.

In our match pair tests, the African American tester always had a better financial profile than the white tester. And we saw very, very high rates of disparate treatment. In fact, for some classes, the disparate treatment was as high as 66 percent.
African Americans and Latinos are much more likely to receive a subprime loan than their white counterparts according to HMDA data. Roughly 54 percent of African Americans and 47 percent of Latinos received subprime loans, compared to approximately 17 percent of whites.

Even higher-income African Americans and Latinos receive a disproportionate share of subprime loans. Borrowers of color are more than 30 percent more likely to receive a higher-rate loan than white borrowers, even after accounting for differences in creditworthiness.

In fact, one of our Ohio member organizations just recently completed a lending analysis in which they found that high-income African Americans and Latinos were more likely to receive a high-cost loan in the State of Ohio than low-income whites.

What we have also seen is that subprime costs do not support the level of risk. Indeed, Fannie Mae and Freddie Mac have reported that some subprime borrowers qualified for prime loans even when they received subprime loans.

The Wall Street Journal recently commissioned a report in which they found that for
some subprime mortgages, as high as 61 percent of
those borrowers would have qualified for a prime
mortgage.

I am just going to spend one minute, if
you will allow me, to talk about the impact. And I
won't go into recommendations. If you have any
questions about recommendations, I would be happy to
answer those in the Q&A.

African Americans owned 15 million acres
of land in 1920. Today they hold just over 1.1
million acres. Wealth of whites has been cumulative
over the years because of some of the programs that I
have mentioned previously, but it has also compounded.
And, of course, it is much more diversified.

Because of that, about two-thirds of net
wealth for African Americans and Latinos is comprised
of their home equity. The percentage is much lower
for whites. For every one dollar of net worth held by
whites, Latinos have 12 cents and blacks have about 9
cents. If home equity is excluded for every dollar of
net worth held by whites, Latinos have eight cents and
blacks have five cents.

And I will conclude my comments there.

ACTING CHAIRMAN KIRSANOW: Thank you.

Mr. Carr?
MR. CARR: Good afternoon, Mr. Chairman and other distinguished members of the Commission, my name is Jim Carr. And I am the Chief Operating Officer of the National Community Reinvestment Coalition.

NCRC is an association of more than 600 community-based organizations across the nation that promote access to basic banking, including credit and savings, in order to create sustainable, affordable housing, job development, and vibrant communities for America's working families. On behalf of our coalition, I am honored to speak with you today.

The U.S. economy is unraveling at a pace unseen in decades. The more than 650,000 jobs lost last month has contributed to a growing concern that the unemployment rate could rise to 10 percent or more before the economy rebounds.

At the center of the economy's instability is the foreclosure crisis that has claimed three and a half million homes over just the last two years and threatens the loss of an additional eight to ten million homes to foreclosure over the next five years.

The loss of wealth associated with the collapse of the housing market is staggering. More
than $5 trillion in housing equity has virtually evaporated since the foreclosure crisis began.

The Dow Jones Index has been literally cut in half, further contributing to a vicious cycle which is now in play, of decreased consumer confidence, substantially reduced spending, lowered productivity, rising unemployment, and additional foreclosures.

The magnitude of the economic decline has led many observers to conclude that the current crisis is an equal opportunity nightmare. But reality paints a different picture.

While few have been able to escape the financial pain completely, African Americans, Latinos, Native Americans, and many Asian subpopulations are bearing the brunt of this national epidemic.

Today, as the national unemployment rate is just above eight percent, African Americans and Latinos are already mired in double digit job losses. The unemployment rate for African Americans is just under 14 percent, for Latinos more than 11, and for non-Hispanic whites a little more than 7. For young black males, that rate is 25 percent and climbing.

Before the current crisis, African Americans and Latinos held on an average a mere $10 of wealth and $12, respectively, for every $100 of saving
for the typical non-Hispanic white household. What that means in reality is that they are much less prepared to weather this current economic decline because they have many fewer savings to rely upon. And, as a result, a major share of the black middle class is at jeopardy.

These severe disparities of wealth and economic attainment are a direct result of more than a century of denial of equal rights and opportunity for people of color in this country. And the disproportionate impact of the foreclosure crisis on African Americans and Latinos will further expand the racial wealth gap.

African Americans and Latinos were the disproportionate targets for unfair, deceptive, and reckless lending practices that triggered the foreclosure crisis and imploded the credit markets.

In recent years, more than half of all mortgage loans to African Americans and 40 percent to Latinos were high-cost subprime. This disproportionate reliance on high-cost subprime loans is translating into exceptional foreclosures for African Americans. As Lisa has stated, the home ownership rate for African Americans has already fallen by more than two percent.
According to a recent survey by the mortgage bankers, the foreclosure start rates for subprime adjustable loans were 3 and a half times greater for adjustable prime loans and 19 times greater than that for fixed rate prime.

But, even if borrowers with high-cost loans were able to avoid foreclosure and maintain their homes, they do so at a huge cost. The typical subprime loan is roughly 300 to 400 basis points above prime. That means a borrower could easily pay about 75 percent to more than the total cost of the original loan, just in the interest rate spread.

Obviously if that interest rate spread is due to the consumer being steered into a loan that they could have avoided, then that is an extraordinary amount of intentional wealth stripping.

The situation is so dire, in fact, within the African American community that the policy group United For a Fair Economy estimates that African Americans could potentially face the greatest loss of wealth since Reconstruction.

Unfair, deceptive, and reckless lending practices increasingly permeated the financial system over the past decade. This crisis was not about financial institutions being pressured by the
Community Reinvestment Act to make loans to low and moderate-income borrowers who could not afford them.

According to the Federal Reserve Board, only six percent of high-cost problematic loans to low and moderate-income borrowers were covered under CRA. Most subprime loans were securitized by Wall Street firms which had no CRA obligations.

Moreover, less than 10 percent of subprime loans originated between 1998 and 2006 were to first-time home buyers. Most subprime loans were for refinancing. And it was refinancing which created the extraordinary and massive house of cards or Ponzi scheme, which ultimately fell apart in 2006 as house prices fell.

Minorities were disproportionate targets for subprime loans because they were disproportionately financially vulnerable and, therefore, easier to exploit.

Rampant misbehavior occurred throughout the subprime market delivery chain, starting with the broker and moving through to appraisers, the lenders, the bond-rating agencies, and the investment banks.

For example, brokers were allowed to steer vulnerable borrowers into high-cost and reckless products. Regardless of their incomes and credit
scores, brokers were allowed to accept kickbacks from lenders if they could encourage borrowers to accept loans at a higher rate than was required by their credit and income histories.

Lenders accepted no documentation loans in qualified borrowers at teaser rates, rather than fully indexed cost of the loans. Fully aware the consumers would not be able to repay these loans, lenders did not establish escrow accounts for tax and insurance payments.

In some cases, they did not inform borrowers about the need to pay tax obligations. Investment banks paid higher fees for high-risk products, thereby incenting lenders to produce high-risk loans. This practice transformed millions of low and moderate-income moderate-risk consumers into high-risk products and consumers.

Securitizers were allowed to sell bonds without maintaining some ownership interest and, therefore, some risk or skin in the game. And the bond-rating agencies literally stamped AAA ratings on bonds that were obvious junk.

In fact, bond-rating agencies played one of the most critical roles in the growth of predatory lending. If the bond-rating agencies had not been
stamping "Investment grade" on junk bonds, the
securitization market for subprime loans would likely
never have materialized.

These practices annoyed more were allowed
to flourish for more than a decade before any action
was taken to address them. In fact, so prevalent were
these practices already in African American
communities more than a decade ago that the State of
North Carolina passed a statewide anti-predatory
lending law in 1999.

All of the unfair, deceptive, and
predatory practices I just mentioned were well-known
and documented for years in thousands of pages of
speeches, refereed research article, news accounts,
and testimony at state, local, and national levels.

None of these issues was beyond the
government's ability to regulate or control. But,
sadly, no actions were taken to eliminate these
practices. And the crisis we are experiencing today
is the legacy of that inaction.

The impacts on communities of color have
been and will continue into the foreseeable future to
be substantial. And response, a threefold response,
is essential.
First, ending the foreclosure crisis is essential to allowing communities to begin to rebuild themselves. Second, channeling funding directly into the communities that were disproportionately targeted for unfair and reckless lending is both fair and appropriate. And, third, passing legislation to ensure that predatory lending is never allowed to occur again is a must. I will focus in the interest of time on the third: eliminating predatory lending.

The current foreclosure crisis would not have occurred had Congress passed a comprehensive anti-predatory lending law back in the late 1990s, when it was clear this problem was already apace.

A comprehensive anti-predatory lending law would apply consumer protection to several types of financial institutions, including banks, brokers, mortgage companies, appraisers, servicers, investment bankers, securitizers, credit-rating agencies, hedge funds, and other financial companies. In other words, it would cover every financial entity in the process.

A central element of an anti-predatory lending law would be strong prohibitions against steering borrowers to high-cost loans who might qualify for prime loans.
In addition, an anti-predatory lending law must have a robust requirement ensuring that lenders have assessed a borrower's ability to repay based on the maximum loan rate, instead of a teaser rate, in the case of adjustable loans.

No or low-document loans should be banned for high-cost loans. Prepayment penalties and yield spread premiums should be banned. Other practices to be eliminated include purging appraisal and servicer abuses and misbehavior. Investors, lenders, securitizers must be held liable when the loans violate the mandate in predatory lending laws, fair housing laws, and fair lending laws.

Due to the unique foreclosure crisis in which the nation is currently mired, a requirement should be imposed on servicers to engage a responsible effort to modify loans that are at risk of default.

Finally, comprehensive anti-predatory lending legislation must not preempt state law that is consistent and stronger with federal law.

In addition, the National Community Reinvestment Coalition has recommended the establishment of a new cabinet-level agency focused on civil rights enforcement. This agency would report directly to the President of the United States and
would be responsible for measuring, monitoring, and eliminating discrimination from the public and private sectors and promote financial inclusion and racial and cultural equality in America.

After all, if the Department of Transportation and Highways is important enough to report to the President, isn't equality and democracy? We have no equality and democracy without the enforcement of civil rights laws.

In conclusion, it is important to note that the current crisis was not the work of market forces. It was the work of individuals exploiting markets that were willfully and adequately regulated. It was the work of institutions that were allowed to further marginalize the nation's most financially vulnerable families and communities.

It was a massive failure to enforce civil rights laws in this country. It was an error that this time is costing the entire country a grave and serious price.

America must use this tremendous time of difficulty to emerge better than we were before the crisis. Your efforts to eradicate the last vestiges of discrimination and inequality will be essential to their success.
We thank you for holding the hearing. I look forward to working with you in any way we might to achieve your goals and ours.

ACTING CHAIRMAN KIRSANOW: Thank you, Mr. Carr.

Mr. Brooks?

MR. BROOKS: Thank you, Mr. Chairman and members of the Commission, for hearing from all of us today on this important topic.

My name is Brian Brooks. And, as an attorney who represents a number of the largest subprime originators, servicers, and investors, I am keenly aware of just how important the topic is.

In my profession, there is a saying that says hard facts make bad law. The idea behind that saying is that when presented with a tragic or shocking or just unsympathetic situation, there is a natural human tendency to impose a fix that is good for the particular case but counterproductive across a whole range of other cases that aren't currently before us.

I think the financial crisis may present a classic case of hard facts because rising default rates in subprime mortgage pools were one of the principal contributors to the financial crisis. And
because the financial crisis itself has turned out to be so severe, there is an understandable clamor to rein in or even prohibit subprime lending or at least large chunks of the subprime lending market.

The clamor is bipartisan. Bush administration Treasury Secretary Paul O'Neill recently called for a ban on mortgages for borrowers who cannot make a 20 percent down payment, the idea being that is a sign of financial fragility that predicts default.

House Financial Services Committee Chairman Barney Frank has gone so far as to say -- and I am quoting here -- "The assumption that everybody can be a homeowner is wrong."

So the idea gaining currency in the land today is that subprime lending is predatory lending and that it should be stopped. I would like to suggest today that the consequences of that approach are likely to be devastating to minority home ownership in the country and that there are better ways to solve the structural problems in the mortgage industry that will not fall so heavily on minority communities.

Let me begin, as all of the other panelists on this topic have done, by trying to define
our terms. I think everyone so far today has agreed that there is no universally accepted definition of predatory lending. And so as the lawyer on the panel, I will try to give you the shortest definition and that I think makes sense. Let me juxtapose that against two common conceptions.

On one end of the spectrum in the debate about what predatory lending means, there are those who suggest that predatory lending is a concept that really is just limited to cases of fraud. And I think all of us, both on the industry side and on the consumer advocate side, can agree that's too parsimonious a concept.

But, on the other end of the spectrum, there are those who would define predatory lending so broadly as to encompass any loan that is more expensive or that contains terms that are different from a 30-year fixed rate prime rate mortgage loan to a borrower with perfect credit. And is surely too broad a definition.

If all of those kinds of loans are predatory, that suggests we can only make loans to people who have the resources to make a 20 percent down payment, we can only make loans to those who have a perfect credit score and who have an income...
sufficient to support loans, even in expensive housing markets. It strikes me that can't be right either.

So my short definition of predatory lending, which I think ought to have fairly broad support, would include loans that are made without regard to the likely ability of the borrower to pay, presumably motivated by a desire to strip the borrower's home equity instead of earn profits from the repayment of the principal and interest. That is a definition that is sort of an encapsulation of the Massachusetts Supreme Judicial Court's recent decision in the Freemont litigation. It has gained a lot of currency on our industry.

And I think it is something that captures the twin concepts that, on the one hand, people shouldn't make loans without regard to the ability to repay but that, on the other hand, there are communities and individual borrowers across the credit spectrum whose access to credit depends on loan structures that are different from the kinds of 30-year fixed rate prime loans that have prevailed in this country since the '40s.

Now, if you gauge the subprime market against that definition of predatory lending, I would want to suggest that while predatory lending is an
important problem, it is a limited problem. And it doesn't come anywhere close to characterizing the broader subprime market. That is for at least three reasons.

First of all, while the word on the street if you were to believe what the Washington Post writes every day is that the subprime market has tanked and that subprime loans are all in collapse. The truth is that, even the most significant financial crisis of the last half century, at least, the significant majority of conventional subprime loans, around 65 percent, are neither past due or in foreclosure.

I also say that the issue of predatory lending doesn't define the subprime market because a significant percentage of subprime loans, around about 40 percent based on most credible estimates, were originated for the purpose of purchasing a home, not for the purpose of refinancing an existing loan, meaning that lenders, at least in those cases, have no preexisting equity to strip.

And, finally, I say that because the significant decline in real estate prices in many markets has resulted in a situation where lenders typically realize massive losses in foreclosure sales,
making an equity-stripping strategy not viable on a mass market basis.

The most recent data that I have seen for the five largest subprime originators is that foreclosure sales typically result in a loss of 51 cents on the dollar of principal.

Now, none of this, I hasten to add, is to suggest that predatory lending as I have defined the concept doesn't exist or that it's not important. It does exist, and it is critical for the stability of the economy and for our civil rights that it be stamped out.

It also suggests that most of the subprime market is not characterized by predatory lending and that defining predatory lending in a way that shuts down the subprime mortgage market will inevitably throw the baby out with the bath water.

One way I like to think about it is this. If you believe that where the rubber meets the road in the predatory lending debate is the likelihood that a given loan will default, then you are confronted inevitably with a very controversial series of line-drawing problems. What I mean by that is this.

Most people don't think the traditional conventional 30-year prime rate mortgages are
predatory mortgages. Those are the traditional features of housing finance we have known for perhaps half a century. At the same time, the default rate in prime loans has more than doubled in the last two years alone, from roughly 2 percent at year end 2006 to roughly 5 percent with an additional 2 percent in foreclosure at year end 2008.

That is a dramatic increase in default rates. And, yet, the mere fact that those loans turn out to be twice as likely to default as we thought doesn't really make anybody think that they were predatory.

At the same time, if you look at subprime data, as recently as year end 2006, which was really the peak of the subprime origination boom, the default rate on conventional subprime mortgage loans was about 13 and a half percent, a little less than that, with an additional 5 percent or so in foreclosure.

Again, nobody suggested at that time that subprime loans were predatory. Instead, the idea was that on a spectrum of credit scores, on a spectrum of wealth distribution, there would be people farther to the left side of that curve that would present a somewhat higher default rate but that an 80 percent
likelihood of repayment was a reasonable likelihood of repayment.

And in a country that believes letting people take a chance on themselves and take a chance to better themselves, it raises troubling questions to say that that likelihood of success isn’t high enough to permit those people access to credit.

Why is this a civil rights issue? It is a civil rights issue because the dramatic rise in the minority home ownership rates in the 1990s and in this decade is directly correlated with the growth of the subprime lending market.

Indeed, the most recent evidence suggests that, even taking into account the rise in foreclosures that we have experienced in the last two years during the financial crisis, even, then, of those foreclosures, the subprime mortgage market contributed to an overall housing increase of more than 430,000 units.

And the relationship between subprime lending and minority home ownership is easy to understand. You have heard earlier evidence that none of us can deny, which is that because of the historic inequality in our society and because of historic de jure and de facto discrimination, wealth and income
and credit histories are not equally distributed among all classes, races, and ethnic groups in the United States.

I would reach a conclusion somewhat different from those of my fellow panelists. And that is to say that given that direct connection, an approach to predatory lending that would purport to ban loans without 20 percent down payments or loans that are more expensive than traditional prime loans would be the solution.

I would suggest that those kinds of rules will fall most heavily on minority homeowners and minority aspiring homeowners in ways that many of us wouldn't be willing to tolerate in a free society committed to goals of equality and social mobility.

That is why I believe the goals of mortgage regulation should be to eliminate fraud and to minimize the impact of mortgage defaults on the broader economy but should emphatically not be to prohibit specific mortgage structures developed by the market to meet the demand for credit among borrowers, especially minority borrowers, who lack the wealth, income, or credit history necessary to qualify for traditional credit products.
In the interest of time, I will point the Commission members to my written testimony, which contains a useful chart from the Fed, which shows the average distribution of all of those things, income, credit score, and asset values, across white and non-white populations, all of which I think demonstrates fairly powerfully that a decision to exclude those kinds of products designed to cater to those populations would result in reduced access to credit in very troubling ways.

I also suggest in the written testimony an approach to mortgage regulation that is designed to achieve the goals of enhanced access to credit for those with credit impairments without drying up credit for those who need it the most.

My proposal is based on the idea that, as others have suggested, it makes a lot of sense to treat subprime lenders more like banks. Banks, as many of you know, are subject to risk-based capital requirements, pursuant to which they must hold a specified amount of capital in respect of their assets, weighted by the risk of those assets. And the purpose of those requirements is to ensure that banks receive capital, reserve capital, to cover foreseeable losses.
There are no such reserve requirements for non-bank organizations. And most subprime loans in the United States, as you have heard, were originated by mortgage companies that didn't operate under bank charters. Yet, the structure of the subprime mortgage market presumes that they should operate in many ways like banks.

They are the most common form of pooling agreements that govern these mortgage securitizations you have heard about. The lenders held the ultimate responsibility to repurchase any loans that were originated through fraud, to repurchase loans that evidenced early payment default. And it had other risk factors.

And, yet, when the defaults came and the investors looked to the lenders to make good those losses in these mortgage pools, the problem was that many of the largest lenders went bankrupt. And there were no assets to look to to make those whole.

My suggestion, which is laid out in more detail in my written testimony, would suggest a fairly straightforward regulatory fix that would require that there be risk-based capital reserves for non-bank mortgage lenders, just as there are for banks, with the result that they would remain an incentive to make
loans to credit-challenged communities in ways that
don't lead to massive macroeconomic distress, as we
have all experienced today.

I thank the Commission very much for the
opportunity to discuss these issues with you and look
forward to your questions. Thank you.

ACTING CHAIRMAN KIRSANOW: Thank you, Mr.
Brooks.

Mr. Markison?

MR. MARKISON: Good afternoon, Mr.
Chairman and members of the Commission. Thank you for
inviting me to join this distinguished panel and to
participate in this discussion.

MBA appreciates the opportunity to provide
its perspective on these issues and looks forward to
working with the Commission on them going forward.

MBA has long regarded abusive lending and
abusive lenders as well as abusive mortgage brokers as
a stain on the mortgage industry and illegal
discrimination as wholly unacceptable.

Loans are and should be provided to
consumers and priced by lenders based on legitimate
business concerns. Non-prime lending based on the
loan's risk is appropriate and does not equate with
predatory lending.
The Home Mortgage Disclosure Act enables
the public and regulators today to review lender
performance in serving borrowers fairly. And MBA has
been proactive in facilitating its implementation.

The sunshine shed on the industry has
helped facilitate fair lending. MBA believes that
greater consumer protection and, even better, fair
lending performance could be achieved if a uniform
national mortgage lending standard were established
and a new federal mortgage regulator established to
regulate independent mortgage bankers and brokers.

New, more consistent national regulation
would regularize competition in the mortgage industry,
better protect consumers, and facilitate enforcement
by both federal and state regulators nationwide.

Accordingly, in my time today, I would
like to talk about how loans are underwritten and
credit is provided to consumers by mortgage lenders;
secondly, how HMDA data facilitates public review and
enforcement of fair lending by mortgage lenders;
third, how issues in the mortgage process can be
addressed through much greater transparency; fourth,
how a strong uniform national lending standard and
more effective regulation for lenders and brokers
could improve lending for all; and, finally, what MBA
is doing to help effectuate these changes.

Lenders make and price mortgage loans
based on the risk factors presented by each borrower
and the particulars of the loan sought. Relevant risk
factors include, but are not limited to, the
borrowers' income, credit history, the amount of the
down payment, the value of the collateral in relation
to the amount of the loan and the availability of cash
reserves.

Protected class membership is not a factor
in loan pricing. Under HMDA, mortgage lenders provide
extensive loan-level data annually on each loan
origination and denial to the unique and
extraordinarily rich HMDA data set.

Since 2004, this data included rate spread
data; that is, data on whether a loan is higher-priced
based upon the regulatory established threshold and if
so the amount by which it exceeded the threshold.

HMDA data, as you know, also includes
race, sex, ethnicity, and locational information. The
public has access to the data for each year, giving
the public an opportunity to scrutinize individual
lenders and their lending performance.
While HMDA data does not include all of the factors in making a loan, it provides sufficient information for the Federal Reserve to review the data preliminarily.

If the data reveals what may appear to be inexplicable disparities, the matter is referred to the lender's regulator, which will review referrals and scrutinize non-public data, such as credit scores.

Notably, the publicly available HMDA data has, in fact, indicated some differences in denial rates and prices of loans between minorities and non-minorities. MBA believes these differences are largely explicable based upon a full consideration of risk factors from nonpublic data. The HMDA process I would emphasize again has proven to be useful means to address any lender problem areas as the law intended.

One issue that has been raised in conjunction with reviewing the HMDA data has been to what extent discretionary pricing; that is, yield spread premiums to mortgage brokers and overages to loan officers based on the rates of loans may have resulted in pricing disparities among borrowers and steering of borrowers into higher-priced products.

MBA believes the HMDA process and scrutiny by regulators are helping address this concern but
that additional steps need to be taken. Mortgage lenders and mortgage brokers differ. And MBA has written extensively on this subject.

Lenders lend money, and mortgage brokers arrange loans as intermediaries between consumers and mortgage bankers. My testimony has a correction in that area, but it should read as broker are intermediaries between consumers and mortgage bankers.

Regulators required lenders to monitor and address issues raised by discretionary pricing, by loan officers, and mortgage brokers. However, as a practical matter, lenders have less control over brokers concerning their contacts with borrowers than they do over their own loan officers.

Lenders underwrite loans after they are initiated by mortgage brokers. It is widely believed that in the last few years mortgage brokers originated roughly 70 percent of non-prime loan. Mortgage brokers, as distinguished from lenders, do not report under HMDA. Brokers do not underwrite loans. They do originate them. A greater understanding of these differences is needed.

MBA has long supported clear and complete disclosure of yield spread premium costs to consumers. We think that would be an important step to resolving
this concern. We believe that since brokers serve as intermediaries, shop for borrowers, and help place borrowers in loans, the borrower is entitled to know if the broker is receiving a higher commission based on the borrower's rate on the loan.

MBA also supports much greater transparency in the mortgage process in general and believes it would help prevent steering. An earlier panelist alluded to the Federal Trade Commission's own study. We agree that there is much that can be done to make the consumer, much more aware of what he or she is paying for their loan.

We also think financial education, financial literacy bear an important part of the solution. But let me say quite clearly today's mortgage crisis is indeed unparalleled. We believe that it demands a careful look at the regulatory structure of the industry beyond improvements to transparency and consumer education.

We think a fundamental reform of regulation is needed. And that reform should take into account not only the problems that we are facing today but some of the good work that has been done, including that of the Federal Reserve.
We believe that new rules can build on the Federal Reserve's requirements and other proposals, including the matter of ability to repay. We believe a rigorous new standard should protect all consumers nationwide. And it should be the standard that state and federal officials enforce.

I have listed in my testimony several principles which should guide one's development of a legislative proposal to give the type of consumer protection that we suggest. I refer you to my testimony for the specific principles.

Let me say, though, that MBA believes again that a tough new standard with consistent enforcement is the road we should take. This change should coincide with assigning a federal regulatory agency responsibility for regulating non-depository bankers and brokers.

MBA is working hard to effectuate these proposals. We know there is a great deal of blame to go around today, but we don't believe that by any measure, the mortgage industry is solely the cause of the problems we face.

Nonetheless, we believe that the industry must work proactively on solutions that restore faith in our market and protect the borrowers who are our
customers. We profoundly believe that proposals along
the lines I have described will achieve these ends.

Thank you.

ACTING CHAIRMAN KIRSANOW: Thank you, Mr.

Markison.

At this point I would like the previous
panel to come forward and make yourselves as
comfortable as possible. And we'll get into
questions.

You will forgive me, but because of
advancing stages of Alzheimer's, I neglected to swear
in the panels prior to their testimony. I am going to
presume very imperiously that you rendered quite an
accurate testimony. And I am going to dispense with
the swearing you in for the question and answer.

It is a policy that we began under our
administrative instructions a few years ago prior to
that. At least during my previous tenure on the
Commission, we didn't do so. So I don't think it's
going to have any consequence.

Whatever comments you have will be
dutifully included in the record and whatever
recommendations and findings we make to Congress or
the President on this very important issue.
Having said that, we have got Commissioner Melendez with his hand up.

III. QUESTIONS BY COMMISSIONERS AND STAFF DIRECTOR

COMMISSIONER MELENDEZ: Yes. Again, thank you for being here.

We talked to a certain extent about responsibilities of lenders. I want to talk a little bit about the responsibility of borrowers and how we can help that.

Can each of you comment more on the role of financial literacy in this mortgage crisis and what financial literacy programs are being conducted by federal agencies? Are there any model programs that are out there?

MS. RICE: Well, the GSEs have financial literacy programs. For example, Freddie Mac has the "Don't Borrow Trouble" financial literacy program. In addition, HUD has funded housing counseling agencies to provide housing counseling and loan counseling to borrowers at costs that are free so the borrower does not have to pay for that.

Organizations like LISC and Neighborhood Housing Services have programs that also borrowers can go through that are free, supposedly free, where the
borrower can learn about the lending process and can hopefully make a wise choice.

                   Our agency has a financial literacy program that we run. We just released the ad campaign. In conjunction with the Ad Council, it is called Questions Protect. You can access the information and the advertisements from questionsprotect.org.

                   And so we have, we hope, a robust cadre of information from the GSEs, from federal regulatory agencies, and from other organizations that provide tools and resources to consumers to help them to better equip them and empower them to shop for the mortgage.

                   Now, having said that, I have to say that, no matter how much education we provide for the borrower, the lender will always have superior knowledge over the borrower. And the lender will always be at an educational advantage over the borrower.

                   So we are never going to be able to educate borrowers enough so that they can wholly navigate every single lending process that is out there and so that they can deal with every single financial product that is out there.
If we end up with a scheme that is similar to the model that we have today, we will have literally thousands of loan products that borrowers can avail themselves of. And you are never going to be able to educate consumers about all of those products that are out there on the market.

ACTING CHAIRMAN KIRSANOW: If I could, so that the Court Reporter can accurately transcribe your testimony, if you would identify yourselves beforehand because you are kind of out of order right now.

MR. CARR: Thank you. Jim Carr. And thank you for asking that question because I think it really is an important one because people really misunderstand and don't really get it, what happened to consumers who were exploited.

I just want to build on the point that Ms. Rice made. And that is, financial education is important, but it can't compensate for basic rules of the road. And particularly when we are talking about people of color, we are talking about populations who have historically been legally excluded from access to financial services. And home ownership is one of those major areas.

And so if you are not brought up in a house that was owned by your parents, if you don't
have uncles and aunts who understand the home-buying process, if you don't participate in the social network that gets it, that knows where to shop, how to shop for a loan, you are at a severe disadvantage.

If that is then compounded by the fact that the mortgage entities that are operating in your community all are saying the same thing, they are giving you misinformation, and they are professionals, they are experts.

And so the idea that you would get somehow educated through some type of counseling program, even if it were two weeks intensive, that you would know as much about the mortgage finance business as an expert is just not realistic.

When I hear that question, it is akin to me to driving a car. Yes, you should have a driver's license, which means you should understand the rules of the road, but there is still going to be a bumper on that car. There are going to be air bags. There are going to be seat belts. And there are going to be laws that say, "You know what? Drunk driving is not permissible."

And that is what was missing from this market. It said, "You can get into it, but there are no protections for you." And, as Elizabeth Warren has
artfully stated, this market was so deficient in terms of protecting the consumers that consumers had better protections buying a toaster or a microwave oven than purchasing the largest asset the typical American household is going to get.

So I just will conclude by saying I believe financial education is really critical and essential. And in my own view, personal view, I think it should be part of the basic curriculum of every child in America to really understand the financial system, including home ownership, before they graduate from the 12th grade.

But, having said that, if professionals, expert financial experts, are able to exploit the trust of the consumer, they will be exploited all the time.

MR. BROOKS: Commissioner Melendez, Brian Brooks.

Let me approach the question in a couple of different ways. First of all, from a lender perspective, financial literacy is critical and a high priority. And, indeed, many of my clients have partnered with, among others, the National Fair Housing Alliance and other leading providers of these
kinds of literacy programs to communities that have historically been excluded.

These things are very important because one of the suppositions of the predatory lending debate is that somehow lenders want to dupe consumers, that they're hoping they can put one over on consumers that won't get noticed.

The way in which home buying is different from toaster buying is that you are signing up for a 30-year relationship with the person. And so that the likelihood that there won't be litigation when the borrower learns of the true facts that were misrepresented to it is about zero. That's what keeps people like me in business, is that these people sue, which is one of the problems.

Financial literacy is critical. But one thing to think about as we talk about financial literacy is there is a fair body of scholarships suggesting that the problem with the mortgage origination process now is not that there is too little disclosure. It is actually that there is too much and too formulaic of disclosures.

Now, there was a joke told earlier by one of the panelists about that what happens when you show up at the closing table and you are presented with a
five-inch stack of documents and you're told "Sign here and here and here and here and here and here." And no one reads those things. We all sort of hope that the basic terms are as we have been told, and we move on from there.

Alex Pollack, who is a scholar at the American Enterprise Institute and a former President of the Federal Home Loan Bank of Chicago, has been proposing over the last 18 months or so a simplified one-page plain English mortgage disclosure that tells you what you really need to know in short, plain, one-page disclosure language, the idea being that at some level, it's all noise and what would be better is, do people know what their monthly payment is, does it include or not include taxes and insurance, will the interest rate reset to a higher level, and if so, when, and a handful of other key things.

So one thing I would suggest as we talk about financial literacy is we need to make it simpler, not more complicated.

MR. MARKISON: Ken Markison for Mortgage Bankers.

I do believe and so does my organization in the importance of financial literacy. We have made
a considerable investment ourselves, and so have our members in conjunction with a variety of groups.

I think there is a problem, though. And that problem is that we need some central focus on financial literacy. Again, in my testimony, the suggestion of a new federal regulator I think would help facilitate that. I think it could also be a focus for counseling activities in those cases where counseling is warranted.

We share the view that Mr. Brooks has. And I indicated in my testimony transparency is a great problem. We have a distinguished representative from the Federal Reserve. The Federal Reserve has responsibility for disclosures under the Truth in Lending Act. HUD has responsibility for disclosures under the Real Estate Settlement Procedures Act. I was active in the RESPA reform effort when I was at HUD.

Today HUD has come out with a rule proposing a new good faith estimate and HUD-1 disclosure. Our understanding is that the Truth in Lending Act rules are forthcoming. Unfortunately, these two activities are not joined.

And in my thinking, what needs to be done is to have a simple disclosure developed by the best
minds in government that coordinates what the legal concerns are, more importantly what consumers need to know.

I think what is happening in lending, unfortunately, in the disclosure world is because of the plethora of information provided to borrowers, abusers are able to hide in plain sight. Why? Because consumers confront the pile and don't notice the real trouble.

So I think financial literacy is a very serious matter. I am not discounting the need for restrictions. And I have testified in favor of regulation. I think these two components, it's impossible to police every transaction, but if the consumer is well-armed, he can empower himself.

ACTING CHAIRMAN KIRSANOW: Mr. Markison, "best minds in government" may be an oxymoron.

(Laughter.)

ACTING CHAIRMAN KIRSANOW: Ms. Harrington?


ACTING CHAIRMAN KIRSANOW: Thank you.

MS. HARRINGTON: Two quick points. One, we believe that disclosures that are made to consumers should be based in sound empirical research. We think
that the disclosures that are being given now in
connection with mortgages and other credit products
aren't necessarily communicating effectively important
information and that before and during efforts to
reform disclosures, there should be very good
empirical research undertaken to learn how to best
communicate material information to consumers. It
doesn't take that long to do that. It can be done
well. And it can be done quickly. And it should be a
high priority.

Second on financial literacy, very
important, at Federal Trade Commission, we participate
through existing programs. We don't have our own.
But we are quite active in that.

That said, we did a workshop a few years
ago on the question of what consumers understood then
about these new and novel mortgage products and heard
at the workshop consumers really do not understand.
People do not understand what is going to happen when
these loans reset.

And I think part of what we have to take
into account is that, even if we have the best
financial literacy education program in the world in
the United States, which we are a long way from
having, sometimes products are so complicated that it
just isn't possible for consumers to do a good job, even from an informed place, of understanding well enough what it is that is being sold. We need vigorous law enforcement. And we probably need conduct regulation of the sort that we haven't had before.

That is, we're at a point in time, I think, of questioning what has been orthodoxy for quite some time. And that is that information alone is sufficient to protect consumers.

ACTING CHAIRMAN KIRSANOW: I'm sorry. I didn't see your hand up.

MR. BROWN: Yes. There is not much to add to what has been said so far. I agree with most of the points that financial literacy is no substitute for standards that should be in place. Everything is more and more complicated. And sometimes it is a challenge with the best disclosures to inform the consumer of what they need to know as they enter into an agreement.

At the same time, I want to mention that the FDIC's Money Smart program that I had mentioned earlier, which rolled out in 2001, initially focussed on adults. But over the years, what we have done is
we have now also focused in on young people in six languages.

And one of the great things about it is we go into high schools. We deliver our modules. And it is sort of a snowball effect. The information is passed on. And we are even involved in the high schools in banking programs, where there is a small bank setup. Essentially they have their own sort of bank accounts and transactions. And young people are learning directly about financial services and how to think and what questions to ask.

So it is a challenge. Everything is complicated. But at the same time, the best that you can do is at least educate people and teach them how to ask the right questions and how to think and to think about the broader picture and what the effects are down the road. So we think it is a very important program.

And, by the way, there is a lot of information on our Web site. If you want more details or if you would like some modules, we would be happy to provide that information as well.

ACTING CHAIRMAN KIRSANOW: Mr. Chanin?

MR. CHANIN: We, like the FDIC, have a number of consumer education programs. The Reserve
Banks provide programs, to schools and assist teachers in terms of communicating financial education. We have a number of programs at the board itself that, either through the Web site or other activities, address consumer education.

I’d like to mention a couple of points in terms of consumer understanding. We do extensive consumer testing; that is, we have hired outside consultants and experts to do consumer testing on all of the disclosures that we provide. We did extensive testing on recent changes to our credit card rules, for example.

We are in the process of doing extensive consumer testing for mortgages as well. So we have gone through a number of rounds of focus groups and one-on-one testings. And we literally give consumers documents that are used in the marketplace today, ask them what they understand, what they don't understand, and we revise those documents, go back and test them further again and again, changing terminology, changing the format of that information.

We also test the timing. When do consumers need this information? When are they most likely to use it? Earlier in the process or later in the process or even after they have closed their loan.
We have had for over 30 years a one-page truth in lending disclosure document. So, there is no question about the scope of the document being too long. But we are looking at that document as well to try and ensure we can get better information to consumers for mortgages, both for home purchase mortgages as well as refinancings, home equity line of credit, and the like.

And so we will be issuing some proposed rules, likely this summer, that will revamp all of those disclosures to try and ensure that consumers better understand these products.

The other thing that I would add is there are differences in how consumers shop in the mortgage market. We have found in testing, and other studies have found, that consumer behavior differs in the prime market and subprime market.

The prime market is far more competitive, both in terms of lender activities as well as to some extent consumer shopping. The subprime market simply doesn't function quite as well.

So one of the things that we have done I mentioned earlier, is to enact the substantive provisions that regulate the most significant issues we have seen in the subprime market because it appears
that disclosures alone will not help consumers in that marketplace.

    ACTING CHAIRMAN KIRSANOW: Back to Mr. Carr.

    MR. CARR: Thank you.

    I just want to make two quick comments. One is that I want to address the idea of increased disclosure. And it's from our perspective welcome news to hear the idea that more disclosure is important and necessary.

    But I just want to point out that disclosure doesn't substitute for banning practices that have just shown themselves to be exploited, period.

    The reason for that is that the disclosure can come in many forms. And if it comes in the form of a size 8 type print, like a credit card, on page 28, it won't do any good. That consumer will never understand it if they ever are able to read it.

    And so I think it is important to recognize that to the extent that we have populations who have been historically marginalized, it really is incumbent upon all of us to work together to figure out how do we get them into home ownership in a way in which they understand the obligation that they are
taking on and they actually perform on it because, in fact, if we had had the home ownership rate continuing to go from 2004 straight up to today, we would be a much healthier nation than we are right now.

The other thing I wanted to say is the idea that the litmus test for whether a loan was exploited is whether you sue. It shows sort of a disconnect between the populations that we are talking about.

Most of these households that we are talking about, low and moderate-income and minority communities, they don't have a lawyer. And even if they knew a lawyer, they don't necessarily have the funds for a lawyer.

The National Community Reinvestment Coalition actually operates a home ownership sustainability fund. Here is what they tell us when they call. They're confused. They're concerned. They're frightened out of their minds. They are also embarrassed. They feel shame that somehow they allowed themselves to get caught up into something.

They are losing all of their wealth. They are being thrown out in the street. Their children are having to relocate. They don't know what to do.
They are not thinking about suing. They are thinking about surviving.

And so I think it is really important and incumbent upon us to understand that the population we are talking about for purposes of the Civil Rights Commission are not wealthy doctors and lawyers who happen to be of the majority.

We are talking about people who are doing the right things in the right ways and trying to enjoy the American dream that has historically eluded them. And they are dealing with financial intermediaries who are not treating them in a manner that is supportive of them actually achieving that dream.

ACTING CHAIRMAN KIRSANOW: Ms. Rice?

MS. RICE: Thank you. I just had a comment related to the education issue.

We have done consumers a disservice. Consumers have been taught for years and years and years that they should use the APR as a shopping instrument. And the government has taught consumers, nonprofit organizations. So there is enough blame to go around.

We all thought that the APR would be a very helpful resource for consumers. The problem is that in this marketplace, the APR really is useless.
It doesn't serve any useful purpose. And it is not a good shopping instrument.

So there is a lot of confusion out there, even in terms of the education that we have already done, what little bit of education we have been able to do for consumers.

So not only do we have to undo some of the things that we have educated consumers to do and their family members have told them "Pay attention to the APR." But we know that the APR really isn't a useful shopping instrument for consumers in today's marketplace.

ACTING CHAIRMAN KIRSANOW: Mr. Markison?

MR. MARKISON: Yes. If I may add? It's Ken Markison.

MBA and I believe seven other trade associations wrote last month to the Secretary of Housing and Urban Development and asked that the RESPA effort and the TILA effort, under these two important laws that require disclosures along the lending process, be linked and that disclosures be simplified in real terms. So to your point, consumers could understand.

We are happy to provide that letter for the record. It is one step along the way of seeking
this outcome, but we feel very strongly that that is
the right approach for the consumer and for the
industry as well.

ACTING CHAIRMAN KIRSANOW: Commissioner
Gaziano?

COMMISSIONER GAZIANO: I had a specific
question for Mr. Brooks and then maybe a more general
question for all for you. I wanted to thank you, Mr.
Brooks, for trying to define predatory lending in a
useful way.

I think your prepared testimony suggests
that even in an application, it is then hard to get
your hand around. But you do have an estimate of
fraud, am I correct, of half of one percent of a
certain type of loan?

Could you give us any estimate or guess or
whatever based on your definition of predatory lending
and how many of a particular class might fall into
that category?

MR. BROOKS: Sure. Well, the most useful
way I think to answer your question is to think about
the particular kinds of loan products that are offered
and then figure out which ones are most susceptible to
fraud.
The number one culprit is I think easy. And that is stated income loans. So these are the kinds of loans that were quite widespread between roughly 2004 and 2007 and are now being banned under the new Fed regulation that takes effect later this fall.

Now, you could debate who was committing the fraud there. I would say that there were probably three different kinds of fraud happening. There were certainly cases where you had either brokers or lenders who were eager to get a fee they could sell on that. That certainly happened.

But there equally unquestionably examples of individual borrowers who were hungry to take advantage of a rising real estate market, looking to get rich.

And there were people like that who made up incomes. And at the same time, there were real property scams of the kind that the FBI has been investigating. So that is clearly very significant.

You know, the other principal kind of fraud I think that drives the numbers that you saw in my written testimony are instances which groups like Mr. Carr's group are probably called bait and switch schemes. It is a common theme that I have seen in the
world of litigation and enforcement actions are allegations that a borrower was told that he was going to get either a fixed rate loan or a loan at a particular interest rate.

Then he shows up at the closing table and is presented with a different kind of loan. Now, it's not that he's not aware at the closing table that it is different from the owner loan, but in that moment of duress, he doesn't see an alternative. And so he signs that. And that is often reported.

So the FinCEN statistics that I talk about here I think are largely driven by those kinds of scenes. There will be other things in the markets, but the point that I try to make there is to say that we should eliminate fraud and that's a critical initiative, but that once we are done eliminating fraud, once we are done with that important job, there remain real economic differences of the kind you have heard from the other panelists in terms of wealth and credit score and income that will still result in significant disparities across racial and ethnic lines that will need to be addressed through innovative mortgage structures.

COMMISSIONER GAZIANO: Sure. And my more general question really relates to your previous
discussion. I don't know. I'm certainly very interested in promoting financial literacy as well, but I certainly don't think that we need to promote the same level of financial literacy as the lenders to -- and I think back to my car-purchasing decisions.

I don't know anything about the manufacturers or whatever. But if I comparison shop with all of the dealers in town and tell them that I am doing it and haggle back and forth, I don't care what the true is. Someone pays sticker price, and then they pay for clear coating and other sort of stuff. I get a lot less than sticker price.

By the same token, I recently refinanced. And I am not very sophisticated but probably more sophisticated. I wanted a 30-year fixed price, no prepayment penalty. But I told the brokers, "I am shopping around." And I caressed them. And I didn't know until closing the lawyer told me what a great deal I did. And I don't need to know any of that.

Is that an approach that -- I mean, are there too many exotic loans out there that people are attracted to to make that kind of an approach useful? Can we not get people to like comparison shop between brokers to get a better deal?

MR. CARR: Jim Carr.
First of all, yes. There are too many products on the market for the wrong people. So 10 years ago or 15 years ago, I would have said no, not at all because what is wrong with stated income for certain types of self-employment, et cetera, et cetera?

The problem is that they had been so abused that they just need to be removed because the lending industry has shown it can't behave with these products or at least they should be precluded for certain types of households that you know just don't need them.

Now, one of the other things that is really interesting is most people when they enter the housing market for a prime loan actually are meeting a very competent, thoughtful, respectful professional who actually explains to them how the market works. And the most of the sort of the push and gib, the push and gib is we can give you an eighth lower or a quarter higher or a quarter lower, but we are really better to go with because we are better, this, that, and the other.

But most people get first-rate service from the mortgage finance industry. The unfortunate
part is they didn't get it from the brokers in the subprime market. That's where the problems were.

So the question and the challenge is, how do you convert them into being like their peer real estate agents in the prime market? And one of the ways that we have recommended is fiduciary responsibility. If they know they are legally liable to tell the truth and give that consumer the best advice they can, they have all of a sudden become a mortgage professional working on the same side.

Then issues such as what is compensation become less important because we now know that they know that they can be severely taken to task legally for misrepresenting themselves. And if we have that, for example, for a lawyer, why not for that person who is helping you invest in the most substantial asset of your life?

All I'm saying is the market needs to change. There needs to be an incentive change that actually drives the industry to want to bring the best advice and information to the table exactly as they do when you go for a prime mortgage.

COMMISSIONER GAZIANO: I can see some potential problems with that. I wondered if some --
MR. BROOKS: Well, I will just quickly say I agree with a lot of what Mr. Carr said except the very first thing he said. I am always very nervous when people tell me that there are too many products out there for the wrong people. That sounds and has a command and control, central planning, almost paternalist flavor to it. And that takes me back to what I said at the very beginning of my presentation, which is that hard facts make bad law.

For every kind of controversial mortgage structure, for high loan-to-value loans, for high debt-to-income loans, for zero down payment loans, for adjustable rate mortgages, and for virtually every other product, you can come up with compelling and even heart-rending stories of fraud and abuse.

At the same time, what the data suggests is that the majority of folks in all of those structures were people who didn't qualify for a different kind of mortgage. And that's why they got that loan in the first place.

Now, that is not to belittle the 20 percent of people, if it is that many, who were duped into taking the loan, but for the other 80 percent of people, which is what policy-makers really need to think about, they were afforded access either to home
ownership in the case of purchased money mortgages or to other important planning issues in their lives.

And in cases I have been involved in, those have included college educations and major medical expenses and children's weddings, and the like. And in a free society, it is a big deal for us to say, "You know what? That product for the 80 percent of you who are in the product for the right reasons is just too costly because of the 20 percent of people who aren't." To me that is a very dangerous policy proposition.

ACTING CHAIRMAN KIRSANOW: Mr. Markison?

MR. MARKISON: Yes. Just to go back to your original question, I think you are quite right. I think shop until you drop is not a bad credo in this market as in the car market. I think a good approach is to go to different brokers and different lenders.

What I indicated in my testimony is there is a difference, I think, functionally between brokers and lenders. Lenders make loans. Brokers do frequently hold themselves out as shopping for the borrower to get them the best loan.

And therein lies the rub because the incentives may include a payment to the broker based on the rate of the loan. What we said is that this
sort of problem -- has to be addressed in disclosure.

And I think that --

COMMISSIONER GAZIANO: It is disclosed, isn't it?

MR. MARKISON: Well, it isn't clear.

COMMISSIONER GAZIANO: It was in my loan.

So --

MR. MARKISON: Well, it is the --

COMMISSIONER GAZIANO: And I didn't care about the kickback --

MR. MARKISON: Yes.

COMMISSIONER GAZIANO: -- because I got an eighth lower by using them.

MR. BROOKS: Not a kickback.

(Laughter.)

MR. MARKISON: Not a kickback in the legal sense. I do know what I'm talking about. Functionally the payment is for services, it's originating a loan.

COMMISSIONER GAZIANO: Yes.

MR. MARKISON: Having said that, because the payment influences the brokers' behavior, it should be crystal clear to the borrower. I think the second step is that, rather than cede your shopping


responsibility to anyone, you should do what you did and shop for yourself. That is what we have said.

I share the concern about removing products from the market. I think that is a problem, particularly when a borrower is trying to negotiate the market with very high prices and you are trying to put a home within his reach.

I think when products adjust quickly, you need to know it. And it needs to be very clear to you so that you can make a choice that doesn't end in foreclosure.

ACTING CHAIRMAN KIRSANOW: Mr. Chanin and Ms. Rice? And Commissioner Taylor has a question.

MR. CHANIN: I wish you were the typical consumer. And I think, in theory, that shopping could solve most of these problems.

COMMISSIONER GAZIANO: Can't we teach that? That's all we need to teach is my point.

MR. CHANIN: Yes, yes. What we found is there are so many obstacles. So, for example, consumers approach their financial institutions and they feel that they trust that individual to give them the best advice and look out for their interests sometimes.
The other thing, we found through testing is that consumers don't understand that the rate that bank A offers on a 30-year fixed rate loan is different than the rate that bank B offers; that is, that there are differences in the market rates that apply, even if the consumer has the same profile; that is, same credit history and the like.

And so that is a big hurdle to overcome to try and educate consumers that you do need to look at different lenders to shop because the rates you get will be different.

Consumers oftentimes look at the monthly payment amount. And that is what we are finding. That is important, obviously, in terms of day-to-day actions, but they also need to look at other factors.

So we are trying to address those issues, doing a lot of consumer testing to try and see where we can pinpoint the best place to succeed, but it is a challenge.

I think we will have some successes in some areas but not for everyone in the marketplace. It's not realistic to think that we are going to touch all points in terms of consumers improving their shopping behavior.
We also found that there is kind of a disbelief in some points. When we tried to test yield spread premiums, where brokers get compensation based on a higher interest rate, consumers didn't accept it. That is, they said, "Well, wait a minute."

There were two problems. One is, how can the interest rate be related to a dollar amount? And then, secondly, they didn't accept the fact that the interest rate the broker was quoting them included a fee that, in essence, got pushed back to the broker.

So there are a lot of complexities in the products in the marketplace that consumers don't understand. And I think ideally the goal is to try and remove some of the complexity and use terminology that consumers understand, but that is a tall challenge.

ACTING CHAIRMAN KIRSANOW: Ms. Rice?

MS. RICE: Hi. I just wanted to address a couple of things. I think Brian mentioned earlier that NFHA has worked quite extensively with a lot of subprime lending shops, some of them after they were targeted or had to settle with the state AGs.

We were working with them on three main issues. One, changing their platforms so that they could offer low-cost mortgages because they recognized
that they had a huge cadre of borrowers who really did qualify for lower-cost mortgages, but they got the higher-cost mortgages; number two, changing their advertising to not focus on the monthly payment but to focus on other more substantive features of the loan.

But, number three, -- and that is the point I want to focus on -- was giving the consumer direct information about loans for which they qualified because in many instances, the subprime wholesalers were sort of hamstrung and many by their own conventions.

Because the mortgage broker would submit an underwriting package to them, the automated system would automatically shoot back to that mortgage broker, "This particular borrower is qualified for these ten different products."

The mortgage broker doesn't give the consumer the ten different products. They choose and pick which one they think is best. And a lot of times it's the product that is most aligned with their own financial incentives. And that is the one that they give to the borrower.

So these subprime wholesalers were saying that perhaps their borrowers, their customers were not getting the best product or the best priced product.
So we were working with them on ways, you know, getting around some of the contractual issues so they could directly communicate with consumers about all of the different other loan products and loan terms and conditions for which the consumer qualified but never was told about.

ACTING CHAIRMAN KIRSANOW: Go ahead.

MR. CARR: I just want to make a quick point about shopping. Mr. Carr.

And that is that it goes to also the fundamentals of the market in which you are located. Probably the majority of people who are looking to buy a home get their real estate advice from the real estate agent.

Where do they get them? They get it from the sign out in front of the "For Sale" house, the place they wanted to buy. Once they do that, they are in that network.

So if what is operating in your neighborhood is a subprime mortgage broker operation, that mortgage broker is not going to send you to a low-cost loan. And they are not going to give you any information about how to get out of that market you are in.
And so it is not just a matter of people don't want to shop. It's a matter of people don't have the opportunity to shop because of the way the financial markets work. And the lack of, again, going back to something I said earlier, the lack of access to those financial resources and information as well as market providers who may not be operating in those markets.

ACTING CHAIRMAN KIRSANOW: Commissioner Taylor?

COMMISSIONER TAYLOR: I wanted to make sure I understood two statements: the one from Mrs. Harrington that you were inclined to favor conduct-based restrictions.

In my mind, I always think disclosure is all, virtually all, but I heard you say it may not now, such society with such complex financial instruments that disclosure is insufficient. Even if the consumer were to understand it, in some cases they simply can't. And, therefore, the restrictions need to be more conduct-based.

So I wondered, would you elaborate on that? Specifically what conduct would you restrict? What conduct would you outlaw? I would like to hear that.
And, second, I would like to hear if you would outlaw it for all individuals or whether you would only outlaw it for communities more likely to be targeted?

And I would like to turn that second point to Mr. Carr to really ask if you were serious when you said that there were perhaps too many products out there.

And what I heard you say -- and I don't want to put words in your mouth -- a statement-only product may be viable for someone who is a trust fund baby who claims they are an artist. Correct? But it may not be viable for that African American talented artist because that's what I heard.

And is that what you were saying, that you would restrict the lending institution's ability to give that statement-only loan or any other product to certain minority groups but you would allow those products to be used in other groups?

That is what I thought I heard you say, and to me that is an important point. That is from a policy perspective if that is what we are talking about: banning products or permitting certain products but only for certain people.
MR. CARR: Mr. Carr. No, absolutely not. I could understand your anxiety if that's what you thought I was stating or implying, which I was not. I was talking about the markets.

The high-cost market is a market that tends to serve individuals who have certain financial characteristics, which suggest that certain products just don't make any sense for them. Stated income don't make sense for individuals. And, of course, the proof is hard facts. I like that term, the "hard facts." The hard facts are having these products available to these consumers without appropriate regulation has literally brought down the entire financial system. And the point --

COMMISSIONER TAYLOR: It is an important point. I am going to stop you because there is a difference in my mind between those products being targeted and sold unlawfully and simply being made available to everyone.

So I guess my question is if you have what you would probably describe as a toxic product being offered to someone with full disclosure, there is no confusion in that case, there is no one being misled, no one is being deceived, would you allow that toxic product to be sold to all communities?
MR. CARR: I think that there are certain products that just don't make sense for certain types of consumers. And I believe that those high-risk consumers, just those very exotic, confusing, and complex products are inappropriate because the consumer simply can't understand them.

Any time you have got the up-front fees, the closing costs, the origination costs, and then you add to that the starting interest rate, the step-up interest rate, on and on and on, it's all but impossible unless you are a financial whiz to really understand how to value that mortgage.

So all I am suggesting is don't force that consumer to have to go through all of that. The 30-year fixed rate mortgage is what made America a solid, powerful home ownership society with the most stable house price appreciation as the most secure asset in this country. And it lasted for over 60 years that way.

Then, all of a sudden, we started getting really sophisticated. Well, we don't need to be sophisticated. That young artist that you were referring to, a 30-year fixed rate mortgage is a good product for them.
Now, a lower down payment? Maybe. With the appropriate consumer education? Absolutely. Much better to put them in a product in which they fully understand what their responsibilities are and they can pay it than giving them something that actually leads them to believe they can actually afford it and then it turns out they can't and it destroys them because that is exactly what happened in this market.

Again, what I say is the hard facts -- I love that phrase. The hard facts are that those products don't work for certain consumer groups. And we have had so much of a demonstration of nearly destroying the financial system. That should be a clarion call.

Get rid of them and go back to the basics: FHA, fixed rate; VA, fixed rate; Fannie-supported, fixed rate. That's where we went wrong. Bring those loans back but for more sophisticated, higher income, higher credit score, et cetera, allow the market to have its flexibility.

ACTING CHAIRMAN KIRSANOW: Mr. Brooks?

MR. BROOKS: Well, this is obviously where the rubber meets the road. I'm glad we got to this question. Here is the thing. For the 60 years that Mr. Carr is referring to, the 60 years of the 30-year
fixed rate mortgage loan, as the single product standard that exists in the United States, we subsisted with a home ownership rate of around about 40 percent.

And starting in the late 1980s, early 1990s with the advent of these products that some people call exotic, we saw roughly a 29 percentage point increase in the total home ownership rate and a significantly higher rate of increase in the home ownership rate among minority borrowers.

Now, it's true that because of the developments of the last couple of years, a couple of percentage points have now been shaved off that rate. So we're a little off the peak. But we are dramatically above the home ownership rate that we lived with when we had the 30-year fixed rate mortgage.

When I was in law school and I took a course in banking law, one of the requirements if you can believe this at the University of Chicago was that we watch "It's a Wonderful Life," not for the entertainment value but because of the important lessons it taught you about the mortgage market.

You may remember that there was Mr. Potter, and then there was Jimmy Stewart. Mr.
Potter's bank only made the 30-year fixed rate mortgage to prime borrowers, and Jimmy Stewart lent to the rest.

The hero of the story, of course, is not Mr. Potter. It's Jimmy Stewart, who made home ownership available on terms that weren't available at the bank. These are critical facts to think about.

And I guess the last point I would make is this. It is easy today in 2009, when what people are talking about are today's foreclosure rates, to talk about what a critical problem high foreclosures are. And they are a critical problem.

But it is very easy to forget the critical problem that confronted America in 2003 or 2002. The critical problem then was median wage earners in the population centers on both costs could not buy the median house because of 30-year fixed rate mortgage terms. They simply couldn't.

And so the development of these other products, like the adjustable rate mortgage and the zero down mortgage, which was what I used to buy my first house, were necessary to step onto the ladder.

And, as I point out in my written testimony, significant numbers of people who took those loans out as their first loan, refinanced into
30-year fixed rate mortgages later once they had benefitted from home equity buildup in their first few years of their mortgage.

So you are making a choice between preferring the problems of today or preferring the problems of the early 2000s. But make no mistake. There is a trade-off.

ACTING CHAIRMAN KIRSANOW: Mr. Markison?

MR. MARKISON: Yes. I simply want to underline the trade-off. It is an important one. I think the trade-off very clearly is that fixed products will not result in all borrowers qualifying.

In a rising real estate market, borrower numbers grew. Borrowers' situations change. There are many borrowers today who are benefitting from a five-year or a seven-year adjustable product. I think we have to be very careful when we remove products from the marketplace for all borrowers.

I think that is why issues like documentation, disclosure, assuring that the borrower has a reasonable ability to repay over what could be a predicted period that the borrower is in a loan, these are important concerns. I think that road of looking at these issues offers more promise to keep our home
ownership rates up than simply taking products wholesale off the market.

ACTING CHAIRMAN KIRSANOW: I am going to get to you, Mr. Carr, Ms. Harrington in a second, but I just want to note that it is currently 3:20. I would like to start to wrap this up. This has been very good. It gets better as we go along also.

I would also like to just make one comment. I am not sure why we come down on this. I am absorbing all of this. Generally, as my fellow commissioners would know, I am pretty much a free marketeer, actually more than an anarchist.

(Laughter.)

ACTING CHAIRMAN KIRSANOW: Having said that, though, although I might come down slightly on the side of, say, Mr. Brooks or Mr. Markison in that regard, when I hear some of what you say -- and, again, I am not taking a position -- when I hear some of what you say, it almost seems as if home ownership is deemed right; whereas, we have got other products.

And I think Mr. Carr would concur that there is nothing wrong with being a renter. There is nothing wrong with subleasing. There are other things available. And is it that imperative to have alternate products, exotic products to get people into
homes when there is the down side of, well, this is very complicated?

I know that when I bought my first home -- you know, I have been a lawyer now for 30 years, despite my extraordinarily youthful and virile appearance.

(Laughter.)

ACTING CHAIRMAN KIRSANOW: When I bought my first home, it was very easy. I understood what was going on. About six or seven years ago, my wife decided it's time to expand the house, despite the fact that the kids left and were in college. I didn't understand that, but I'm not the boss.

Nonetheless, when I looked at the documentation placed before me, I was completely befuddled, a state I find myself in quite often but not when I am reading documents that I am supposed to understand.

So I wonder whether the trade-off of having 60 percent or 64 percent of the people in their homes versus maybe a lower percentage of people who are in homes that they can afford and they understood what the terms were -- I'm not sure where I come down on that. It was just a comment.
I will let you comment upon that comment, but first we go to Mr. Carr.

COMMISSIONER GAZIANO: Yes. I thought it was Mrs. Harrington.

ACTING CHAIRMAN KIRSANOW: I'm sorry. Maybe it was Ms. Harrington.

MS. HARRINGTON: I just wanted to answer Commissioner Taylor's question. And that is that what I said is that I think that there has been for a long time an orthodoxy that as long as all material terms and conditions are disclosed, everything is all right. And I think that orthodoxy has failed and is failing.

And I think that we are already seeing the Fed has done a couple of things recently that certainly go beyond disclosure. In the credit card area, there are new regulations that address fees and prohibit basically certain high-fee credit card products, the kind of product that the FDIC and the FTC recently sued a card marketer and issuers that were very active in the subprime market over.

In that case, there wasn't an issue about whether the defendants had complied with the Truth in Lending Act. They had. But they were still, nonetheless, deceiving prospective cardholders.
And they charged fees that basically ate up two-thirds of the line of credit. And it was a $300 credit limit. The fees that were charged chewed up two-thirds of the line of credit. And we challenged those practices. And the Fed has recently issued new regulations that go beyond disclosure.

And the same with the HOEPA regs and the recently modified HOEPA regs. There are certain practices. There is conduct that is prohibited there, you know, making mortgage loans, subprime mortgage loans, without regard to the borrowers' ability to repay.

I think we would agree strongly that that is conduct that should not be permitted, even if all of the terms and conditions are fully disclosed.

ACTING CHAIRMAN KIRSANOW: Mr. Carr?

MR. CARR: Mr. Carr.

Yes. A few things. One is the home ownership rate was not 40 percent of 1980s was probably in excess of 60 percent.

ACTING CHAIRMAN KIRSANOW: I think the comment was -- I don't think it was. Was it 1980?

MR. BROOKS: Well, I mean, first of all, I was talking about over the last 60 years.

ACTING CHAIRMAN KIRSANOW: Right.
MR. BROOKS: And, in point of fact, in the 1980s, it started in the mid 40 percent and went up to about 69 percent. I think two years ago was the peak.

MR. CARR: First of all, I'm under oath.

(Laughter.)

ACTING CHAIRMAN KIRSANOW: Actually, you are not.

MR. CARR: Okay. Good. Well, in that case, let me --

(Laughter.)

MR. BROOKS: I think it was at 20 percent.

(Laughter.)

MR. CARR: At any rate, what is important to recognize, the fixed rate mortgage is the gold standard today. And the fact that exotic mortgages were being introduced into the system on a home ownership rate was going up is a very different statement from saying it went up because of exotic mortgages. It didn't. It went up because of the standard gold plates of fixed rate mortgage.

And everyone who is in the market who has any good common sense knows that is the mortgage to get. If you can get it at 5 percent, fix that baby for 30 years, go for it.
Having said that, adjustable rate mortgages are also in my view pretty standard mortgages. So I don't mean to imply -- and if that is what was being perceived -- that adjustable rate mortgages shouldn't be allowed in the subprime market, absolutely not.

When I say, "exotic," I mean things that have no dots, piggybacks, and all the rest of this nonsense that goes into a loan that perceives, gives the perception of making it affordable, but it really is heading straight to foreclosure. So that is not what I intend.

Another comment and a final comment is just the issue about the Jimmy Stewart and Mr. Potter. Those banks weren't giving loans to blacks. And I think it is important for us to remember that because that is one of the reasons why the markets are so dysfunctional because it was legal not to do that.

And as we think about how to correct the market failures and go forward, we need to recognize that everyone didn't have access to a Jimmy Stewart character, who was giving them the best information. They taught it to their children. They passed it down to their grandchildren, et cetera, et cetera. Instead, they were looking for loan sharks.
And that is what happened with the brokers entering that market in the mid 1990s just wearing pin-striped suits this time supported by Wall Street but, nevertheless, equally exploited.

And as we go forward to restructure this market, we need to understand that many of those consumers in the subprime market have never had a fair chance to access mainstream sources of credit. And acting and talking as if they have really just ignored the reality of that legacy of discrimination that really must be addressed as we reshape the functioning of the financial system.

ACTING CHAIRMAN KIRSANOW: I will let Mr. Brooks go. Then I have one question of my own. And then we are going to have to close up so that we can have our -- Linda has got a flight. A few of us have flights.

Mr. Brooks?

MR. BROOKS: Well, I will make this very, very quick. I just want to address your earlier question about whether home ownership is a right. I don't think and wouldn't argue that home ownership is a right, but what I was --

ACTING CHAIRMAN KIRSANOW: You're from a Chicago school.
MR. BROOKS: What my view is and what I think the evidence shows is that societies with high home ownership rates are wealthier societies than the societies with low home ownership rates.

We know this from a variety of sources. The one that is most persuasive and interesting to me comes from a study I did two years ago of the Latin American mortgage market, which is quite interesting to study.

In Latin America, that is a very sclerotic consumer finance structure. The result is that home ownership rates are very, very low.

Even not being under oath, I won't speculate as to how low they are, but I can tell you that in Mexico, as of the most recent World Bank data, 2007, there was a 5 million-unit housing shortage.

And the reason for that was that Mexico had never developed a robust securitization market. And, accordingly, the only lender, the only significant lender, of any scale was the Mexican government-run pension system, which would only make loans to people who had a certain -- when they measured down there, it was a certain number of average monthly minimum wages.
So there was a gigantic overhang of lack of housing wealth, which is, according to the IMF and World Bank, one of the drivers of immigration northward from Latin America.

In the United States, this evidence that I point to in my prepared statement is that for every dollar of housing wealth added to the U.S. economy, consumer spending increases in sixth sense.

So it's not that it's a right, but if one of the things that we are trying to do is to make poor people wealthier and make society wealthier for all of the goods that come from that, housing is one of the most important components.

ACTING CHAIRMAN KIRSANOW: One question that I have is for Mr. Markison, actually.

I don't recall exactly how you said this. This is more of a housekeeping matter. I just want to be sure that we are correct on this.

At one point I think you were addressing the data related to disparities in lending to minorities versus whites and that there were certain metrics that could account for that. But then there were certain other metrics that you said that the differences in the HMDA data are explicable by other factors.
What other factors would those be besides the credit rating, income, whatever they may be?

MR. MARKISON: What I was trying to distinguish between was public HMDA data that are used by the Federal Reserve and the public to look at lenders' behavior. It includes income. It includes race, property location.

In the regulatory model today, the Federal Reserve looks at those public data and then makes a judgment based on public data controlling for income and public factors, choice of property, size of loan, and race whether that there are disparities that they would refer to the regulator for that particular lender.

That regulator can get much more than the public data. The can get credit scores, the full raft of non-public factors that were considered in making loans.

In that process, what I was suggesting was it takes HMDA data, uses it for one of its purposes, which is enforcement. And then essentially the regulator enriches the public data set and digs deeper.

ACTING CHAIRMAN KIRSANOW: I think I understand. Unfortunately, I think I am going to have
to bring this to a close. It has been a pleasure
listening to all of you. This has been highly
informative. This is one of our lengthier hearings,
but I think it is necessary. The record will remain
open for 30 days in case you want to supplement it.
For the things that you have heard during the
commentary period that you would like to elaborate on,
feel free to do so.

(Whereupon, the panel was excused.)

ACTING CHAIRMAN KIRSANOW: And I will
entertain a motion to adjourn.

COMMISSIONER TAYLOR: So moved.

ACTING CHAIRMAN KIRSANOW: Second?

COMMISSIONER GAZIANO: Second.

(Whereupon, the foregoing matter was
concluded at 3:30 p.m.)