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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1 P-R-O-C-E-E-D-I-N-G-S

2 (9:30 a.m.)

3 I. INTRODUCTORY REMARKS BY CHAIRMAN

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

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

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

20 On behalf of the Civil Rights Commission,
21 I want to welcome all of our witnesses today. We have
22 a very distinguished panel or group of panels,
23 frankly. As usual, our staff has done a splendid job
24 in securing some really outstanding witnesses on a

1 very timely and important topic. That topic is civil
2 rights issues with respect to the mortgage crisis.
3 This is the U.S. Commission on Civil
4 Rights. We are convening at 9:30 on March 19th
5 Eastern Standard Time. And, again, this has to do
6 with the mortgage crisis. Many of you are probably
7 asking yourselves, what does the Civil Rights
8 Commission have to do with the mortgage crisis or the
9 housing market or anything like that? Well, there are
10 a number of different perspectives in which you can
11 examine this overall issue.
12 The issue in which we have some authority
13 is the enforcement of federal legislation or
14 regulation or policies intended to prevent
15 discrimination in housing and mortgage lending that
16 may have contributed to weakening credit standards,
17 lending standards, creating pools of risk, borrowers
18 unable to meet their financial obligations, and
19 anything else we can get our hands on. We will take
20 authority over everything and jurisdiction over
21 everything we can.
22 (Laughter.)
23 ACTING CHAIRMAN KIRSANOW: We are also
24 going to examine very closely any evidence that
25 minority homeowners were somehow unfairly targeted or

1 otherwise treated in a discriminatory fashion by
2 lenders in terms of their own lending policy.
3 Typically what we do is after we have a
4 hearing such as this, we keep the record open for a
5 period of 30 days so that supplemental comments can be
6 submitted to the Commission. If someone has
7 supplemental comments to submit to the Commission,
8 send them to the Office of the General Counsel here at
9 the U.S. Civil Rights Commission, 624 9th Street,
10 Northwest, Washington, D.C. 20425.
11 As I said, we have got a number of
12 witnesses today. They will consist of three panels,
13 but, in fact, those panels will be bifurcated in
14 panels 1 and 2. There are going to be various facets
15 of this particular issue that we are going to cover
16 today.
17 Given the fact that we have got a number
18 of people who have got travel commitments and this
19 will probably prove to be a fairly lengthy hearing, I
20 am going to Draconianly enforce the speakers' time
21 restraints and also that of the commissioners when we
22 ask questions. I know that we will be able to have a
23 very informative presentation and done so in an
24 efficient fashion if we do so. And please forgive me

1 if I act arbitrarily, capriciously. That is my
2 nature.
3 So, if you could, if you could keep your
4 comments to just ten minutes, please?
5 COMMISSIONER YAKI: The Chair has a
6 present theory that life is nasty, brutish, and short.
7 ACTING CHAIRMAN KIRSANOW: Absolutely,
8 very Hobbesian. If we can keep the comments to ten
9 minutes and possibly even less than that, that would
10 be greatly appreciated. Again, we will have the
11 opportunity for follow-up questions, have the
12 opportunity to submit supplemental comments.
13 And also with respect to commissioners, if
14 each commissioner could limit their comments or
15 questions to no more than a total of five minutes per
16 panel, that would be greatly appreciated so that we
17 can get everybody out of here on time.
18 What we are going to do also given the
19 fact that we have got essentially five panels, we are
20 going to take a 5-minute break after the first panel
21 and then a 20-minute break after the second panel so
22 people can tend to whatever e-mail business they may
23 have and maybe get a cup of coffee or something to
24 eat.
25 II. SPEAKERS' PRESENTATIONS

1 PANEL 1 -
2 THE EFFECTS OF THE COMMUNITY REINVESTMENT ACT AND
3 ITS ALLEGED EFFECTS ON THE MORTGAGE CRISIS
4 ACTING CHAIRMAN KIRSANOW: So the first
5 panel we have has to do with the Community
6 Reinvestment Act and whether or not it has had any
7 effect on the mortgage crisis. The Community
8 Reinvestment Act is designed to encourage home
9 ownership in low and moderate-income neighborhoods by
10 encouraging banks to invest in those communities.
11 Now, as I stated before, the panels will
12 be bifurcated given the limited amount of seating that
13 we have and the fact that our panel number 1 actually
14 consists of more than just the three individuals
15 currently seated there.
16 So we are going to hold our questions
17 until both panels of the first panel testify. And
18 then we will recall the first set of panelists
19 currently seated at the table so that they can
20 participate in questioning.
21 I am going to introduce the first panel in
22 seriatim. And then after I introduce each of you,
23 then we will begin with Mr. Wides. And then we will
24 proceed in order.

1 Now, I know many of you have contributed
2 biographies that are really spectacular. And I
3 apologize for not being able to read publicly all of
4 them. Otherwise we would be here all day long. We
5 have got, as I said, really distinguished panelists
6 who have done a lot of work in these areas. And I
7 think we will be presenting very interesting
8 testimony.
9 On the first panel, our first witness will
10 be Mr. Wides, Barry Wides, who is Deputy Comptroller
11 for Community Affairs at the Office of Comptroller of
12 the Currency. Prior to joining the OCC in 1991, he
13 was Director of Affordable Housing Sales at Freddie
14 Mac and Deputy Director of the Resolution Trust
15 Corporation's Affordable Housing Program.
16 Our second panelist is Mr. Luke Brown. He
17 is Associate Director at the FDIC and directs the
18 Compliance Policy Branch and serves as Chair of the
19 FDIC's representative to the Federal Financial
20 Institution's Examination Council's Consumer
21 Compliance Task Force.
22 Wow. Do you have a button? And how big
23 is it?
24 (Laughter.)

1 ACTING CHAIRMAN KIRSANOW: Before joining
2 the FDIC, Mr. Brown headed the Regulatory Affairs
3 Group at Fannie Mae.
4 And our third witness on this particular
5 panel is Glenn Canner, Ph.D., Senior Adviser in the
6 Division of Research and Statistics of the Board of
7 Directors of the Federal Reserve. His current areas
8 of specialization are home mortgage and consumer
9 lending with a strong focus on fair lending laws and
10 community reinvestment issues. Whereupon,
11 BARRY WIDES, LUKE BROWN, and GLENN CANNER were called as a
12 panel of witnesses by the United States
13 Civil Rights Commission and, having been first duly
14 sworn, was examined and testified as follows:
15 ACTING CHAIRMAN KIRSANOW: Thank you very
16 much.
17 Now, as I said before, we are going to try
18 to keep it to ten minutes each. And then we will wait
19 until each one of the panelists currently seated has
20 completed their testimony before we open it up to
21 questions.
22 So, Mr. Wides, if you could begin, we
23 would appreciate it.
24 PANEL 1A

1 MR. WIDES: Okay. Thank you. Members of
2 the Commission, we appreciate the opportunity to
3 participate in today's briefing on the subprime
4 mortgage crisis.
5 My name is Barry Wides. I serve as Deputy
6 Comptroller for Community Affairs at the OCC. The OCC
7 is a bureau within the U.S. Treasury Department which
8 is charged with chartering, regulating, and
9 supervising the national banking system. The OCC
10 regulates approximately 1,600 national banks as well
11 as 50 branches of foreign banks operating in the
12 United States representing about two-thirds of the
13 total assets in U.S. commercial banks as of the end of
14 2008.
15 Given the OCC's jurisdiction over national
16 banks subject to CRA, I will focus my remarks on the
17 erroneous connection some have made between CRA and
18 the current mortgage crisis.
19 Let me start off by saying unequivocally
20 that CRA is not the culprit behind the abuses in the
21 subprime mortgage lending nor the broader credit
22 quality issues in the marketplace, as some have
23 suggested.
24 CRA lending and investment have been
25 responsibly underwritten and conducted in a safe and

1 sound manner. The CRA was enacted by Congress in 1977
2 to encourage banks and thrifts to increase their
3 lending and services to low and moderate-income
4 persons and areas in their communities consistent with
5 safe and sound banking.
6 It also requires the federal financial
7 supervisory agencies to assess the record of each
8 covered institution in helping to meet the credit
9 needs of its entire community, including low and
10 moderate-income individuals and neighborhoods.
11 The CRA applies only to banks and savings
12 associations whose deposits are insured by the FDIC.
13 Affiliates of insured depositories that are not
14 themselves insured depository institutions are not
15 directly subject to the CRA, nor are credit unions or
16 independent mortgage companies.
17 Under regulations implementing CRA,
18 financial supervisory agencies take into account a
19 bank's performance under CRA when deciding whether to
20 approve an application by a depository institution to
21 establish a branch, relocate a branch or main office,
22 merge with or acquire another insured depository
23 institution or convert an insured depository
24 institution to a national charter.

1 Neither the CRA nor its implementing
2 regulations provides specific thresholds and ratios
3 applicable to the examination or application processes
4 I just referred to. Rather, the rules contemplate an
5 evaluation of each lender's record, taking into
6 consideration individual institutions' business model
7 and the environment in which it operations. An
8 institution's capacity to help meet community credit
9 needs is influenced by many factors, including its
10 financial condition and size, resource constraints,
11 legal impediments, and local economic conditions that
12 could affect the demand and supply of credit.
13 Examiners must consider these factors when
14 evaluating an institution's performance under CRA.
15 The CRA regulations prescribe different evaluation
16 methods tailored to respond to differences in
17 institutional size, structure, and operations.
18 However, the majority of assets in the
19 national banking system or in banks governed by what
20 is called the large bank examination procedures, these
21 procedures apply to institutions with assets over
22 $1.109 billion and include 3 tests: the lending test,
23 the investment test, and the service test.
24 The lending test performance criteria
25 focus on the number and amount of home mortgages,

1 small businesses, small farm, and community
2 development loans originated and purchased in the
3 bank's assessment areas; two, the distribution of the
4 bank's lending to individuals of different income
5 levels and businesses and farms of different sizes;
6 and, three, the bank's performance and lending to
7 geographies within its assessment areas.
8 The investment test is used to evaluate a
9 bank's record in helping to meet the credit needs of
10 its assessments areas to investments with the primary
11 purpose of community development while the service
12 test considers the retail and community development
13 services that the bank has provided.
14 Generally OCC examiners evaluate each
15 large bank's CRA performance every three years. Upon
16 conclusion of the CRA examination, the OCC provides
17 the bank with a written performance evaluation, which
18 is a public document, all of which are published on
19 the OCC's Web site.
20 By statute, the ratings that a bank
21 receives are either outstanding, satisfactory, needs
22 to improve, or substantial noncompliance. There has
23 been much public discussion over the past several
24 months concerning whether CRA may have contributed to
25 the mortgage crisis.

1 The discussion has focused on the
2 connection between CRA-related lending to low and
3 moderate-income borrowers and what some allege to be a
4 disproportionate representation in failing subprime
5 loans.
6 The OCC and the other federal bank and
7 regulatory agencies have been looking at this question
8 in some detail. And all four agencies have concluded
9 that the CRA is not responsible for the mortgage
10 crisis. In analyzing independent studies and
11 comprehensive home lending data sets, we have
12 concluded that only a small portion of subprime
13 mortgage originations are related to CRA.
14 CRA-related loans appear to perform
15 comparable to or better than other types of subprime
16 loans. For example, single family CRA-related
17 mortgages offered in conjunction with NeighborWorks
18 organizations have performed on par with standard
19 conventional mortgages.
20 Foreclosure rates within the NeighborWorks
21 network were just 0.21 percent in the second quarter
22 of 2008 compared to 4.26 percent of subprime loans and
23 0.61 percent for conventional conforming mortgages.
24 Similar conclusions were reached in a
25 study by the University of North Carolina's Center for

1 Community Capital, which indicates that the high-cost
2 subprime mortgage borrowers default at much higher
3 rates than those who take out loans for CRA purposes.
4 Overwhelmingly, CRA lending has been safe
5 and sound. The Federal Reserve Board has reported
6 extensively on these findings for all CRA loans.
7 Federal Reserve Board study of 2005-2006 Home Mortgage
8 Disclosure Act data show that banks subject to CRA and
9 their affiliates originated or purchased only six
10 percent of the recorded higher-price loans made to
11 lower-income borrowers within their CRA assessment
12 areas.
13 The Federal Reserve also found that less
14 than two percent of higher-priced and CRA-eligible
15 mortgage originations sold by independent mortgage
16 companies in 2006 were purchased by CRA-covered
17 institutions.
18 Federal Reserve loan data analysis also
19 found that 60 percent of higher-priced loan
20 originations went to middle or higher-income borrowers
21 or neighborhoods and, further, that more than 20
22 percent of the higher-priced loans extended to
23 lower-income borrowers or borrowers in lower-income
24 areas were made by independent non-bank institutions
25 that are not covered by CRA.

1 OCC's analysis of lending by banks that we
2 regulate also confirms that the vast majority of
3 subprime loans were not originated by national banks
4 supervised by the OCC. In 2006, subprime lending by
5 national banks amounted to roughly ten percent of
6 total subprime mortgage originations by all lenders.
7 Further, our analysis shows that subprime
8 and alt-A loans originated by national banks defaulted
9 at lower rate than those originated by non-bank
10 lenders.
11 Our analysis compared the foreclosure
12 start rates for loans originated between 2005 and 2007
13 that were placed in subprime or alt-A securities.
14 These loans originated by OCC-regulated institutions
15 defaulted at roughly two-thirds the rate of comparable
16 loans originated by non-bank lenders.
17 In conclusion, I want to reiterate my
18 belief that the CRA has made a positive contribution
19 to community revitalization across the country and
20 generally encouraged sound community development
21 lending, investment, and services initiatives by
22 regulated banking institutions. Only a small
23 percentage of higher-priced loans were originated by
24 CRA-regulated lenders to either lower-income borrowers
25 or neighborhoods in bank CRA assessment areas.

1 Similarly, banks purchased only a small
2 percentage of higher-priced CRA-eligible loans
3 originated by independent mortgage companies.
4 And, finally, the performance of
5 higher-cost loans originated by national banks is
6 markedly better than loans originated by non-bank
7 institutions.
8 Thank you for the opportunity to appear
9 today. And I will be pleased to respond to your
10 questions at the appropriate time.
11 ACTING CHAIRMAN KIRSANOW: Thank you, Mr.
12 Wides.
13 Mr. Brown, you are up.
14 MR. BROWN: Thank you. Members of the
15 Commission, good morning to you. And thank you for
16 inviting me here to speak about the FDIC's role in
17 evaluating Community Reinvestment Act and our
18 involvement in looking at CRA in the midst of the
19 mortgage crisis.
20 The FDIC has three main missions. We
21 serve as federal supervisor of non-Federal Reserve
22 member banks. We serve as deposit account insurer for
23 financial institutions and receiver of closed banks.
24 The CRA was signed into law 30 years ago,
25 on October 12th, 1977. The purpose of the CRA is to

1 encourage banks to serve the credit needs of their
2 entire communities, including low and moderate-income
3 neighborhoods, consistent with safe and sound lending
4 practices. I emphasize consistent with safe and sound
5 lending practices.
6 At the time CRA was enacted, there was a
7 severe shortage of credit available to low and
8 moderate-income neighborhoods and concern about racial
9 redlining and discrimination.
10 Studies have pointed to increases in
11 lending to low and moderate-income customers and
12 minorities in the decade since the CRA's passage. For
13 example, a study by the Joint Center for Housing
14 Studies at Harvard University reported that HMDA data
15 from 1993 through 2000 shows that home purchase
16 lending to low and moderate-income people living in
17 low and moderate-income neighborhoods grew by 94
18 percent, more than in any other income category.
19 However, the success has been overshadowed in recent
20 months by critics asserting that CRA caused the
21 financial crisis.
22 A complex interplay of risky behaviors by
23 lenders, borrowers, and investors led to the current
24 financial storm. As we all know, there is plenty of

1 blame to go around, but when it comes to laying the
2 blame on CRA, we disagree.
3 Studies have shown that only about one in
4 four higher-priced first mortgage loans were made by
5 CRA-covered banks during the peak years of subprime
6 mortgage lending. The rest were made by private,
7 independent mortgage companies and large bank
8 affiliates not covered by CRA rules.
9 Recently, some commentators have alleged
10 that the government told banks they had to make loans
11 to people who were bad credit risks who could not
12 afford to repay just to prove that they were making
13 loans to low and moderate-income people. That is
14 simply wrong.
15 The CRA affirmatively states that banks
16 must make loans consistent with safe and sound lending
17 practices. The FDIC believes the lending practices
18 that are causing problems today were driven by a
19 desire for market share and revenue growth.
20 CRA encourages FDIC-insured banks to lend
21 in low and moderate-income areas. The CRA regulations
22 always recognize that there are limitations on the
23 potential volume of lending in low-income areas due to
24 safety and soundness considerations.

1 It also recognizes that a bank's capacity
2 and opportunity for safe and sound lending in
3 lower-income communities may be limited. That is why
4 CRA never set lending target or goal amounts. CRA was
5 intended to expand access to credit and reduce
6 discriminatory credit practices.
7 Consistent with safe and sound operations,
8 CRA assigns regulated financial institutions a
9 continuing and affirmative obligation to help meet the
10 entire credit needs of their communities, including
11 the needs of low and moderate-income neighborhoods.
12 The CRA evaluation process. FDIC
13 examiners evaluate the CRA performance of
14 approximately 5,200 institutions under the
15 corporation's supervision. For most institutions,
16 this performance is evaluated under tests that draw
17 distinctions among institutions based on their size
18 and business strategies.
19 When conducting CRA evaluations, examiners
20 consider factors such as the business opportunities
21 available as well as the size and financial condition
22 of institutions.
23 Upon the consideration of each
24 examination, the examiner prepares a written
25 examination of the institution's record of meeting the

1 credit needs of the entire community, including low
2 and moderate-income neighborhoods.
3 The written evaluation must have a section
4 available for public disclosure. The FDIC and other
5 financial institution regulatory agencies facilitate
6 public review of CRA evaluations by posting them on
7 their Web sites.
8 The nature and effect of CRA ratings. The
9 agencies assign each institution one of four
10 performance ratings: outstanding, satisfactory, needs
11 to improve, and substantial noncompliance.
12 Determining the CRA rating for an
13 institution involves an assessment of a number of
14 qualitative and quantitative factors against a
15 backdrop of the institution's performance context.
16 To foster consistency in this process, the
17 agencies rely upon a matrix which sets forth a
18 description of the elements of the various tasks and
19 what performance level is required of the rating.
20 Unlike fair lending or other regulatory violations,
21 which can be addressed through mandatory corrective
22 action and financial penalty, CRA is enforced through
23 the application process and the public disclosure of
24 ratings. Instead, it essentially incentivizes
25 financial institutions to act.

1 The FDIC takes an institution's CRA
2 performance into account when evaluating its
3 applications for deposit facilities. Such
4 applications must be submitted when an institution
5 proposes to open a branch, relocate a home office,
6 merge, or acquire another institution.
7 In evaluating these applications, the FDIC
8 must take into account the applications', applicant
9 institutions', CRA performance, as well as the views
10 expressed by any interested parties about
11 institutions' CRA performance. The FDIC can deny or
12 conditionally approve applications based on CRA
13 concerns, the effect of fair lending violations on CRA
14 ratings.
15 Consistent with the 2005 amendments to the
16 interagency CRA regulations, illegal credit practices,
17 including violations of fair lending laws, are
18 considered when evaluating CRA performance and may
19 result in lower CRA ratings.
20 Evidence of discriminatory or other
21 illegal credit practices considered as part of CRA
22 evaluation includes but is not limited to
23 discrimination against applicants on a prohibited
24 basis in violation of ECOA, violations of HOEPA,

1 violations of section 5 of the FDI Act, violations of
2 section 8 of RESPA, and violations of TILA.
3 The 2005 amendments strengthen CRA
4 regulations in several respects. First, they
5 expressly incorporate into the regulation the specific
6 statutory example cited above. Second, the amendments
7 clarify the illegal credit practices carried out in
8 any geography could have negative impact on an
9 institution's CRA rating.
10 This part of the amendment made clear that
11 the agencies could consider lending discrimination
12 that had occurred outside of financial institutions'
13 CRA assessment area.
14 Finally, the amendments added express
15 coverage of illegal credit practices by an affiliate
16 within the institution's assessment area if the
17 relevant lending were considered as part of the
18 institution's CRA performance evaluation.
19 The effect of an illegal credit practice
20 by an institution is determined in the overall context
21 of the institution's CRA performance. The FDIC's
22 regulation states that in determining the effect of
23 evidence of such practices on the bank's assigned
24 rating, the FDIC considers the nature, extent, and
25 strength of the evidence of the practice, the

1 policies, and procedures that the bank has in place,
2 preventive practices, any corrective action that the
3 bank has taken or committed, including voluntary
4 correction action resulting from self-assessment, and
5 any other relevant information.
6 The role of CRA in addressing current
7 challenges. CRA provides flexibility because it
8 contains broad goals without detailed requirements.
9 With its focus on the needs of the community, as
10 opposed to specific products or services, it allows
11 bankers to change their business activities in
12 response to changing credit demands.
13 It also allows federal financial
14 institution regulatory agencies to address emerging
15 issues and respond quickly to local and national
16 crises. For example, we extended CRA consideration
17 for activities that benefitted the Gulf Coast during
18 that period.
19 Today the FDIC is promoting the use of CRA
20 to encourage solutions to several key consumer
21 financial concerns, specifically encourage
22 alternatives for homeowners facing mortgage
23 foreclosures, addressing the demand for affordable
24 small credit, and the need for basic banking services
25 in many under-served areas. Those are issues that

1 Chairman Bair has championed and is aggressively
2 pursuing.
3 Foreclosure prevention. As you know, the
4 FDIC strongly supports sustainable loan modifications
5 for at-risk homeowners that appropriately balance the
6 interests of homeowners, servicers, and investors.
7 In April 2007, the banking agencies issued
8 guidance encouraging financial institutions to
9 consider prudent workout arrangements to keep
10 borrowers in their homes and made clear that there may
11 be able CRA considerations for programs to transition
12 low and moderate-income borrowers from high-cost to
13 lower-cost loans provided the loans are made in a safe
14 and sound manner.
15 However, the agency stated in a recent
16 release to interagency guidance that such loan
17 programs again should result in long-term affordable
18 sustainable homeowners because the last thing that we
19 want is for the problem to be kicked down the road.
20 Because Congress wrote CRA in a way that
21 allows for adaption to changing conditions,
22 CRA-implementing regulations allows flexibility. The
23 FDIC is prepared to work with partners consistent with
24 CRA's statutory requirements to resolve many of the
25 issues that we are facing today.

1 I am prepared to answer the Commission's
2 questions. Thank you for your time.
3 ACTING CHAIRMAN KIRSANOW: Thank you, Mr.
4 Brown.
5 And, finally, at least with respect to
6 this bifurcated panel, we have got Mr. Canner.
7 DR. CANNER: Members of the Commission, I
8 am pleased to be here today to present the results of
9 research conducted by the Federal Reserve staff on the
10 role of the CRA in the subprime mortgage crisis.
11 As the current mortgage market
12 difficulties have unfolded, an argument that the CRA
13 is at its root has gained a foothold. The argument
14 draws on the fact that the CRA encourages banking
15 institutions to help meet the credit needs of
16 lower-income borrowers and neighborhoods.
17 Critics of the CRA contend the law pushed
18 banking institutions to undertake high-risk mortgage
19 lending and defaults on these loans and spark their
20 current mortgage market difficulties.
21 To my knowledge, the critics of the CRA
22 have basic contention on lines of reasoning, rather
23 than analysis of relevant data. In my remarks, I will
24 discuss key features of the CRA and results from the

1 analysis of data that we have been doing to address
2 this issue.
3 On balance, the findings from available
4 data run counter to the contention that the CRA lies
5 at the root of or otherwise contributed in any
6 substantive way to the current mortgage crisis.
7 The CRA directs the banking agencies to
8 use their authority to encourage these institutions to
9 help meet the credit needs of all segments of their
10 local communities, including low and moderate-income
11 areas.
12 For the purposes of the CRA, the local
13 communities are the areas where banking institutions
14 have their branch offices and take deposits. The
15 banking agencies periodically assess the performance
16 of those institutions and then take those performance
17 evaluations into considerations when they are dealing
18 with applications.
19 I want to emphasize that the CRA instructs
20 banking institutions to fulfill their obligations
21 within the framework of safe and sound lending. The
22 CRA does not stipulate minimum targets or even goals
23 for the volume of loans, services, or investments
24 banking institutions must provide.

1 Over the years, the Federal Reserve has
2 prepared two reports for the Congress to provide
3 information on the performance and lending to
4 lower-income borrowers and neighborhoods, the
5 populations that are the focus of the CRA.
6 These studies have found that lending to
7 lower-income populations has been nearly as profitable
8 and performed similarly to other types of lending done
9 by CRA-covered lenders.
10 Before I turn to our recent analysis of
11 the data, I want to make two general comments
12 regarding the CRA and its possible connection to the
13 mortgage crisis. The first point relates to timing.
14 The current crisis is rooted in the poor
15 performance of mortgage loans made primarily over the
16 period of 2005 to 2007. If the CRA did indeed spur
17 the recent expansion of the subprime mortgage market
18 and subsequent turmoil, it would be reasonable to
19 assume that some change had occurred in the rules
20 during 2002, '03, '04, or '05.
21 In fact, nothing happened in that regard.
22 However, the CRA rules, as I said, had nothing happen
23 in that regard.
24 Second, considering the potential role of
25 the CRA in the current mortgage crisis, it is

1 important to account for the originating party. In
2 particular, mortgage companies not affiliated with
3 banking institutions originated a substantial share of
4 subprime mortgages. But they're not subject to the
5 CRA and has not directly been influenced by CRA
6 obligations.
7 I want to turn to the data analysis in
8 order to assess the merits of the claims that the CRA
9 was a principal cause of the current problems. The
10 analysis focuses on two basic questions. First, what
11 share of subprime originations are reasonably related
12 to the CRA? And, second, how have CRA-related loans
13 performed? The answers to these two questions shed
14 considerable light on the role of the CRA in the
15 subprime crisis.
16 First, with respect to the question
17 regarding loan originations, we determined what types
18 of lending institutions made subprime loans, to whom
19 the loans were made, into what types of neighborhoods
20 the loans were extended. The analysis, therefore,
21 depicts the fraction of subprime mortgages that could
22 be reasonably related to the CRA.
23 Using loan origination data obtained
24 pursuant to HMDA, we find that in 2005 and 2006, 55
25 percent of subprime originations were made to middle

1 or higher-income borrowers or neighborhoods'
2 populations. And they're simply not the target of
3 CRA.
4 Of the subprime mortgages that were
5 extended to lower-income borrowers for borrowers in
6 lower-income neighborhoods, independent mortgage
7 companies; that is, institutions not covered by the
8 CRA, originated nearly half of these loans.
9 In total, of all the subprime loans
10 originated in 2005 and '06, only 6 percent were
11 extended by CRA-regulated lenders or their affiliates
12 to either low-income borrowers or neighborhoods within
13 the local communities.
14 Having said this, it's possible that CRA
15 might have indirectly encouraged independent mortgage
16 companies to undertake some lending because examiners
17 give banking institutions credit for loans they
18 purchase.
19 We have looked at the HMDA data once again
20 here. So the data suggests that the link between
21 independent mortgage companies and banks through
22 direct secondary market transactions is very weak.
23 For example, in 2006, less than two
24 percent of all the mortgage originations sold by
25 independent mortgage companies were subprime and made

1 to lower-income borrowers or neighborhoods and to
2 banking institutions covered by the CRA.
3 In sum, the evidence indicates that only a
4 very small share of subprime lending can reasonably be
5 linked to the CRA. This suggests that unless
6 CRA-related loans perform far worse than other loans,
7 it is very unlikely that the CRA could have played a
8 substantial role in the crisis.
9 Let me turn to the performance
10 information. To assess the relative performance of
11 CRA-related subprime loans, we looked at data from
12 First American loan performance and compared
13 delinquency rates for subprime loans in lower-income
14 zip codes relative to those in middle and upper-income
15 areas. The results indicate that delinquency rates
16 for subprime loans are high in all neighborhood income
17 categories.
18 In order to gauge more precisely the
19 possible independent effect of the CRA, we examined
20 the LP data a little more carefully and focused
21 attention on the subset of neighborhoods that are
22 similar except for their relationship to the CRA.
23 Specifically, we compared the performance of loans in
24 neighborhoods right above and right below the
25 neighborhood-to-income threshold that CRA uses.

1 As such, the only major difference between
2 these two sets of neighborhoods should be that CRA
3 focuses on one group but not the other. This analysis
4 indicates that subprime loans in neighborhoods that
5 are the focus of the CRA; that is, just below the
6 neighborhood-to-income threshold is used, performed
7 slightly better than the loans right above and
8 neighborhoods right above the threshold.
9 To gain further insight to the risks of
10 lending to lower-income borrowers, we compared the
11 performance of mortgages originated and held in
12 portfolio under the nationwide affordable lending
13 programs operated by NeighborWorks America to the
14 performance of loans of various types as reported by
15 the Mortgage Bankers Association of America.
16 Many loans originated through
17 NeighborWorks programs are done in conjunction with
18 banking institutions subject to the CRA. So the
19 performance of these loans provides a basis to assess
20 the relationship between CRA and the subprime crisis.
21 Along any measure of loan delinquency, the loans
22 originated through the NWA program have performed
23 better than subprime loans.

1 Another way to measure the relationship
2 between the CRA and the subprime crisis is to examine
3 foreclosure activity across neighborhoods.
4 Data on foreclosure filings from
5 RealtyTrac covering the period of January 2006 through
6 August 2008 indicates that most filings have taken
7 place in middle and upper-income neighborhoods.
8 More importantly, foreclosure filings have
9 increased at a faster pace in middle and higher-income
10 neighborhoods than they have in lower-income
11 neighborhoods.
12 In conclusion, two basic points emerge
13 from our analysis of the available data. First, only
14 a small portion of subprime mortgages are related to
15 the CRA. Second, CRA's related subprime loans appear
16 to perform about as well and perhaps even better than
17 other subprime loans.
18 Taken together, the available evidence
19 seems to clearly run counter to the contention that
20 the CRA contributed in any substantive way to the
21 current mortgage crisis.
22 I would be pleased to answer any questions
23 you have.
24 ACTING CHAIRMAN KIRSANOW: Thank you very
25 much, Mr. Canner. And I want to thank the panelists

1 for being very timely in presentation of your remarks.
2 If you could yield your seats to panel 1b and if panel
3 1b can come forward, I would appreciate it.
4 At the conclusion of this subpanel, we
5 would ask those who have just completed their
6 testimony to return to the table so that we can begin
7 our questioning of the entire combined panel 1.
8 That is, with the first subpanel, I will
9 introduce each speaker and give a brief recitation of
10 their bio. And then if you could testify in order of
11 your introduction? And then we will forward
12 questions, as I indicated, until we have reconvened
13 both subsets. And then we will proceed on to the next
14 panel after that.
15 Let's see. I guess we have got everybody
16 here. Okay. Our first witness in this particular
17 subpanel is Howard Husock, who is Vice President of
18 the Policy Research and Director of Manhattan
19 Institute's Social Entrepreneurship Initiative. He
20 was formerly Director of Case Studies in Public Policy
21 Management at Harvard University's Kennedy School of
22 Government.
23 Mr. Stan Liebowitz is Professor of
24 Managerial Economics, University of Texas-Dallas and

1 Director of the Center for the Economic Analysis of
2 Property Rights and Innovation.
3 Ms. Marsha Courchane is Vice President of
4 Financial Economics Practice for Charles River
5 Associates. Her work focuses on issues in primary and
6 secondary mortgage markets, including fair lending,
7 affordable housing, credit scoring, origination,
8 pricing, securitization of mortgages.
9 Previously she was Director of Financial
10 Strategy and Research at Freddie Mac. Prior to that,
11 she was Senior Financial Economist at the Office of
12 Comptroller of the Currency.
13 And, finally, on this subpanel we have got
14 David Berenbaum, who is the National Community
15 Reinvestment Coalition's Executive Vice President.
16 The coalition is an association of more than 600
17 organizations. And they have no access to basic
18 banking services for America's working families.
19 Whereupon,
20 HOWARD HUSOCK, STAN LIEBOWITZ,
21 MARSHA COURCHANE, AND DAVID BERENBAUM were called as a
22 panel of witnesses by the United States Civil Rights
23 Commission and, having been first duly sworn, was
24 examined and testified as follows:

1 ACTING CHAIRMAN KIRSANOW: Thank you very
2 much. Good. We will start with Mr. Husock.
3 MR. HUSOCK: Thank you very much, Mr.
4 Chairman.
5 PANEL 1B
6 MR. HUSOCK: I should stress that I really
7 speak to you today as a policy journalist who has
8 following this issue for some decades, not as a
9 technical expert. But I hope, nonetheless, that I
10 will help you be able to engage these issues.
11 Almost nine years ago, writing for Forbes
12 magazine, I offered the following observations.
13 Hardworking upwardly mobile families don't need easy
14 credit. They desperately need tough credit standards
15 in order to have some assurance that they and their
16 neighbors can afford their investment and are likely
17 to maintain their properties. This is how
18 neighborhoods have built and preserved.
19 I was writing about the Community
20 Reinvestment Act and expressing the concern that it
21 risked undermining low-income communities by giving
22 lenders the incentive to make loans for reasons other
23 than or in addition to the best and time-honored one:
24 the ability of borrowers to repay. I continue to have
25 these fears.

1 This is not to assert, I should hasten to
2 add, that I believe that the CRA is the precipitant of
3 the mortgage crisis that we face now. I do not
4 believe that. However, I do believe that the current
5 situation provides an important moment to reflect on
6 the ongoing appropriateness of the CRA and the
7 companion standards known as the affordable housing
8 mandates for Fannie Mae and Freddie Mac. So there is
9 a philosophical connection, I believe, between our
10 present situation and these twin requirements. Let me
11 try to connect the dots.
12 Let's start by saying that it is not my
13 view that at the time of the original passage of the
14 act, the CRA, in 1978, that there was no justification
15 for it. But I do believe that these factors which
16 gave rise to it were an artifact of a regulatory
17 structure no longer in existence, not an inherent
18 problem with the U.S. banking system.
19 As many of you know, before the 1980s,
20 mortgage lending was largely the province of just one
21 sector of the banking industry, the so-called thrift
22 or savings and loan institutions. And they had a kind
23 of a deal with the government. They would pay
24 relatively low rates of interest in exchange for

1 charging relatively low interest rates for home
2 mortgage loans.
3 This limited spread strongly discouraged
4 risk and, combined with the lack of bank competition
5 at that time, undoubtedly led many low-income
6 neighborhoods in which house values were declining or
7 not increasing as fast as others to have limited
8 access to credit, the term "redlining," aptly
9 developed to describe the situation and caused many,
10 including myself at the time, to conclude that only a
11 legislative mandate can guarantee that those of modest
12 means struggling in urban areas would have access to
13 credit.
14 Until the Clinton administration, this
15 kind of CRA compliance was not a significant matter,
16 what amounted to an A for effort for outreach in
17 neighborhood newspapers and things like that. But the
18 Clinton Treasury Department's 1995 regulations did
19 change matters, requiring banks which wanted
20 outstanding CRA ratings to demonstrate numerically
21 that they were lending both in poor neighborhoods and
22 to lower-income households.
23 In my view, this new era of strict
24 enforcement was in response to conditions which no
25 longer existed. The bank deregulation of the 1980s,

1 begun, by the way, not by Republicans, by the Carter
2 administration's Federal Depository Institutions
3 Deregulation and Monetary Control Act, has put us on
4 the road to seeing sharp competition among mortgage
5 lenders.

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

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

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

23 As the leader of one such group told me
24 eight years ago, our job is to push the envelope. He
25 specified that he would use his so-called delegated

1 lending authority to make loans to households with
2 limited savings, significant debt, and poor credit
3 histories. So it is that we begin to see a connection
4 between CRA and our present troubles.
5 Quite sizeable pools of capital began to
6 be allocated in an entirely new way. Rather than
7 lending on the basis of an individual household's
8 demonstrated ability to repay, regulators were pushing
9 for lending to occur on the basis of additional
10 criteria.
11 Bank examiners began to use federal home
12 loan data broken down by neighborhood, income, and
13 race to rate banks on their CRA performance. In my
14 view, this stands traditional lending on its head.
15 They key difference, in sharp contrast
16 should the traditional regulatory emphasis solely on
17 safety and soundness, banks were now being judged not
18 on how their loans perform but on how many they made.
19 I am not even aware of banks having to report
20 specifically on how their CRA loans as a succinct
21 group performed.
22 As one former Vice President of Chicago's
23 Harris Bank once told me, you just had to make sure
24 you didn't turn anyone down. If anyone applies for a

1 loan, better to give it to them. A high denial rate
2 is what gets you in trouble.
3 It is no surprise that as early as 1999,
4 the Federal Reserve found that only 29 percent of
5 loans in bank lending programs established especially
6 for CRA compliance purposes could be classified as
7 profitable.
8 The White House observes today that the
9 impact of lax underwriting is felt most by
10 lower-income households who pay their bills on time
11 and find themselves living next to a house on which
12 foreclosure has occurred. Poor neighborhoods in order
13 to build both social and economic capital must rely on
14 the frugality and prudence of their residents.
15 As Congressional Budget Office analysts
16 Charles Capone and Albert Metz put it presently in
17 their 2003 study, "Mortgage Default and Default
18 Resolutions, Their Impact on Communities," once
19 neighborhood foreclosures start to rise, the
20 foreclosure cycle starts" --
21 ACTING CHAIRMAN KIRSANOW: Try saying that
22 three times.
23 MR. HUSOCK: I did it. Two is the magic.
24 It becomes progressively harder for other households
25 to sell their homes. Abandoned properties and blight

1 can destroy neighborhoods where low down payment
2 affordable housing programs are prevalent. This is
3 true, to be sure, whether the loans are made by
4 regulated lenders or unregulated mortgage companies.
5 But all were facilitated in some way by the extension
6 of CRA-type thinking and regulation to the secondary
7 mortgage markets through the government-sponsored
8 enterprises: Fannie Mae, Freddie Mac. I think their
9 activities are much more important for our present
10 situation than the CRA narrowly considered.
11 Beginning in 1992, the Department of
12 Housing and Urban Development pushed Fannie and
13 Freddie to buy loans based on criteria, in addition to
14 their creditworthiness.
15 The affordable housing goals and subgoals
16 authorized, ironically, by the Federal Housing
17 Enterprise's Financial Safety and Soundness Act became
18 ever more demanding and by 2005, required that Fannie
19 and Freddie strive to buy 45 percent of all loans from
20 those in low and moderate-income, including 32 percent
21 from central cities and 22 percent to very low-income
22 families.
23 As one former Fannie official told me,
24 both HUD and many advocates in the early 2000s were
25 anxious for the GSEs to extend credit to borrowers

1 with blemished credit. How will such goals met?
2 Crucially, subprime loans sold to Fannie and Freddie
3 could help the secondary mortgage giants meet their
4 affordable housing goals.
5 This is not to say that all or even a
6 majority of subprime loans were made for CRA purposes.
7 Clearly, the combination of cheap money, imprudent
8 borrowers made for a tremendous bubble.
9 But such loans, bundled into asset-backed
10 securities, could be and were purchased according to
11 the June 2007 HUD report, the GSE's funding of
12 affordable loans, especially by Freddie Mac, to help
13 fulfill its affordable housing goals.
14 Indeed, as recently as April of this past
15 year, Fannie actually boasted about, "mortgage
16 products and options," which included "reduced
17 requirements for down payment and closing costs,
18 choices for borrowers with less than perfect credit,
19 and flexibility to provide loans to home buyers with
20 no traditional credit history.
21 By insisting that such under-qualifiers
22 buyers be dealt into home ownership, we helped create
23 our present crisis. How many of the troubled Freddie
24 Mac/Fannie Mae loans were also used for CRA regulation

1 purposes, by those who originated them? That is
2 impossible to know.
3 Nor did CRA advocates, who have long
4 insisted that such loans were profitable, if not as
5 profitable as other mortgages, push for performance
6 tracking at the time of the lending. But they were
7 clearly implicated in our present situation.
8 The Bank of America, for instance,
9 reported in the third quarter of the year past the
10 non-performing CRA-eligible loans were a significant
11 drag on its 2008 income to that point, representing on
12 an annualized basis 29 percent of its residential
13 mortgage net losses.
14 I understand that looking at small
15 programs, like NeighborWorks, and the Small Sample of
16 North Carolina, are useful comparisons, but the big
17 bank reporting has not been analyzed in that same kind
18 of way. It is a long way from making loans which are
19 profitable, just less profitable than standard
20 mortgages, as CRA advocates have always claimed would
21 be the case, to 29 percent of net losses.
22 It undermines more the assertion that
23 traditional underwriting standards failed to capture
24 the likelihood of defaults by low-income buyers, a
25 view which has held since such buyers were especially

1 likely not to default because of the importance of
2 home ownership to them.
3 Whatever the extent of housing mandates in
4 increasing home mortgage delinquency and foreclosure,
5 it is most important at this point to look ahead. How
6 should we think about our financial system as it
7 relates to Americans of modest means?
8 It seems clear in retrospect that we have,
9 as a matter of policy, pushed too many households
10 towards home ownership using subsidies to do so. This
11 turned out to be a disservice to them.
12 We have in place the tools for a fair and
13 effective housing policy. Fair housing
14 anti-discrimination laws must be enforced to ensure
15 that prospective borrowers are not turned away for
16 non-financial reasons.
17 Credit scoring, which did not really exist
18 at the time of the original CRA passage, allows
19 lenders to differentiate among households of similar
20 incomes but different levels of frugality and thrift,
21 rather than through such illegitimate proxies as race.
22 We have the tools, in other words, to
23 judge those seeking credit as individuals, not as
24 residents of zip codes, census tracts, or income
25 groups.

1 In the wake of the current high levels of
2 default, delinquency, and foreclosure, it is in my
3 view incumbent upon proponents of all manner of
4 affordable housing mandates and renewal of the CRA and
5 its extension to specify what the problem is to what
6 such mandates continue to be the answer.
7 Why would the financial system deny credit
8 to households with good credit rating? If minority
9 households confront different terms than others with
10 equivalent qualifications, fair lending laws provide a
11 way to punish lenders engaging in such practice.
12 If more broadly we come to the conclusion
13 collectively that a long history of discrimination has
14 led to a situation in which members of minority groups
15 lag others in the accumulation of assets, there are
16 other ways to address that problem, rather than
17 distorting housing markets in the way that puts
18 neighborhoods at risk. Let us cease, then, to rely on
19 regulatory housing mandates and the political risk
20 they introduce into financial markets.
21 Thank you very much.
22 ACTING CHAIRMAN KIRSANOW: Thank you.
23 Mr. Liebowitz?
24 MR. LIEBOWITZ: Thank you.

1 Ladies and gentlemen, members of the
2 Commission, thanks for having me here and allowing me
3 to express my views on the mortgage meltdown. I am
4 going to go back to the beginning.
5 In the early 1990s, the banking industry
6 was under attack for presumably discriminating against
7 minority and poor applicants. The yearly publicity
8 surrounding the release of the HMDA data, which showed
9 the projection rates were related to race, was
10 enormous, but no conclusion was capable of really
11 being drawn from that data.
12 Thereupon, after creating what appeared to
13 be a data set that could allow analysts to determine
14 whether or not banks were discriminating, researchers
15 at the Boston Fed using that data that they
16 constructed did come to the conclusion that banks
17 discriminated.
18 Yet, when a colleague and I examined the
19 data used by the Boston Fed, we found hundreds of
20 obvious errors in a data set with only about 3,000
21 observations. Anyone who examined the minimum and
22 maximum values of the variables in the data set would
23 quickly have discovered some of these mistakes.
24 We found mortgages with implied negative
25 interest rates, mortgages that were sold in the

1 secondary market but had been supposedly rejected by
2 the mortgage lender, mortgages that didn't match up
3 with the original data, the HMDA data, that the Boston
4 Fed used as its starting point, and so on.
5 My colleague Ted Day and I concluded after
6 examining the possible impact of the errors on the
7 coefficient measuring discrimination that the Boston
8 Fed data set did not and could not provide evidence
9 that banks discriminated.
10 Our most fundamental point was that the
11 data set was so plagued by transcription errors, most
12 of which could not be checked for internal
13 consistency, that no conclusions could really be drawn
14 from that data set.
15 All the other researchers of whom I am
16 aware except the original Fed researchers agreed that
17 the data had serious problems, although these latter
18 researchers came to disparate conclusions about what
19 the results looked like after cleansing the data. The
20 over-arching point that the data itself could not be
21 trusted was largely ignored in the later studies.
22 Nevertheless, the Boston Fed results when
23 first announced were reported with great fanfare in
24 which was described as a landmark study. The Boston
25 Fed result was heralded by government officials in the

1 media as if the results had been written on stone
2 tablets and brought down from Mount Sinai.
3 It was suggested the day the results of
4 the study were made public, that no further research
5 on the subject was even necessary. This rush to
6 judgment by the regulatory and political community
7 appeared to be the order of the day. And later
8 criticisms of the study were largely disregarded.
9 The government then embarked on a
10 multi-faceted program to fix the problem that it was
11 so intent on finding. First, the government decided
12 to increase the home ownership rate, particularly for
13 poor and minority individuals.
14 Second, the government tried to weaken the
15 mortgage underwriting standards, beginning with a
16 booklet put out by the Boston Fed shortly after the
17 ink on their study had dried. By changing the
18 underwriting standards, the government was able to
19 pursue its policy without using its own money.
20 The new underwriting standards came to be
21 known as "Innovations in Mortgage Lending" or
22 "Flexible Underwriting Standards" by the supporters of
23 those standards, who apparently believe that there
24 were no costs in weakening the lending standards.

1 The CRA, which is the topic that seems to
2 be most heavily discussed today, was given some of the
3 credit by proponents of the weak underwriting
4 standards in helping to achieve those underwriting
5 standards.
6 But I want to make the point it's those
7 underwriting standards that were the problem, not the
8 CRA. Not everyone thought that the weakened
9 underwriting standards were a good idea. My co-author
10 and I thought, among others, that it was a dangerous
11 idea. And we said so.
12 When our paper was published, we warned
13 that the attempts to lower mortgage underwriting
14 standards would lead to a large increase in
15 foreclosures.
16 In a letter to the Fed's Board of
17 Governors, I warned that lowering the standards
18 combined with pouring trillions of dollars into
19 low-quality loans, would be a disaster -- that was the
20 actual word I used -- for the country. But the home
21 ownership trend had its own seemingly unstoppable
22 political momentum and the results from that much
23 worse than I imagined.
24 We all know the impact of the policy.
25 First, home ownership began to increase in the mid

1 1990s, which, predictably, led to an increase in the
2 housing prices a year or two later. Lax underwriting
3 standards enhanced speculative returns and eventually
4 led to an enormous bubble in housing prices.
5 Of course, the bubble burst. And many
6 individuals were left in houses they either couldn't
7 afford or didn't want. We are all familiar with the
8 current state of our financial system as a result of
9 what happened with the housing bubble.
10 Now, the last few months, as blame has
11 begun to be assigned for the current financial
12 problems, there has been an attempt to discredit a
13 bowdlerized version of the general thesis that I just
14 presented.
15 To put things in perspective, it is
16 helpful to use a simple analogy. Let's assume that
17 some owners of high-performance cars form a coalition
18 with the goal of eliminating traffic lights and speed
19 limits. Let's also assume that they represent only a
20 small portion of drivers but, nevertheless, are
21 successful at changing the laws. We could say, in
22 other words, that driving standards had been weakened.
23 Then, with no traffic lights and no
24 traffic speed limits, all hell breaks loose on the

1 roads. Traffic jams are everywhere. Accidents occur,
2 and injuries skyrockets.
3 Let's assume the economy is going to a
4 standstill by the dysfunctional transportation system.
5 Naturally the government would attempt to figure out
6 who caused this problem.
7 The owners of the high-performance
8 vehicles can point out, those who belong to that
9 group, that their vehicles make up only a small
10 proportion of all the vehicles stuck in traffic jams.
11 And, therefore, it can't be that the traffic jams are
12 due to them or their vehicles.
13 Further, they can point out that their
14 members incur fatalities at no higher rates than other
15 drivers of high-performance cars that do not belong to
16 their coalition. They can claim, therefore, that
17 their group has nothing to do with the traffic
18 problems that have befallen the country.
19 This is essentially the argument that has
20 been made by those who are trying to deflect attention
21 away from the true problem, which is the reduction in
22 lending standards, and, instead, saying it has to do
23 with just the CRA.
24 The problem was the decline in
25 underwriting standards. The most important cause of

1 that problem, which is almost never addressed, was the
2 propaganda that was put out by a small army of housing
3 analysts and community activists claiming that not
4 only that the weakened underwriting standards were
5 required from bankers to avoid engaging in
6 unintentional discrimination but, more importantly,
7 that such weak lending standards were actually sound.
8 Propaganda when officially blessed and
9 sanctioned can be very powerful. Once the propaganda
10 had been accepted as being correct, all mortgages
11 became potential outlets for flexible underwriting
12 standards.
13 Once the propaganda had been given the
14 stamp of approval by the academic and regulatory
15 community, rating analysts felt secure in providing
16 AAA ratings. And investors were happy to purchase
17 mortgage-backed securities.
18 The propaganda received positive
19 reinforcement when loans based on relaxed lending
20 standards seemed to be doing fine because the
21 continued increase in home prices kept the
22 foreclosures hidden from view.
23 But, instead of focusing on the claims and
24 causes for the relaxed underwriting standards, the
25 defenders of the status quo are trying to deflect

1 attention away from the standards and, instead, focus
2 solely on the CRA. Even then, their arguments are
3 often misleading.
4 Sometimes these defenders of the CRA point
5 out that many subprime loans were made by institutions
6 not covered by the CRA. This is true, but it's also
7 irrelevant because the CRA did cover most lenders back
8 in the early and mid 1990s when the underwriting
9 standards were first being weakened and the CRA could
10 be used as a cudgel on recalcitrant lenders.
11 Some defenders of the CRA claim that the
12 CRA loans were only a small percentage of all
13 defaults. This is also true and also irrelevant. As
14 my traffic analogy should make clear, once the
15 standards have been changed, everyone tends to be
16 affected in a similar manner.
17 Now that the general public sees the folly
18 of weak lending standards, most of the analysts who
19 were so strongly supportive of weakening the lending
20 standards are silent on the benefit of mortgage
21 innovations.
22 They are silent about allowing the
23 possibility of people to get mortgages with no money
24 down, no possibility of being able to make the monthly
25 payments at market interest rates. The housing

1 regulatory establishment failed to see or warn of the
2 foreclosures engendered by those policies. They
3 should be embarrassed by their performance, which hurt
4 poor and minority homeowners as well as everyone else.
5 Thank you.
6 ACTING CHAIRMAN KIRSANOW: Thank you, Mr.
7 Liebowitz.
8 Ms. Courchane?
9 DR. COURCHANE: Good morning,
10 Commissioners. I am Marsha Courchane, Vice President
11 of Charles River Associates. I want to thank you very
12 much for inviting me to testify today on the Community
13 Reinvestment Act.
14 The hearing today actually covers three
15 topics, not just the Community Reinvestment Act. And
16 I think all three of these topics are important for
17 understanding the current and potential impacts of the
18 crisis the U.S. is now facing in our mortgage markets.
19 Clearly a long-term goal of policy-makers
20 in the U.S. has been the reduction of financial
21 barriers to home ownership; for example, through
22 implementation of CRA and also through the affordable
23 housing goals set by HUD for the GSEs.
24 Both CRA and HUD's affordable lending
25 goals were implemented, in part, to address perceived

1 contemporaneous problems with mortgage markets. As
2 envisioned in 1977 and also today in 2009, CRA does
3 encourage federally insured banking institutions to
4 meet the credit needs of their communities while
5 maintaining a safe and sound operation.

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

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

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

23 And, as part of the GSE Act, HUD
24 established housing goals that were specifically meant
25 to help improve and increase the opportunities for

1 housing for low and moderate-income and other
2 under-served borrowers in neighborhoods.
3 Both CRA and the GSE Act were meant to
4 encourage financial institution participants in both
5 primary and secondary mortgage markets to meet the
6 housing needs of these borrowers in safe and sound
7 ways.
8 It was also meant to provide through
9 supervision and examination of the financial
10 institutions that meeting these needs not come at the
11 cost of predatory or discriminatory practices. The
12 current mortgage crisis has, however, forced the
13 consideration of not just access to credit for
14 homeowners but, rather, access to credit that is
15 compatible with sustainable home ownership, keeping
16 borrowers in the homes they purchased. Lessons
17 learned from the past decade will contribute, I hope,
18 to achieving that sustainability.
19 Rapidly changing credit and housing market
20 conditions in the past 15 years have markedly impacted
21 home ownership rates. Home ownership rates in the
22 U.S. increased steadily and significantly from 1995 to
23 2004 from 64 to 69 percent overall for the U.S.
24 Notably, however, no additional increase
25 in home ownership in the aggregate occurred with the

1 expansion of non-prime lending after 2004. By 2009,
2 in fact, the overall U.S. home ownership rate has
3 fallen to a level below what we saw in 2002.
4 As delinquencies and foreclosures mount,
5 putting the nation's homeowners and the economy at
6 risk, home ownership rates continue to decline. How
7 do we explain this reversal of fortune?
8 There has been a lot of recent research on
9 this topic by many. And they have emphasized the role
10 of structural changes in mortgage markets,
11 characterized by the extension of non-prime credit;
12 the progressive weakening of layered credit standards;
13 mispriced risks in both the primary and second
14 markets; and possibly misaligned incentives, which
15 have led to the meltdown.
16 Many have questioned whether the uneven
17 coverage of the financial regulatory system
18 contributed to the collapse. Some have questioned
19 whether CRA's or HUD's affordable lending goals were
20 responsible for the mortgage meltdown.
21 I am not of that view. In fact, CRA
22 loans, as has been pointed up by many here, were not
23 generally subprime, nor were the bulk of the
24 affordable loan purchases by the GSEs comprised of
25 risky subprime loans.

1 However, today specifically I want to
2 focus on CRA in light of the changing financial
3 landscape and address the role of regulation and
4 supporting responsible mortgage lending that could
5 encourage sustainable home ownership.
6 CRA has evolved considerably over the past
7 three decades. It continues to meet some of the goals
8 that were originally intended for CRA. As was
9 mentioned by others earlier today, CRA did not
10 contribute much to the subprime crisis in terms of the
11 percentage of loans. The number given to you earlier
12 today by Glenn Canner was about six percent.
13 This does not mean, however, that CRA's
14 reach and effectiveness have not been impacted by the
15 surge of subprime lending. In recent research that I
16 conducted with Bob Avery at the Federal Reserve Board
17 and Peter Zorn at Freddie Mac, we specifically looked
18 at CRA in the context of the changing financial
19 landscape.
20 Since the passage of CRA back in 1977, the
21 financial markets evolved in several ways that have
22 potentially important implications for CRA. First,
23 the share of overall financial activity covered under
24 CRA has declined substantially for two key reasons.
25 One is the growth of financial institutions not

1 covered by CRA and the reduction in the within
2 assessment area activity by the largest of the
3 CRA-regulated institutions.
4 Second, the footprint of those financial
5 institutions has increased dramatically. And
6 financial activity is no longer largely locally based.
7 Instead, the institutions operate across several
8 states and have nationally based operations. And they
9 conduct most of the financial activity.
10 Third, there has been an increase in LMI
11 lending, although much of it occurs outside the CRA
12 assessment areas. And that increase is observed for
13 both CRA-regulated and non-CRA-regulated institutions.
14 Finally, we do observe, again as has been
15 pointed out by others this morning, that CRA-regulated
16 institutions and particularly the top 25, which is
17 what we focused on in our research, disproportionately
18 get outstanding CRA ratings and do not get
19 unsatisfactory ratings.
20 At this time, however, we are, arguably,
21 in the midst of the most dramatic financial changes of
22 the past several decades. And some of those changes
23 will impact CRA and CRA regulations going forward.
24 What we have seen over the last 30 years
25 has been a dramatic increase in the market share

1 measured in dollars of single-family home mortgages
2 held by the top 25 regulated institutions.
3 Their share back in 1977 was only 20
4 percent, and it's grown to over 60 percent by 2007.
5 The share of mortgages in dollars held by small
6 CRA-regulated institutions fell from 40 percent back
7 in 1977 to only 15 percent now.
8 The increasing share of the mortgage
9 originations for the top 25 has also been quite
10 evident. Mortgages are increasingly originated by
11 depositories with a large and often national
12 footprint.
13 We have also seen a dramatic increase in
14 the share of originations by non-CRA-regulated
15 institutions from 17 percent in 1990 to a high of 40
16 percent in 1993. Since then the share of originations
17 by these non-CRA-regulated institutions has trended
18 downward a bit, but generally it's remained above 30
19 percent.
20 This rise in mortgage originations was
21 coincident with the rise in the importance of
22 securitization and the increasing role of subprime
23 lending as independent mortgage companies were not
24 subject to CRA regulations.

1 We also observed that the share of LMI low
2 and moderate-income CRA lending increased. In my
3 written testimony, I present the actual shares of LMI
4 mortgage originations over time, but they show a
5 fairly consistent trend across all types of
6 institutions with a general upward trend at the
7 CRA-regulated institutions up through 1996.
8 By 2004, that trend has leveled off, but
9 roughly the share of low and moderate-income mortgage
10 loans exceeded 30 percent for all sizes of
11 CRA-regulated institutions. So they were in this
12 measure meeting the goals that were set out for them.
13 As a consequence, low and moderate-income
14 borrowers and tracts were receiving a greater share of
15 the mortgage activity of the CRA-regulated
16 institutions. Moreover, these trends began when LMI
17 customers were, arguably, under-served.
18 For example, in 1990, if you look at
19 census data, 16 percent of owner-occupied
20 single-family homes were in LMI tracts, but the LMI
21 tract share for lending was only 10 percent of the
22 CRA-regulated institutions.
23 By 2007, the average CRA-regulated lender
24 share of loans in LMI tract has increased to 70
25 percent, a share equal to the 2000 census number for

1 the percent of owner-occupied single-family homes. So
2 there has actually been an increase in performance of
3 CRA over the past 15 years in reaching out to LMI
4 neighborhoods.
5 However, there also appears to be strong
6 evidence that LMI mortgage customers have enjoyed an
7 improvement in service from others than CRA-regulated
8 lenders.
9 While the CRA-regulated lenders increased
10 the share of mortgages from 26 to 34 percent in 2007,
11 those unregulated by CRA also increased their share
12 from 29 to 35 percent over the same period of time.
13 So the low/mod-income lending was coming about not
14 only from CRA-regulated but also from other
15 institutions.
16 The similarity of changes in the share
17 might be because lenders face different regulatory
18 environments. It can suggest either that the growth
19 of LMI lending comes from CRA or from something else.
20 And, for example, one of the other things that might
21 have prompted this increased share for everybody was
22 the enactment of the affordable housing goals for
23 Fannie and Freddie back in the mid 1990s.
24 But, due to several recent changes in
25 mortgage markets, we actually believe it is quite

1 likely we will see the CRA-regulated institutions
2 regain further market share.
3 The criticisms concerning the uneven
4 coverage of were they or were they not subject to CRA
5 will matter less because non-CRA-regulated
6 institutions are ceasing to exist. The subprime
7 lenders are mostly out of business. And the
8 investment banks have merged with the CRA-regulated
9 institutions.
10 We also expect to see further increases in
11 concentrations of the top lenders that are CRA-covered
12 will continue to have a larger share of the business.
13 We also believe that because the underwriting
14 standards have tightened significantly, there will be
15 a reduced share of high-priced originations.
16 What I am worried about is that this may
17 mean less access to credit for exactly those borrowers
18 CRA was meant to reach. And what we hope to see is
19 that that access to credit does not diminish as we
20 look at the impact of the subprime crisis on the
21 mortgage meltdown. Thank you very much.
22 ACTING CHAIRMAN KIRSANOW: Thank you, Ms.
23 Courchane.
24 Mr. Berenbaum?
25 MR. BERENBAUM: Thank you.

1 Good morning, Commissioner Kirsanow and
2 members of the Commission. My name is David
3 Berenbaum. I serve as the Executive Vice President of
4 the National Community Reinvestment Coalition.
5 NCRC is an association of more than 600
6 community-based organizations that promotes equal
7 access to banking services, including credit and
8 savings, to create and sustain affordable housing, job
9 development in vibrant communities for America's
10 working families.
11 The United States economy is unraveling at
12 a pace not seen in decades. The more than 600,000
13 jobs lost last month has contributed to a growing
14 concern that the unemployment rate could rise to 10
15 percent or higher before the economy rebounds.
16 At the center of the economy's instability
17 is the foreclosure crisis that has claimed 3.5 million
18 homes in the last year alone and threatens the loss of
19 an additional 8 to 10 million homes to foreclosure
20 over the next 5 years. The loss of wealth associated
21 with the collapse of the housing market is staggering.
22 More than $5 trillion in housing equity
23 has virtually evaporated since the foreclosure crisis
24 began. Major stock indexes have also been cut in
25 half, further contributing to decreased consumer

1 confidence, substantially reduced spending, lower
2 productivity, rising unemployment, and additional
3 foreclosures.
4 The magnitude of the economic decline has
5 led many observers to conclude that the current crisis
6 is "an equal opportunity financial nightmare." But
7 reality paints a different picture.
8 While few have been able to escape the
9 financial pain completely, African Americans, Latinos,
10 Native Americans, and many Asian subpopulations are
11 bearing the brunt of this national epidemic.
12 Even before the crisis, the unemployment
13 rate for African Americans was nearly double that for
14 non-Hispanic white workers. Today, as the national
15 unemployment rate rests at 8.1 percent, African
16 Americans and Latinos are mired in double-digit job
17 losses.
18 The unemployment rate for African
19 Americans is just under 14 percent, Latinos more than
20 11 percent, and non-Hispanic whites at a little over 7
21 percent. For young African American males, the rate
22 is 25 percent and climbing.
23 Before the crisis, African Americans and
24 Latinos held on an average a mere $10 and $12 of net
25 worth, respectively, for every $100 of saving for the

1 typical non-Hispanic White household. This
2 disproportionate impact of the foreclosure crisis on
3 African American/Hispanics forms a wider expansion of
4 a racial and ethnic wealth gap.
5 African Americans and Latinos were the
6 disproportionate target for unfair, deceptive, and
7 reckless lending practices that triggered the
8 foreclosure collapse and imploded the credit markets.
9 The situation is so dire in the African
10 American community that United For a Fair Economy, a
11 Boston-based policy group, estimates that African
12 Americans could experience the greatest loss of wealth
13 since reconstruction.
14 This morning I will focus my remarks on
15 the Community Reinvestment Act and the new CRA
16 Modernization Act of 2009 introduced in Congress last
17 week by Representatives Johnson and Gutierrez.
18 Later this morning, my colleague Jim Carr,
19 COO of the National Community Reinvestment Coalition,
20 will focus his remarks on the role of Wall Street,
21 related predatory and fair lending issues and
22 recommend solutions for your consideration.
23 Relative to CRA and the mortgage crisis,
24 it is important to note that CRA is one of the most
25 important laws for building wealth and revitalizing

1 neighborhoods, period. CRA provides incentives for
2 safe and sound lending, period, and should be more
3 broadly applied throughout the financial services
4 industry.
5 Had CRA been applied more broadly to
6 non-bank financial institutions and independent
7 mortgage providers, it is arguable that the
8 foreclosure crisis would not have occurred.
9 Current anti-predatory lending law is weak
10 and lacks adequate enforcement at the federal level.
11 In response to this, NCRC hopes to also work in the
12 111th Congress to enact comprehensive anti-predatory
13 lending laws in conjunction with CRA modernization.
14 To put it simply, option ARMs, toxic loan
15 products, no income verification loans, despite
16 representatives from panelists here, economists here
17 on this panel, were never CRA-related products.
18 CRA, simply put, is the antidote to the
19 current crisis in the housing and credit markets. I
20 am not going to go over how CRA works. I feel that
21 was presented already quite effectively in the
22 benefits of CRA.
23 A number, a number, of studies have
24 already, reports have been, presented by other
25 panelists on how CRA has leveraged substantial amounts

1 of loans and investments in low and moderate-income
2 communities and how that has a positive boarder
3 impact, both locally and nationally, on our economy.
4 To quote Sandra Browenstein, Director of
5 the Division of Consumer and Community Affairs, at her
6 congressional testimony last week before a consumer
7 credit subcommittee of the Financial Services
8 Committee, "I can state very definitively from the
9 research we have done that the Community Reinvestment
10 Act is not one of the causes of the current crisis.
11 "We have run the data on CRA lending and
12 where loans are located. And we have found that only
13 six percent of all higher-cost loans that were made by
14 CRA-covered institutions and neighborhoods targeted,
15 which would be low and moderate-income neighborhoods
16 covered by CRA. So I can tell you that is where you
17 are going." And this was to a Republican questioner.
18 "That CRA was not the cause of the loan crisis."
19 Additionally, Mr. Michael Milken,
20 President and COO of the Community Bank of Tri-County
21 Maryland, in testimony representing the American
22 Bankers Association before the same subcommittee
23 noted, "We really find CRA is a tool, not an obstacle.
24 And I mentioned that of all of our affordable housing

1 loans, that they are all current. And none of them
2 are in default."
3 From these reports, it should be noted
4 that CRA-covered depository institutions also do other
5 work beyond mortgage lending. Small business lending,
6 community development lending, access to quality
7 banking services are all critically important as we
8 move to a financially inclusive society.
9 CRA, as noted also in earlier testimony,
10 works to preclude foreclosure. Foreclosure prevention
11 is a very important element of what regulated
12 institutions are now doing.
13 And now to move to my conclusion with
14 regard to the CRA Modernization Act of 2009. NCRC and
15 our members have worked very closely with moderates
16 from both sides of the aisle in both the House and the
17 Senate to see the introduction of the CRA
18 Modernization Act of 2009.
19 This legislation will require CRA exams in
20 the great majority of geographical areas, banks
21 served. Currently CRA exam banks are in areas where
22 they have branches and not in other areas where they
23 lend for brokers, for example.
24 We will address racial disparities in
25 lending by requiring CRA exams to explicitly consider

1 lending and services to minorities, in addition to low
2 and moderate-income communities.
3 It will require that small business loan
4 data, including race and gender of small business
5 owner, be recorded. The Home Mortgage Disclosure Act
6 would also be linked to a new loan performance
7 database tracking foreclosures and loan modifications.
8 We do want that accountability. We have always wanted
9 that accountability, despite the representation of
10 another testimony today.
11 Insurance companies would also be required
12 to submit data similar to HMDA data in the future.
13 And, last and most significantly, as we look to the
14 role of the rating agencies, we look to the role of
15 financial service corporations, and we look to the
16 role of Wall Street, in fact, facilitating the entire
17 financial meltdown, we would apply CRA to a variety of
18 non-bank institutions, including independent mortgage
19 companies, mainstream credit unions, insurance
20 companies, and securities firms to promote responsible
21 lending and eliminate disparities in lending and equal
22 access to credit issues.
23 Inadequate regulatory oversight and
24 outdated consumer protection laws underscore the need
25 for a strong civil rights enforcement program,

1 anti-predatory lending legislation, and CRA
2 modernization.
3 We look forward to the dialogue that you
4 have done today and to working with the U.S.
5 Commission on Civil Rights. And I look forward to
6 answering any questions that you may have.
7 ACTING CHAIRMAN KIRSANOW: Thank you, Mr.
8 Berenbaum.
9 At this time, I would like to ask the
10 other three panelists who testified on the first
11 subpanel to come forward. Logistically it's maybe a
12 bit of a challenge.
13 Again, thank you very much. We will begin
14 the questioning. And, again, in consideration of the
15 fact that a number of panelists and/or commissioners
16 have got flight arrangements and we would like to get
17 out of here so that we can make those flights, I am
18 going to limit our questions to a total of one-half
19 hour. And if, in fact, we could terminate them prior
20 to that, that would be helpful.
21 Nonetheless, if there is something of a
22 great concern and usefulness, I will extend that,
23 obviously, but we are going to try to shoot for that
24 time frame.

1 So also logistically because you are kind
2 of arranged in a fashion that is a little haphazard,
3 if you could prior to beginning any response to any
4 questioning state your name so that the Court Reporter
5 can transcribe who it is who is responding? Okay?
6 Thank you very much.
7 Commissioners have any questions?
8 Commissioner Melendez?
9 III. QUESTIONS BY COMMISSIONERS AND STAFF DIRECTOR
10 COMMISSIONER MELENDEZ: Yes. First of
11 all, I want to thank all of the panelists for a
12 meaningful first panel. I would like to know and
13 basically have you comment on how you think the CRA is
14 working right now.
15 I know Mr. Brown mentioned that they
16 assisted in Katrina, in the Gulf. Could you comment
17 on what you think we're doing right now as far as
18 people, the situation?
19 MR. BROWN: Sure. The FDIC sees it as an
20 effective mechanism to incentify financial
21 institutions to invest in low-income areas and
22 low-income individuals, be sure that they are
23 receiving credit.
24 The example that I used essentially was
25 focused on the flexibility of CRA. And we can use it

1 in many ways. I mentioned the Gulf Coast. Another
2 example is we are in the midst of this foreclosure
3 crisis.
4 So CRA consideration can be used when
5 examiners are looking at a financial institution if
6 they have invested in foreclosure prevention programs
7 and even foreclosure counseling, for example.
8 So not only does CRA incentify lending in
9 certain areas, but it also can be used as events
10 change and regulators have been using that in
11 interpreting CRA to help provide credit to those
12 areas.
13 ACTING CHAIRMAN KIRSANOW: Commissioner
14 Taylor?
15 COMMISSIONER TAYLOR: Thank you.
16 This is a question which is a follow-up to
17 Commissioner Melendez's question. I practice in the
18 regulatory area generally. So I want you all to know
19 my bias and my perspective on this issue.
20 The CRA is not designed to address active
21 discrimination. It's designed to incentivize lending.
22 Translation: It's a regulation designed to change
23 corporate behavior. Correct?

1 Isn't the corporate behavior impacting the
2 underwriting standards? Isn't that the corporate
3 behavior the CRA is designed to impact and change?
4 MR. BERENBAUM: If I may, this is David
5 Berenbaum. I will start the topic, and then others
6 can jump in there.
7 You are absolutely right in pointing out
8 that CRA is not a punitive statute. It is an
9 incentivizing statute and safety and soundness is
10 critical to that.
11 And, frankly, I think if you speak with
12 any regulated institution, they will tell you that the
13 audits by the regulators are quite extensive looking
14 at safety and soundness issues, but the flip side of
15 that is that it has been an amazing law to promote
16 creativity in the open marketplace, develop new and
17 innovative products or housing developments, business
18 opportunities that meet community needs.
19 And that side of it has, frankly, never
20 really been celebrated enough.
21 COMMISSIONER TAYLOR: That sounds like a
22 yes to my question because none of those new creative
23 products can be created unless you change the
24 "traditional" underwriting standards and approaches.

1 MR. BERENBAUM: Yes, right. I mean, for
2 example, there are products developed for areas of the
3 colonials of Texas or New Mexico or other areas that
4 are quite unique for those areas. But the
5 underwriting review, especially for regulated banking
6 institutions, has been very, very strong.
7 You will never hear a regulated banking
8 institution describe an option ARM product as a
9 CRA-related product, even in areas of high-cost
10 housing, for example, because that would not meet the
11 test. Community advocates historically have not
12 supported non-prime or some of these toxic products.
13 So there is a very important distinction
14 there: creativity in the non-regulated areas of
15 industry versus regulated.
16 MR. LIEBOWITZ: If I could say something?
17 This is Stan Liebowitz.
18 From my understanding -- and I don't claim
19 to be an expert on the CRA -- there was a change in
20 1995 which was an important change. We said, "Instead
21 of looking at your behavior," the "you" being the
22 lenders, "we want to actually take a look at the
23 performance."
24 That was a big change, and I think it was
25 the wrong type of change. I think, in fact, looking

1 at behavior is, in fact, the type of thing you want to
2 look at or do banks appear to be trying to be fair in
3 your lending because once you start going beyond that
4 and say, "Well, we want to see the results," then you
5 start getting closer to quotas on we want to compare
6 the numbers here. And then it becomes very difficult
7 to know whether or not the difference in rejection
8 rates is due to discrimination or something else. And
9 you do tend to force change.
10 Now, as far as the reduced underwriting
11 standards, the fact is that the groups that were
12 pushing that in the mid 1990s were very much the
13 community activists. The groups that were supportive
14 of the Boston Fed manual on how not to discriminate in
15 your lending, where they were saying, "You shouldn't
16 be looking at those old standards of 28 percent and 36
17 percent affordability, and you shouldn't be looking at
18 having to come up with down payments and a whole lot
19 of these other reasons."
20 They were very supportive of weakening
21 them. And they argued that, in fact, particular types
22 of lenders didn't have -- those were not good markers
23 of whether or not they were going to be able to repay
24 their loans. All right?

1 So they were in favor of reducing the
2 traditional 20 percent down. And then if you don't
3 have it, you have to pay mortgage insurance and having
4 to have 28 percent and 36 percent of the monthly
5 income devoted to the mortgage.
6 There was a very serious attempt to weaken
7 those. And when they were weakened, you could find
8 papers. I have some that I referenced in a paper that
9 I wrote on this recently.
10 We are very happy that the people who were
11 pushing those changes were very happy with the
12 results. They were crowing about the great results
13 they were getting with the reduced underwriting
14 standards, but, in fact, it was those reduced
15 underwriting standards with large changes spread out
16 all over the place that led to the really bad loans
17 that has caused the problems that we have.
18 And so I think it is misleading to say
19 that oh, "everyone is in favor of soundness." And
20 everyone is in favor of loans that are good." But
21 everybody has a different idea of how you measure
22 that.
23 And it turns out that a lot of people
24 thoughout that it was perfectly safe to have these loans

1 with these very weak underwriting standards. And they
2 were wrong, but they won't say so.
3 ACTING CHAIRMAN KIRSANOW: Mr. Husock?
4 MR. HUSOCK: Nothing for me.
5 ACTING CHAIRMAN KIRSANOW: Okay. Ms.
6 Courchane?
7 DR. COURCHANE: I am just going to respond
8 to two things that Stan said. First of all, I often
9 work with the banks on the bank side and sometimes in
10 matters on the opposite side of David, but I would say
11 that back in the late 1990s, when I was still at the
12 OCC, we did not see community activists coming to us
13 pushing us to weaken lending standards.
14 I am also a little concerned about
15 throwing out the baby with the bath water, so to
16 speak. It was not just allowing people to have lower
17 down payments that led to the mortgage crisis. There
18 was responsible lending done with higher LTV ratio
19 loans.
20 In my mind, it's not like I want to
21 advocate for the toxic loans we have seen lately, but
22 it was a combination of weakening many, many standards
23 simultaneously, 500 credit scores, and 100 percent LTV
24 loans, and no verification of employment and income.

1 And it is the layering of those risks that I believe
2 led to the toxic loans.
3 So I actually still believe that we can
4 have responsible higher LTV lending. And that's
5 essential if we actually want to reach out to low and
6 moderate-income borrowers in minority neighborhoods.
7 So I do not believe it was the community
8 activists pushing for the weakened standards. I do
9 believe that public policy in general pushed us to try
10 to erase home ownership gaps between white
11 non-Hispanic in minority neighborhoods and a variety
12 of innovative products, some of which were toxic, were
13 developed to try to do that.
14 Also, the motivation may have been profit,
15 market share, and a lot of other things, but I don't
16 think changing standards one at a time would
17 necessarily have led us to where we are today.
18 ACTING CHAIRMAN KIRSANOW: Mr. Husock?
19 MR. HUSOCK: Okay. I just continue to
20 wonder. And now we have heard a reiteration of a
21 defense of the lower underwriting standards that were
22 not being defended supposedly, but I don't understand
23 why tough underwriting standards are not a friend to
24 those who are trying to struggle and get ahead.

1 The risk that foreclosures will occur
2 because underwriting standards are flexible puts those
3 with relatively small accumulated wealth at the
4 greatest risk. They lose everything because of
5 foreclosures.
6 Just, really, my mouth is open to hear
7 things in the name of expanding home ownership. And,
8 by the way, let's be careful about setting that out as
9 our public policy goal to say, "Well, we went from 64
10 percent to 69 percent." Was that good or bad?
11 Maybe it was actually not good. Maybe we
12 pushed through a variety of instruments to extend home
13 ownership beyond the actual rate of wealth. And maybe
14 gradual accumulation of wealth over time is
15 sustainable wealth, rather than changing corporate
16 behavior, right, not mandating underwriting standards,
17 changing corporate behavior, absent the accumulation
18 of wealth that really gives people a sustained chance
19 to keep that wealth.
20 MR. BERENBAUM: Mr. Kirsanow, since
21 community groups were represented and in response to a
22 question, I would like to jump in. I know time is
23 limited.
24 First, I can tell you with authority that
25 the membership of the National Community Reinvestment

1 Coalition had never, never called for home ownership
2 for anyone who cannot afford that home through a
3 responsibly underwritten loan product. It's as simple
4 as that in our entire history.
5 With regard to the representations being
6 made about low to moderate-income consumers here or
7 potential homeowners, I think there are two issues.
8 One, the data is ripe with smoke and mirrors. And,
9 two, it's replete with isms that continue to exist in
10 our society.
11 Frankly, the majority of homeowners facing
12 foreclosure now are middle-income white folk who have
13 received toxic products from Wall Street due to
14 regulatory failure.
15 The problem initiated in urban and core
16 areas, initiated because of discrimination targeted
17 against African Americans, Latinos, Asians, and
18 others, but, frankly, the failure on a regulatory and
19 an underwriting level is so extreme that it has gone
20 beyond even all fair housing issues.
21 The impact is stealing more wealth,
22 though, from protected classes and constituents whom
23 the Commission is concerned about. But I strongly
24 disagree with the representations that continue to be
25 made by those funded by industry or representing

1 industry that CRA or community advocates were in any
2 way responsible for this.
3 ACTING CHAIRMAN KIRSANOW: Mr. Husock?
4 MR. HUSOCK: I was just wondering who the
5 gentleman is referring to as funded by industry
6 because I just wonder who he is talking about here.
7 MR. BERENBAUM: I think it is
8 self-explanatory, sir,
9 MR. BROWN: This is Brown from the FDIC.
10 I do want to mention that this issue is a
11 little more settled than is being discussed here.
12 Safety and soundness should be connected with CRA for
13 comments.
14 And it's not just about underwriting.
15 It's also about going into a financial institution and
16 encouraging them, for example, to have a marketing
17 plan or a strategy to reach out to under-served areas,
18 under-served people. That's not necessarily about
19 lowering any standards in terms of underwriting.
20 So another example would be the borrower
21 who has decent credit, decent job, can get an
22 affordable loan, but they are steered to the wrong
23 loans. Maybe they would have access to the right
24 loans. So it's not all about underwriting.

1 CRA also identifies people that are a good
2 credit risk at the normal credit standards.
3 ACTING CHAIRMAN KIRSANOW: Commissioner
4 Gaziano?
5 COMMISSIONER GAZIANO: Yes. Thank you,
6 all. I wish I could ask you all questions. But since
7 I am limited to five minutes, I wanted to try to probe
8 Mr. Liebowitz on two matters regarding the Boston
9 Fed's manual, lending manual, whether it was community
10 activists who convinced them to do really silly things
11 or they decided to do really silly things on their
12 own.
13 I just want to understand, first, if you
14 could confirm for me or explain the theory that
15 underlaid it. As I understand it, they said that
16 these profit-maximizing lenders were really stupid
17 because they only were getting the cream of the
18 profit. We know better than the entire market where
19 the profit line is.
20 And, you know, these particular
21 loan-to-value ratios that they have established, you
22 know, they have drawn their line. And they think they
23 are getting every dollar of profit they can. But we
24 know better.

1 And if they just move the line here in
2 these five, is that kind of a necessary explanation
3 for -- you know, our study supports this theory. Can
4 you explain that?
5 MR. LIEBOWITZ: Yes. That would have to
6 be, in fact, the case that they were essentially
7 arguing that these would be good loans if you changed
8 the underwriting standards in particular ways. And,
9 therefore, if they were going to be good loans and
10 profitable loans, they were loans that were not being
11 caught.
12 The market hadn't previously realized that
13 they could get those good loans. And the Boston Fed
14 was doing them a favor by telling them, "Look, this is
15 how you can, number one, not discriminate, but at the
16 same time, you will actually increase your profits.
17 The thing that would be the really
18 unfortunate part about it is in the late '90s is when
19 they began the really private securitizing of these
20 loans.
21 And the increasing house prices already
22 went on the way at that point. And it looked like
23 they might have been right because those loans were
24 performing well. And, you know, common sense was sort
25 of thrown out the window.

1 So there was this quote that the Wall
2 Street Journal had with somebody who was from one of
3 the rating agencies. And he said, "Well, we were
4 looking at piggyback loans."
5 And all common sense said the piggyback
6 loans were where you get a first mortgage and any
7 percent down payment, but you get a second mortgage
8 for the 20 percent to make the first.
9 All common sense says those loans won't
10 perform as well as people who actually put down just
11 the one, 20 percent, put the real money down. But we
12 can't go with our gut. We have to go with the
13 numbers. And at that point, the numbers were saying
14 there's very little difference between them.
15 So they gave the same ratings, very same
16 ratings, to the two types of loans. It was
17 ridiculous. They should have gone with their gut
18 because their gut was not just common sense, but
19 simple economic understanding of the way markets work.
20 So there was a lot of thinking that people
21 understood how the markets work better than the market
22 participants early on. And they worked very seriously
23 to try to change the market.
24 And I should mention one other thing.
25 Since the people in Texas are the ones who are paying

1 me, I get paid by them, therefore, obviously what I am
2 about to say is very biased. The academics who are
3 writing very positively about the reduced underwriting
4 standards in the early 2000 period were giving some
5 credit to CRA for helping to lead to those reduced
6 underwriting standards.
7 Now, maybe they were wrong or maybe they
8 wanted to give CRA credit just because they like CRA
9 so much and it really had nothing to do with it. But
10 they were giving it credit back in the days when
11 they're not ashamed to give CRA credit for doing that.
12 So I do think that CRA --
13 COMMISSIONER GAZIANO: The second question
14 I would like to ask -- and then others can join in.
15 But to you since you talked about the importance of
16 the Boston Fed's manual and the study that supposedly
17 backed it up that you and others have questioned, why
18 did anyone care about this Boston Fed manual? To what
19 extent did it kind of take a life of their own?
20 And you have already testified, and I have
21 read some of your other articles about some of the
22 effects and how that fed a little bit back into the
23 CRA.
24 You know, I imagine or at least think that
25 one of the partial effects where there are these HUD

1 lending goals to Fannie/Freddie to buy up and some
2 lenders who may have thought the Fed manual was bunk
3 became convinced by it, became convinced by it. Maybe
4 someone said, "Well, there is no risk to us if our
5 loans are going to be bought back up." That is my
6 hypothesis.

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

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

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

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

24 The Boston Fed study, I don't think people
25 pay a lot of attention to the details. When I say,

1 "people," I mean the regulators and the industry. I
2 think it was largely a fig leaf. They wanted
3 something to which they could say, "Ah. We finally
4 have proof of something that they wanted to act on."
5 Whether it was true or not, they wanted to
6 act on it. They believed it was true perhaps or they
7 thought it was politically useful, but whatever it is,
8 they wanted to act on it.
9 The Boston Fed study gave them a chance to
10 do that, which is why the day it came out as a pure
11 study, people were saying, "We don't need anything
12 more. We don't need any more studies like this."
13 That's what the head of the Boston Fed
14 said. The OCC made a comment that said "This is
15 definitive. This is it. We don't need any." That's
16 not a way you study and find out what the truth is.
17 That's a way that you go ahead and do your politics.
18 COMMISSIONER GAZIANO: Sure, but the
19 lending manual itself, was it symptomatic or was the
20 manual itself relied on?
21 MR. LIEBOWITZ: I don't know whether or
22 not the manual was relied on. I think it was put out
23 there to tell banks, "Look, these are the marching
24 orders. And you should follow in line." That's what
25 I think.

1 COMMISSIONER GAZIANO: Anyone else?
2 ACTING CHAIRMAN KIRSANOW: Commissioner
3 Yaki? I'm sorry. Mr. Berenbaum wanted to respond.
4 MR. BERENBAUM: Well, first, I am not
5 quite sure which manual we are talking about, but if
6 we are talking about a policy that expands home
7 ownership for qualified homeowners, particularly in
8 areas that or communities that have had unequal access
9 to credit and not had equal quality to services, not
10 only is that realizing the American dream. That is
11 helping the tax base.
12 You know, again, there are a lot of
13 references today in others here. I have no problem
14 saying that home ownership remains, even in this
15 difficult time, a very critical part of sound
16 communities, of strong communities, of vibrant
17 communities, and American values. I don't think we
18 should step away from that. We need a correction.
19 And in deference to my colleagues, I do
20 believe my remark was taken out of context. I have
21 been on several different panels over the past two
22 weeks, including congressional testimony, where
23 remarks have been made that I really take strong
24 exception to, about members of the African American,
25 Latino community, low and moderate-income consumers.

1 I stand by what I said, but I wasn't intending it to
2 be taken personally or professionally by my colleagues
3 here.
4 ACTING CHAIRMAN KIRSANOW: Thank you.
5 Commissioner Yaki?
6 COMMISSIONER YAKI: Thank you. Thank you
7 very much, Commissioner Kirsanow.
8 One, I wanted to say I am pleasantly
9 surprised by the first panel. Usually I am one of the
10 people who says we have panelists of three people, and
11 we seem to draw conclusions from that. Here we have a
12 large number of people from different walks of life,
13 by different disciplines, and I am very pleased to see
14 that here.
15 I just had a quick question to ask for a
16 response on. I am someone who delves in civil rights
17 and in the past has done work, full disclosure, with
18 the groups who have worked on our CRA in California,
19 especially with the groups like Greenlining Institute
20 with Abby.
21 I would just like to get a response from
22 maybe Mr. Canner or others about the sort of ad
23 hominem attacks on the Boston Fed study that had been
24 made during this hearing.

1 DR. CANNER: So I am quite well-aware of
2 the Boston Fed study. Actually, I helped consult when
3 they were designing the questionnaire that was used in
4 the study. And I've done quite a bit of analysis
5 using that data over the years.
6 I would like to step back for a second and
7 start by trying to distinguish between what I would
8 call flexible underwriting and loose underwriting.
9 And the concerns expressed here are all of loose
10 underwriting, which I think demonstrably are related
11 to the problems we are having.
12 I think flexible underwriting is a little
13 different. I don't think there was any reason to
14 believe that the underwriting standards established in
15 the '30s, '40s, and '50s, when technologies were
16 different and information available was quite
17 different, including credit reference and credit
18 scoring, should be the only standards that are
19 consistent with safe and secure credit extensions.
20 And things change over time.
21 One of the things that the CRA I think did
22 contribute to was the notion that we ought to look
23 beyond the tight constraints of the underwriting
24 standards of the past to see if loans could be done
25 safely using flexibilities.

1 And so there has been and there was over
2 the course of the '80s and '90s some experimentation
3 in the layering of risks, if you will, but with
4 offsets, whether it was counseling or a higher credit
5 score being required when you allowed a lower down
6 payment.
7 The studies that the Federal Reserve
8 conducted for the Congress in 1993 and 2000, where we
9 interviewed organizations or questioned them,
10 demonstrated pretty amply that CRA-related loans
11 perform about as well as other loans and are about as
12 profitable. That's the first point.
13 The second point, this is a little more
14 subtle. And that is all the discussions here tend to
15 focus on any loan that is lower-income to a low-income
16 borrower or a low-income neighborhood as being caused
17 by or related to CRA. I think that is not true.
18 As an economist, what I think about the
19 effects of a law -- I don't want to measure what
20 occurs because of the law -- you are looking for the
21 marginal effect. And in this case, you would be
22 asking yourself the question, is all low-income
23 lending only because of the CRA or if CRA disappeared
24 tomorrow, would low-income lending disappear? The
25 answer is quite clearly no. There was actually

1 low-income lending going on before the CRA was
2 enacted.
3 So when we actually did our report to
4 Congress on the profitability and performance of CRA
5 lending, we did look at a section of the data that we
6 tried to capture that focused, really, on what was
7 driven by CRA, as opposed to what regulators routinely
8 count, which is all low-income lending. And it's a
9 very, very small part of the market. But, even in
10 that segment of the data, the lending for most of the
11 institutions was at least marginally profitable.
12 So all of that is to say flexible
13 underwriting I believe can be done safely and soundly
14 and can expand opportunities for people. And that is
15 different than the experience over the last few years,
16 which was, by the way, driven mostly, I think, by
17 independent mortgage companies that were clearly
18 driven by profits and market shares and are not
19 regulated by the CRA.
20 ACTING CHAIRMAN KIRSANOW: Okay. I do
21 have a couple of questions. The first is -- and I
22 think maybe this would be to Professor Liebowitz --
23 there was some testimony that it would be a good thing
24 to apply CRA more broadly; that is, to institutions
25 not currently covered, and that it would, frankly, be

1 an antidote to the crisis that we currently are
2 experiencing. What is your view of that? And I would
3 like anyone else who wants to chime in on that to
4 respond, too.
5 MR. LIEBOWITZ: Well, I'm not sure how it
6 would be an antidote to the current problem. I mean,
7 I am all in favor of having regulations that you think
8 are worthwhile so that, for example, the borrower
9 knows exactly the deals of the loan that he is
10 purchasing. And if there is a belief that that is not
11 the case, then you make it as clear as possible.
12 Maybe you make the guy write 20 times in a
13 row the way you help kids in school, you know, "I
14 understand that in 5 years, the interest rate is going
15 to go up by" X percent, have them do it. And then you
16 could say they definitely knew it.
17 And so to the extent that there are
18 regulations that inform it for the borrower, I think
19 that's fine. And to be national, instead of
20 statewide, I think that is fine as well. As far as
21 the CRA in general somehow helping the current
22 problem, I don't see how that would happen.
23 The claim that is made by those who want
24 to say that it's not just the underwriting standards,
25 I agree with Glenn that there are probably some amount

1 of changes to underwriting standards compared to the
2 ones that have been in place, that might have been
3 reasonable.
4 Once you start loosening them, though,
5 where is the dividing line between the flexible
6 underwriting standards and the loose underwriting
7 standards?
8 I am well-aware of the people who are
9 doing the research. And Glenn does lots of good
10 research. Where were they when the line was crossed
11 saying, "Stop. Stop. Stop. Stop" because it really
12 only took a bully pulpit to stop a lot of that to warn
13 people because warned off the secondary market to be
14 careful. None of that was done.
15 So when we crossed that line, wherever
16 that line was, no one seemed to know we crossed that
17 line. No one was stating we were crossing that line.
18 And it's not clear we really know where that line is
19 or that much study has really been done on exactly
20 where that line is relative to where the old
21 underwriting standards happened to be.
22 So I don't know offhand that, you know,
23 making the CRA cover more banks than it currently
24 covers would do much of -- the subprime originators
25 seem to have disappeared.

1 And the other thing is it's not just
2 subprime. The people who were in here who have a
3 certain point of view who were saying, "It's all CRA.
4 This is about the CRA. And it's all subprime," it's
5 not all subprime. Right now there are more prime
6 loans that are in foreclosure than there are
7 subprimes.
8 Now it's very close to 50/50, but the fact
9 is it's not just a subprime problem. And to say it is
10 is misleading. It's a prime problem as well. If you
11 include the alt-A's, those are usually lumped in with
12 the primes. And so when they say, "subprime A," do
13 they mean subprime and alt-A's?
14 We need to be sort of careful. It's not
15 just subprime. It's not just high interest rates.
16 Only 15 percent of the houses in foreclosure had an
17 increase in the interest rate on their mortgage from
18 when they first took it out. Eighty-five percent of
19 them had the same interest rate that they got
20 originally. So it's not "Oh, the interest rate is
21 going to go up" and then it did and they got caught.
22 They went to foreclosure before their interest rate
23 went up.

1 I see there is a lot of misinformation in
2 the way this tends to be discussed. So we need to be
3 careful about that as well.
4 ACTING CHAIRMAN KIRSANOW: Mr. Wides?
5 MR. WIDES: I would just add that I think
6 when you get to the panel talking about the Fannie Mae
7 and Freddie Mac, that that would provide a very good
8 opportunity to learn more about the changes in
9 underwriting standards over a particular time period,
10 let's say roughly 1990 through 2005, because their
11 underwriting stance is a matter of public record.
12 They published guides that were in the
13 public domain that they were driving a very
14 considerable portion of the market. And you can delve
15 in with the next panel about what percentage of the
16 market, but I think you can look at the standards over
17 that period of time.
18 And then the movement by the GSEs from
19 manual underwriting to automated underwriting and how
20 those models were is a way of really looking at this
21 question of how underwriting standards change over
22 time.
23 And in terms of the impact of underwriting
24 standards on housing prices, perhaps that was a factor
25 during the period when we saw the explosion of prices

1 with the explosion of the secondary market, the
2 unregulated sector, in terms of the subprime, the
3 payment option ARM, the interest-only, no-doc, low-doc
4 type of lending.

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

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

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

22 MR. BERENBAUM: If I could quickly jump
23 in?

24 ACTING CHAIRMAN KIRSANOW: Sure.

1 MR. BERENBAUM: You know, unfortunately,
2 fair lending and equal access to credit is an issue
3 that we need to pay constant attention to. I agree
4 with Glenn's point that, in fact, there was lending to
5 low-income communities before CRA, but I need to bring
6 the point out that over the past three years, NCRC has
7 filed ten complaints against lenders,
8 non-CRA-regulated lenders, who are, in fact, redlining
9 communities.
10 Now, we are not talking 1960s. We are
11 talking 2000s, where if a home is less than a certain
12 value, they will not lend. If it's a rowhouse, they
13 will not lend. If it's a tribal community, they will
14 not lend. There was no regulator to ensure
15 enforcement with the most basic of "Thou shalt not
16 redline."
17 So there is a purpose behind CRA. And,
18 again, these were safe and sound loans. There is no
19 business defense in these cases. And a number of the
20 lenders quickly said, "Oh, then they are now lending
21 to their credit." So there is an ongoing issue here.
22 ACTING CHAIRMAN KIRSANOW: Let me follow
23 up on that. I think there has been testimony that the
24 CRA acts as an incentive. Maybe it was Commissioner
25 Taylor's question that characterized it in that way.

1 As you indicated, this is not 1974, 1964,
2 but I would tend to think that in 2009, there was
3 probably less discrimination than there was in 1964
4 if, in fact, that is the case. And I don't know if
5 that is the case, but I think that is a reasonable
6 presumption.
7 If the CRA acts as an incentive, why
8 wouldn't it be the case that the market itself would
9 cause lenders if it were profitable to loan to
10 low-income individuals on the same basis? And why
11 doesn't the market drive what the interest rates that
12 are charged or other costs of lending would be as
13 rationally or as effectively as, say, a CRA-driven
14 rate would be or lending practice would be, open to
15 anybody?
16 MR. HUSOCK: Asked and answered, I would
17 say.
18 MR. BERENBAUM: I think that it gets to
19 where we are going as a nation in the coming decade
20 with regard to our national civil rights commitment
21 and how we partner with industry and Wall Street to
22 get beyond this current mortgage crisis right now.
23 We have a wonderful opportunity, you know,
24 out of the difficulties we are facing to engineer a
25 solution that will, in fact, celebrate community, the

1 individual, treat all Americans equally based on their
2 qualifications.
3 If we fail to do that, Mr. Carr later will
4 speak to how, frankly, that will -- we are going to be
5 on a very uncompetitive basis economically as the
6 middle class continues to shrink, there is more
7 pressure on low and moderate-income consumers.
8 We won't be able to compete globally if we
9 do not clean up within our own house here locally. We
10 must address the civil rights issues to move ahead
11 economically.
12 ACTING CHAIRMAN KIRSANOW: We are actually
13 beyond the 30 minutes I have prescribed by about 2
14 minutes.
15 CHAIRMAN REYNOLDS: Commissioner Kirsanow,
16 can I get in a question? This is Reynolds.
17 ACTING CHAIRMAN KIRSANOW: No, you may
18 not.
19 (Laughter.)
20 ACTING CHAIRMAN KIRSANOW: This is
21 Chairman Reynolds who is speaking in a disembodied
22 fashion. Go ahead.
23 CHAIRMAN REYNOLDS: I will make it quick.
24 My question is, in the absence of discrimination, is
25 there a reason for the government to issue policies

1 that affect the underwriting standards? I mean,
2 shouldn't the underwriting standards be determined by
3 the businesses themselves in the absence of
4 discrimination?
5 MR. HUSOCK: If I might?
6 ACTING CHAIRMAN KIRSANOW: Mr. Husock?
7 MR. HUSOCK: I am Howard Husock.
8 I think it is important to distinguish
9 between underwriting standards. CRA does not speak to
10 underwriting standards specifically.
11 CHAIRMAN REYNOLDS: It affects them,
12 though.
13 MR. HUSOCK: It does. I agree. But I
14 think what we really ought to focus on is its ultimate
15 goal might be called the allocation of credit. And
16 CRA advocates believe that in reference to Mr.
17 Kirsanow's question previously that the market
18 fundamentally is in ways unjust, unfair, unequal in
19 the way it will allocate credit.
20 And if you believe that, then you should
21 believe that you want the CRA to be extended to other
22 areas. If you believe -- I am really trying to be as
23 fair as I can in characterizing this. If you believe
24 that there are flaws in the market, that there will
25 not be competition, that the rowhouse owner who is

1 turned down won't be able to turn to another mortgage
2 lender, and that, actually, the person who turned down
3 the rowhouse will be penalized for not understanding
4 the profitability of that rowhouse, if you believe
5 that all of those flaws are there, then you believe in
6 allocation of credit.

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

13 ACTING CHAIRMAN KIRSANOW: Mr. Chairman?

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

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

24 MR. BROWN: One thing -- this is Luke
25 Brown speaking from the FDIC -- the majority of our

1 banks that at the FDIC we supervise are
2 community-based banks, very small institutions.
3 So, you know, I just want to say that
4 banking is not always big. It's still in communities.
5 It's still about being interested in communities and
6 looking at certain under-served areas and focusing
7 your resources in those areas.
8 So although it was said earlier that the
9 market now maybe does not discriminate as much as it
10 has in the past, as we have seen, one of the big
11 pieces of why we are where we are today is the market
12 is about money. It's about chasing money. It's about
13 your bottom line.
14 So at the end of the day, if that is the
15 big motivation, a lot of lenders are not going to be
16 focused on certain communities. So the good thing
17 about CRA is it focuses them and incentifies them to
18 start thinking about those areas.
19 ACTING CHAIRMAN KIRSANOW: Again, I will
20 leave this open for a couple of more minutes because,
21 as you know, your testimony will probably be
22 instrumental in whatever recommendations are sent by
23 this Commission to Congress or the White House related
24 to this particular subject.

1 And given that we are talking about the
2 CRA, I am wondering if -- and I think this was raised
3 nominally, at least, in someone's testimony. I can't
4 recall whose it was. What, if any, changes should be
5 made to CRA going forward if any changes need to be
6 made?
7 COMMISSIONER TAYLOR: Mr. Chairman?
8 ACTING CHAIRMAN KIRSANOW: Yes?
9 COMMISSIONER TAYLOR: Along those lines,
10 can we get agreement from everyone on the panel that
11 in the discussion that we have had today? And in
12 making the changes and modernizing the act, there has
13 been little attention on what I like as a paradigm for
14 flexible versus loose standards or creative products.
15 Could we all agree that that is the
16 problem? We failed to draw the line, we failed to
17 identify where the line was. And when it was crossed,
18 we failed to call it.
19 MR. BERENBAUM: Relative to the Community
20 Reinvestment Act?
21 COMMISSIONER TAYLOR: Yes.
22 MR. BERENBAUM: I would respectfully -- I
23 think I am going to disagree --
24 COMMISSIONER TAYLOR: Okay.

1 MR. BERENBAUM: -- because I believe that
2 the underwriting standards of CRA-regulated
3 institutions, as demonstrated by all of the reports
4 discussed today by the regulators and presented by
5 NCRC as well as by Marsha, document that they were, in
6 fact, a stronger underwriting, not loose.
7 COMMISSIONER TAYLOR: Which goes to your
8 point of expanding the CRA --
9 MR. BERENBAUM: Exactly.
10 COMMISSIONER TAYLOR: -- to encompass
11 those unregulated institutions.
12 MR. BERENBAUM: So if we're talking a
13 broader discussion about the marketplace, I think it's
14 a very effective way of capturing the types of loan
15 products.
16 COMMISSIONER TAYLOR: Okay.
17 ACTING CHAIRMAN KIRSANOW: Okay.
18 MR. WIDES: This is Barry Wides with OCC.
19 I would also agree with David that it may
20 be true with respect to the independent mortgage
21 companies, but that line was clearly crossed.
22 I would argue that with respect to the
23 banks that we supervise and the other federally
24 supervised banking agencies, whose regulators are at
25 this table, we put out considerable guidance during

1 the period 1999 to 2007, which was provided in a
2 letter that was sent by Julie Williams, our chief
3 counsel, to the Commission several weeks ago, which
4 delineates in a great deal of detail the guidance that
5 we put out to banks, making very clear to them what
6 type of underwriting that is credit
7 quality-deteriorated was acceptable for national banks
8 and what wasn't.

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

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

18 ACTING CHAIRMAN KIRSANOW: Mr. Husock?

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

21 In answer to the question about going
22 forward, I think it has been pretty clear that I am
23 not a big fan of the CRA. But if it is going to be
24 with us and if it were to be extended, I think the
25 most important modernization would be transparency.

1 And that would be ongoing timely reporting of the
2 performance of CRA-qualified loans by lenders.
3 I would expect that the NCRC would favor
4 that. The assertion has always been made that these
5 are profitable but maybe slightly less profitable. Of
6 course, that is a form of non-profitability because
7 capital is being used in a less profitable way, but
8 okay.
9 If you are not a strong free market guy,
10 let's at least find out how those loans are performing
11 in a timely way to make sure going forward that we're
12 not inviting a new problem.
13 ACTING CHAIRMAN KIRSANOW: I have to limit
14 this to two more minutes. Ms. Courchane?
15 DR. COURCHANE: I should be 30 seconds.
16 Two things that came up in the research we did, one is
17 that the biggest banks are the ones who are making
18 many of the CRA loans if you are focusing on mortgage
19 lending.
20 I think we could revisit the definition of
21 in and out an assessment area. When you have
22 nationally based lenders, how will you define that
23 footprint? And what gets covered under CRA could be
24 addressed.

1 The second thing I would say -- and,
2 again, we also noticed this in the data that we looked
3 at -- is that you have this voluntary reporting of the
4 lending activity by the affiliates that might be subs
5 of the banks.
6 And you could make mandatory all of that
7 coverage as well, which would bring in the coverage
8 fairly simply beyond the points that David raised
9 earlier about going to the independent mortgage
10 companies, credit unions, et cetera.
11 But, even as it stands, changing the
12 assessment and changing the reporting and for the
13 affiliates are some of the things that could be done
14 to broaden coverage.
15 ACTING CHAIRMAN KIRSANOW: Mr. Liebowitz?
16 MR. LIEBOWITZ: Yes. I just wanted to say
17 that, with all due respect to my colleagues from the
18 agencies that do the regulating, I think when we go
19 through this with a fine-toothed comb in the later
20 years, we are going to find that all of the banks, all
21 the groups of banks, all of the regulated banks, all
22 the different types of regulated, that all went over
23 the line. Okay? We're not going to just find it's
24 some small little group of unregulated or lightly

1 regulated mortgage brokers that went over the line in
2 terms of the loose lending standards.
3 ACTING CHAIRMAN KIRSANOW: Okay. That
4 being the conclusion of panel number 1, I want to
5 thank all of the witnesses for their splendid
6 testimony. This has been highly informative. I think
7 this is the first comprehensive hearing on all of
8 these matters. And it has been very useful to all of
9 us. Thank you very much.
10 We will take a five-minute break. And
11 then we will reconvene to talk to panel 2 about HUD
12 lending goals and their effects, if any, on Freddie
13 Mac and Fannie Mae.
14 (Whereupon, the panel was excused.)
15 (Whereupon, the foregoing matter went off
16 the record at 11:36 a.m. and resumed at 11:45 a.m.)
17 PANEL 2 -
18 THE HUD LENDING GOALS AND THEIR EFFECTS ON
19 FANNIE MAE AND FREDDIE MAC
20 ACTING CHAIRMAN KIRSANOW: I think we are
21 prepared to go forward at this particular point on HUD
22 lending goals and their effects, if any, on Fannie Mae
23 and Freddie Mac.
24 Just a few statements with respect to the
25 outlook on this particular briefing and panel. When

1 Fannie Mae was chartered as a GSE in 1968, Congress
2 assigned regulatory authority over the entity to the
3 Department of Housing and Urban Development.
4 HUD was authorized to require that a
5 reasonable portion of Fannie Mae's mortgage purchases
6 be related to the national goal of providing adequate
7 housing for low and moderate-income families. Similar
8 housing goals were authorized for Freddie Mac, as the
9 panel will examine the impact of lending goals, as I
10 have stated, on the effects of Fannie Mae, Freddie
11 Mac.
12 As I understand it, the Department of
13 Housing and Urban Development had intended to send the
14 former Director of HUD's Office of
15 Governmental-Sponsored Enterprises Oversight, which
16 had the responsibility for setting housing goals, but,
17 unfortunately, the director is out on medical leave,
18 not expected to return until sometime in late March.
19 And, due to the transfer of HUD's staff
20 who worked on the housing goals to the FHFA and
21 retirements, HUD related to us that they did not
22 believe they had any other officials with sufficient
23 knowledge to provide testimony as to the establishment
24 of the goals but that they are prepared to make the

1 former director available to the Commission upon her
2 return from medical leave.
3 Again we will follow the same procedures
4 we did in the previous panel. And I will introduce
5 each of you. And again forgive me for not citing all
6 of your accomplishments.
7 We have on our first panel -- and also
8 forgive me if I mispronounce your name -- John
9 Wiecher, Ph.D. and Director of the Hudson Institute's
10 Center for Housing and Financial Markets.
11 From 2001 to 2005, Mr. Wiecher served as
12 Assistant Secretary for Housing and Federal Housing
13 Commissioner for the Department of Housing and Urban
14 Development with responsibility for FDA mortgage
15 insurance. His major initiatives included promoting
16 minority ownership, regulatory reform of the real
17 estate summit process and mission regulation of Fannie
18 Mae and Freddie Mac.
19 Mr. Alfred Pollard is General Counsel of
20 the Federal Housing Finance Agency, which has been
21 appointed conservator of Fannie Mae and Freddie Mac.
22 His work focuses on regulatory matters affecting
23 Fannie Mae and Freddie Mac and the 12 Federal Home
24 Loan Banks, including regulations governing capital,
25 corporate governance, internal controls, affordable

1 housing and accounting, as well as on legal
2 developments affecting mortgage markets and legal
3 representation of FHFA.
4 Mr. Pollard has worked on a major
5 interagency report on mortgage-backed securities
6 markets and currently serves on the President's
7 corporate fraud task force and Justice Department's
8 bank fraud working group and mortgage fraud working
9 group. You have a lot on your portfolio there.
10 He has had a leadership role in major
11 investigations and enforcement actions and in the
12 conservatorships imposed on Fannie Mae and Freddie Mac
13 in 2008.
14 And, again, as though they will not be
15 formal presentations, the officials from Fannie Mae
16 and Freddie Mac have joined us at the table. They
17 will be available to answer questions.
18 MR. POLLARD: Can I take the liberty of
19 introducing them?
20 ACTING CHAIRMAN KIRSANOW: Yes. If you
21 could, I would appreciate that.
22 MR. POLLARD: Bill Senhauser, to my
23 immediate left, is the Senior Vice President and Chief
24 Compliance Officer at Fannie Mae. And Bob Tsien is

1 the Senior Vice President for Mission Oversight and
2 Development at Freddie Mac.
3 Both of these gentlemen, if I could, I
4 want to say I appreciate their coming. They are
5 intimately involved in the new loan modification and
6 refinance programs, and we were able to get them to
7 come. I do appreciate their joining me today with
8 their factual expertise.
9 ACTING CHAIRMAN KIRSANOW: And we
10 appreciate that also, especially on relatively short
11 notice. Whereupon,
12 JOHN WIECHER and ALFRED POLLARD were called as a panel of
13 witnesses by the United States Civil Rights
14 Commission and, having been first duly sworn, was
15 examined and testified as follows:
16 ACTING CHAIRMAN KIRSANOW: Thank you very
17 much. So we will begin with Mr. Wiecher.
18 MR. WIECHER: Thank you, Mr. Kirsanow.
19 And I want to thank the Commission for the opportunity
20 to discuss civil rights issues and concerns arising
21 from the mortgage and housing market crises of the
22 last two years. This is a panel on the affordable
23 housing goals, and I will limit my remarks to that
24 subject.

1 The Department of Housing and Urban
2 Development is charged by statute, was charged by
3 statute, with formulating the affordable housing goals
4 for the government-sponsored enterprises for the GSEs
5 in 1992.
6 As Assistant Secretary for Housing at HUD,
7 2001-2005, I held the authority for those activities
8 under delegation from the Secretary of HUD. If that
9 authority had been delegated to the Assistant
10 Secretary for Housing since 1993, it has now, of
11 course, been transferred to the Federal Housing
12 Finance Agency and the Housing and Economic Recovery
13 Act of 2008.
14 In my written statement, I discuss the
15 nature of the goals and how they were established. I
16 will skip over that in the interest of time and look
17 at two factual questions: first, the extent to which
18 the GSEs have served minority homeowners; and, second,
19 the effect of the 2005 housing goals on GSE purchases
20 of subprime mortgages.
21 The affordable housing goals are not set
22 in terms of the race or ethnicity of the borrower, nor
23 are they set with respect to whether the borrower is
24 buying a first home or refinancing a mortgage or
25 buying a home for the second or third time. But there

1 is always interest in the extent to which borrowers
2 are first-time home buyers and the extent to which
3 they are members of minority groups.
4 In the policy discussions and analysis
5 prior to the promulgation of the 2005 affordable
6 housing goals, HUD analyzed the extent to which the
7 GSEs were serving first-time home-buyers. A summary
8 of the analysis appears as table 2 in my statement.
9 As the table shows, the GSEs did not serve
10 first-time home buyers very well. During 1999 to 2003
11 -- and this is the latest data that has been publicly
12 available -- about 39 percent of mortgages to home
13 buyers in the overall conventional conforming market
14 were to families buying their first home. Only about
15 26 percent of mortgages to home buyers who were
16 purchased by the GSEs were to first-time home buyers.
17 The GSEs did a particularly poor job in
18 serving minority first-time home buyers. About 12
19 percent of mortgages to home buyers in the
20 conventional conforming market were to first-time
21 minority home buyers compared to only about 7 percent
22 of GSE purchases.
23 Now, the conventional conforming market is
24 the market in which the GSEs do make loans. It
25 excludes the lower half of the subprime market known

1 in the trade as the B and C loans. It includes the
2 higher-quality subprime loans, the A- loans, and has
3 since the mid 1990s.

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

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

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

21 The second issue is the extent to which
22 the GSEs were buying subprime mortgages, both before
23 and after the 2005 rule went into effect. The
24 evidence indicates that the affordable housing goals
25 had little, if any, impact on GSE activities in these

1 markets. Instead, it appears that the GSEs were
2 responding to the same factors in the mortgage markets
3 as other lenders.
4 In my statement, table 3 reports the
5 dollar values of subprime mortgage purchases by the
6 GSEs during 2001 to 2006. As I mentioned, the GSEs
7 had been buying A- loans since the later 1990s, but
8 they began buying subprime mortgage-backed securities
9 heavily in 2002. Their subprime mortgage-backed
10 securities purchases doubled between 2002 and 2003,
11 doubled again in 2004, from 38 billion to 81 billion
12 to 176 billion.
13 After the new goals went into effect,
14 their subprime mortgage-backed securities purchases
15 actually declined slightly to 169 billion in 2005 and
16 then dropped sharply to 110 billion in 2006.
17 Their share of the subprime MBS market
18 rose from 31 percent in 2002 to 49 percent in 2003.
19 Then it declined slightly to 44 percent in 2004 and
20 much more sharply after the new goals to 33 percent in
21 2005 and 20 percent in 2006.
22 Essentially what happened was that the
23 market for subprime mortgage-backed securities took
24 off in the early years of this decade. And the GSEs

1 became active in that market for a couple of years.
2 And then the GSEs began pulling back.
3 The data I have quoted come from a series
4 of annual reports by the Office of Federal Housing
5 Enterprise Oversight, which has been the GSE safety
6 and soundness regulator until last summer. The
7 reports are entitled annually "Mortgage Markets and
8 the Enterprises in" whatever year it might be.
9 It appears that OFHEO did not think that
10 these purchases posed a risk. In each year's report,
11 the discussion of subprime purchases was followed
12 immediately by a section on overall single family
13 mortgage credit risk in which OFHEO concluded that the
14 risk was not great.
15 In the 2006 report, for example, the
16 discussion of subprime purchases is followed by a
17 section titled "Enterprise Single Family Credit Risk
18 Remains Low." Similar discussions appeared in earlier
19 reports.
20 Further evidence on GSE behavior comes
21 from a recent analysis by HUD staff economists
22 published in the August 2008 issue of HUD's periodical
23 "U.S. Housing Market Conditions."
24 The study reports the distribution of
25 mortgage/income ratios for the GSEs and other lenders

1 from 2001 to 2006. Higher ratios indicate greater
2 risk of default, mortgage payment burdens that will be
3 a particularly large share of the borrower's income.
4 The data are shown in table 4 for loans
5 that were in the 90th percentile of the
6 mortgage-to-income ratio, close to the most risky
7 loans being made, close to the loans which posed the
8 highest burden on incomes of the borrowers.
9 What we have in that study is evidence
10 that beginning in 2002, the GSEs began taking more
11 risks. And they increased their risk through about
12 2004. And then their appetite for risk remained about
13 the same. The ratio remained about the same. But
14 they did not choose to take less risk after 2004 but
15 chose to take about the same amount of risk. Of
16 course, when the new goals went into effect in 2005,
17 there wasn't a change in the GSE behavior.
18 Other lenders were taking more risks at
19 the same time. If you look at the portfolio lenders,
20 their appetite for risk increased beginning in about
21 2002. If you look at the private issuers of mortgage
22 pools, who tend to be the subprime lenders, their
23 appetite for risk increased at about 2002. And their
24 appetite for risk will continue to grow until
25 2005-2006.

1 I think the GSEs were reacting to the same
2 factors that other lenders were reacting to, a relaxed
3 monetary policy, especially in the aftermath of 9-11,
4 when everyone was persuaded that we were about to see
5 a major recession and the Fed took action to prevent
6 that. Everybody saw an opportunity to profit in the
7 mortgage market, and everyone took advantage of it.
8 The GSEs were acting like other lenders.
9 And their experience was a lot like other lenders.
10 They were by no means the first lenders to run into
11 the problem of excessive risk. It's just over two
12 years ago the first HSBC and then New Century were
13 reporting major problems with their subprime mortgage
14 portfolios.
15 The GSEs' problems surfaced later,
16 surfaced in the Summer of 2008. But the GSEs are the
17 largest lenders in the mortgage market. They have
18 been traditionally and by statute the least
19 well-capitalized, certainly among the portfolio
20 lenders, and their problems when they hit attracted
21 much more serious for the economy.
22 Thank you very much.
23 ACTING CHAIRMAN KIRSANOW: Thank you, Mr.
24 Wiecher.
25 Mr. Pollard?

1 MR. POLLARD: I first heard of the Civil
2 Rights Commission in 1972, which shows my age, when I
3 was an intern on the Hill and there was a hearing
4 about the Civil Rights Commission. That is the first
5 time there, but this is my first time in attendance.
6 I appreciate the opportunity today.
7 We have met with your staff and hope we
8 provided some useful information and hope that has
9 contributed to the work of the Commission. And we
10 will be happy to continue that.
11 The staff made one mistake when they spoke
12 to me. They said, "We're going to get you up to talk
13 about affordable housing. But if you would like to
14 comment on some of the other issues, go ahead." So I
15 will be the fastest-speaking Georgian you have heard
16 from and cover a few topics.
17 It is great to be on a second panel. You
18 get to either agree with what everybody else has said
19 or you can disagree with what everybody else has said.
20 I will maybe take the former and say there is a little
21 bit of what everybody said that has some good kernels
22 of truth.
23 Let me give you, if I could, a few seconds
24 about my view of this market. This is not 1957. This
25 is not '67, '77, '87, '97. It's today and what has

1 happened. And I will just hit some themes for you
2 because I think they are useful. I hope they are.
3 First, complexity. This is not an S&L and
4 a borrower and maybe Fannie and Freddie. That world
5 is gone. This is investors in China, bond insurers,
6 rating agencies, securities firms. None of these
7 people were participating in 1987. I mean, there was
8 some securitization going on in '87-'89, but it is a
9 new world in terms of its complexity and the number of
10 players.
11 So that's number one. Number two, you all
12 remember what went on in the 1990s. We had rapid
13 growth, a technology boom. So three things came
14 about: a technology boon, which increased
15 immigration; a baby boom, which increased migration;
16 and speculation. We had some lower interest rates, as
17 Mr. Wiecher said.
18 All of this got concentrated in a new
19 area: housing. People are moving in. People are
20 moving up. A lot of housing got built. There was a
21 great deal of pressure to accommodate that.
22 So where do you come down? What is new in
23 this new system that is different? First, the
24 government has continued to call for housing. The
25 government has never called for poor underwriting.

1 Number two, we took on perhaps a new view
2 of risk spurred by some of our new technologies and
3 new devices. The theory sort of was if it was just an
4 S&L with 100 percent of the risk and someone on Wall
5 Street is willing to buy part of the risk and someone
6 in Europe is trying to buy part of the risk and we
7 have mortgage brokers who are just helping getting
8 mortgages in the system who have very little risk,
9 then we have spread the risk.
10 Unfortunately, there took to be an element
11 from that that there was no risk, no risk for me, or I
12 just got a percentage of the risk. But, remember, we
13 have this complex interconnected system.
14 So to say that I have a half a percent of
15 the risk but I am connected to you is different than
16 saying I have 100 percent of the risk and I am over
17 here. That to me is one of the major fundamental
18 changes.
19 And we did this through things called
20 hedging and derivatives and insurance. People get
21 insurance. But they forget that they have deductibles
22 and put-backs. And insurance doesn't pay if there is
23 fraud. So all of this risk transfer that people
24 entered into did not eliminate risk. We still have
25 risk.

1 And, to be candid, they are moved into the
2 housing world a different attitude. My dad told me
3 when I started to buy my first house. He said, "Buy a
4 house you can afford to live in. You may have to." I
5 kind of always took that pretty seriously.
6 Housing became a method of wealth
7 accumulation in many people's mind. As prices
8 inflated in certain markets, people began to see,
9 well, if I get in and everybody is a part of this, the
10 media, everyone was get in, get part of this -- and
11 some of your prior speakers said, you know, there's an
12 emphasis on housing, there is.
13 But it wasn't just housing for residents.
14 It became housing for speculation and then what we
15 call layering, where people get into the house, barely
16 get in, and then borrowed again to furnish the house
17 and get the big TV and get the rest of what they
18 needed. So a lot of this came about with low-risk,
19 no-risk attitudes and speculation.
20 Two final things before I get to my
21 statement. There is a good statistic I thought the
22 realtors put out a few years ago, which was -- I
23 forgot the time frame. Let's say a five-year time
24 frame. Housing prices went up 50 percent. Income
25 went up 13 percent. People were getting in houses

1 with mortgages that were going up a lot, going up a
2 lot faster than their incomes were.
3 And, finally, -- and I'll turn to subprime
4 -- I don't know that subprime is the only reason we're
5 in a housing crisis. Inflated housing prices could
6 have burst on their own, not people being unable to
7 default. Perhaps in certain markets we simply built
8 so many homes. The builders would have gone down. It
9 turned out it happened to be in subprime. Investors
10 may have just been going too far. But the short of it
11 is we will focus on subprime, and that's where we
12 were.
13 So with those sort of -- and I am not an
14 economist, but I will call those economic views that
15 are my own. Let me turn to my quick remarks for you.
16 The mortgage crisis that began in '07 and
17 '08 has many causes. In my mind, it is a systemic
18 event. The crisis and its repercussions for the
19 broader economy should be viewed from a systemic
20 perspective, not merely one sector.
21 As regulators and others consider the
22 future beyond our immediate challenge of resolving
23 current market conditions, we need to look at all
24 elements and all elements at the same time. That is
25 at least my view.

1 Financial panics in the Nineteenth Century
2 were frequent, about every 20 years. In the Twentieth
3 Century, we created the Federal Reserve, the FDIC, the
4 Securities and Exchange Commission. We have had
5 technological advances. This promised prosperity,
6 greater access to credit.
7 After the second world war is when people
8 really begin buying homes. Before the second world
9 war, mortgages were five years. It's not a very
10 popular product.
11 Still, here at the beginning of the
12 Twenty-First Century, we meet at the Commission to
13 discuss what has transpired and how one of those parts
14 of this system has had an impact.
15 Our agency, the Federal Housing Finance
16 Agency, prior to July 30th this year was the safety
17 and soundness regulator for Fannie Mae and Freddie
18 Mac. On that date, we became both the safety,
19 soundness, and mission, which includes affordable
20 housing goals, regulator as well as overseer for the
21 12 Federal Home Loan Banks.
22 I would tell you at this time we are
23 preparing a draft for comment on affordable housing
24 goals for the coming year. Clearly these goals will
25 be important, particularly in light of current market

1 conditions, but should reflect the ongoing commitment
2 of the enterprises to their core missions, as
3 established by Congress.
4 We have to address 2009 under the existing
5 rules. We will promulgate our first rule of housing
6 goals for the year 2010, as Congress placed it in
7 position in our statute.
8 Now, what is the role of Fannie Mae and
9 Freddie Mac? I think it is important to note that.
10 They buy or guarantee mortgages or mortgage
11 securities. They issue thousands of mortgage-backed
12 securities a year. They hold $1.6 trillion in
13 portfolio of mortgage loans and guarantee in one
14 fashion or another $4 trillion of securities.
15 The fundamental purpose is a secondary
16 market function to buy and provide liquidity and
17 stability to the system. The core banking laws to
18 protect consumers from discrimination and unfair
19 marketing practice apply at the point of origination.
20 Fannie Mae and Freddie Mac are prohibited from
21 originating mortgages.
22 I would tell you it is a complex system
23 having worked in the banking industry. There are over
24 35 separate retail banking laws. And many of these do
25 affect mortgages.

1 Indeed, if not conflicting with federal
2 law, state laws are relevant in jurisdictions,
3 deceptive advertising, things like this.
4 The retail delivery system, not the
5 secondary market, is the major point of contact with
6 borrowers. Let me pause to say immediately I am not
7 here to tell you that Fannie and Freddie don't have a
8 role. I am not here to tell you let's talk about
9 somebody else.
10 Fannie Mae and Freddie Mac do undertake
11 steps and have undertaken steps to support federal
12 laws across the board. The major method they employ
13 is called a rep and a warranty, a representation and a
14 warranty, which is that their seller/servicers, many
15 of whom are unregulated, which is one of the benefits
16 when Fannie and Freddie set a standard, will comply
17 with applicable federal and state laws or face having
18 their mortgages returned to them and the enterprises
19 reimbursed. This is a very powerful incentive.
20 Further, their seller/servicer guides,
21 which have been referenced, provide instructions on
22 how to conform standards and avoid law violations.
23 For example, there are specific requirements to meet
24 anti-predatory lending statutes and rules.

1 Now let's talk about the affordable
2 housing goals very quickly. I won't go over the
3 entire history. I think Mr. Wiecher has done a good
4 job in that.
5 What I would note is that in 2004, there
6 was a sizeable increase in the housing goals pressing
7 Fannie and Freddie to match or exceed the market; in
8 effect, to lead the market.
9 In 1996, the percentage for low-income was
10 40 percent. In 2003, it was 50 percent. And it was
11 to be 56 percent by 2008. And there is a chart
12 attached showing this growth.
13 In sum, the goals address income levels
14 and geographic delineations. They provide various
15 targets to be set by the government. They support all
16 forms of housing, including multi-family, rental,
17 manufactured housing, and under-served areas.
18 The goals do not go directly to
19 underwriting criteria in the primary market, but the
20 enterprises do take actions to try and limit the
21 threats to their safe and sound operations.
22 The current market, in many ways Fannie's
23 and Freddie's market share, which is reflected in one
24 of the charts, demonstrates that many mortgages were
25 being made outside of the Fannie and Freddie Mac

1 channel; in part, because of their underwriting
2 criteria.
3 These were being made and purchased by
4 firms on Wall Street and became known as private label
5 securities. They were, in fact, creating a secondary
6 market. What you had was Fannie and Freddie going
7 from about 55 percent of the market to about under 44
8 percent of the market.
9 With the housing goals, these ambitious
10 goals, announced, it is clear that the enterprises did
11 increase their purchases in the subprime market.
12 Indeed, the HUD guidance at the time mentioned looking
13 into the subprime market as a place for potential
14 targeting to find these housing goals.
15 The share of loans, however, was less than
16 one percent of their portfolios. They were
17 significant purchasers of private label securities
18 that had subprime. They did take the higher quality
19 of these. They are divided into tranches and
20 frequently had a good deal of credit enhancements for
21 these loans, where they had insurance and other
22 things.
23 So while they were buying subprime, they
24 were focusing, trying to get on the higher level of

1 the quality spectrum. And there is some information
2 in my chart, in my testimony, regarding it.
3 And the delinquency rates, which is also a
4 chart, it reflects this, that their delinquencies are
5 aggregate two to two and a half percent. The regular
6 market in these loans is as high as 23 and 34 percent
7 for subprime loans.
8 During this time, the bank regulators, who
9 had begun as early as 1999 issuing statements -- they
10 issued statements in '99, 2001, 2002, 2005, 2006, and
11 2007 regarding subprime lending and concerns for the
12 financial community. These guidances were put out.
13 Our predecessor agency, OFHEO, in 2007 on
14 its own initiative applied these to Fannie and
15 Freddie. In other words, the guidance by the bank
16 regulators in a spirit of working together and making
17 sure this was being done properly, we applied them to
18 Fannie and Freddie.
19 Now, what this did was to add not only
20 that a bank dealing with Fannie and Freddie had to
21 abide by these guidances but unregulated firms that
22 wanted to sell products to Fannie and Freddie had to
23 as well. And we believe that was helpful to pulling
24 down this market in these products.

1 Let me digress one second as well. Not to
2 defend the products, but there is a situation. And
3 this is a complex situation where many products that
4 were created were created for a particular type of
5 borrower.
6 If you are a well-to-do borrower and you
7 want to borrow money and you borrowed money from a
8 bank quickly, maybe the bank doesn't want to have to
9 get as much paperwork and take as much time. They're
10 willing to take a risk. This is a sophisticated
11 person.
12 Maybe that type of credit is okay. I am
13 not saying it is or it isn't, but it clearly would not
14 be okay for someone who is a first-time home buyer
15 with modest means to get into a loan where, as we
16 talked about today, they really didn't qualify.
17 Now, let's talk about initiatives. And I
18 will quickly finish. I do want to let you know what
19 is going on and what we are trying to do.
20 Before the crisis, I would note that the
21 enterprises have had anti-predatory loan provisions as
22 early as 2000 on their loan purchases. And for
23 private label securities, they have required, where
24 possible, due diligence by the sellers and that the
25 sellers do anti-predatory lending reviews of their

1 portfolios, where possible. There are some securities
2 laws issues.
3 Since the crisis, the enterprises have
4 begun a refi program for people in danger, not there
5 yet, of not being able to meet their mortgages. They
6 are part of a Treasury-directed with us loan
7 modification program to help people who are crossing
8 the line, in imminent default, or who are delinquent
9 on their loans.
10 They have put in foreclosure forbearance
11 programs with modified payments. They have put in
12 foreclosure preventions programs. They have put in
13 rental continuation programs, where landlords have
14 been the subject of foreclosure and where the
15 enterprises own the properties.
16 They have put in place new appraisal rules
17 -- appraisals contributed to this house price
18 inflation -- to protect appraisers from undue
19 coercion. And they have enhanced their mortgage fraud
20 efforts, which our agency began about 2004 and 2005.
21 I personally have spent the last five
22 years with a great deal of time on those task forces
23 trying to get mortgage funds which prey on all
24 communities but particularly on low and
25 moderate-income families.

1 ACTING CHAIRMAN KIRSANOW: Mr. Pollard,
2 could you please wrap up?
3 MR. POLLARD: I am going to wrap up. Let
4 me talk about the future. I think when we look at
5 things to be done in the marketplace, there are
6 various ideas out there. Affordable rentals, are we
7 doing enough there? Licensing of mortgage brokers,
8 mortgage originators; regulation of key players at the
9 state level as well as the federal level; ID numbering
10 for mortgages and individuals who touch mortgages so
11 we can find out who is doing what; enhanced mortgage
12 fraud prevention, not just detection; and, finally, a
13 return to that traditional underwriting, which may
14 mean some more time and in some cases some increased
15 costs. But, as some of your other speakers said, the
16 benefit would be greater assurance that a homeowner
17 that buys the home stays in the home.
18 ACTING CHAIRMAN KIRSANOW: Thank you very
19 much.
20 We will proceed to questions from the
21 commissioners. Commissioner Melendez?
22 III. QUESTIONS BY COMMISSIONERS AND STAFF DIRECTOR
23 COMMISSIONER MELENDEZ: Yes. Thank you
24 very much. Yes. First of all, thank you all for
25 being here this morning.

1 I would like to ask Mr. Wiecher. I am
2 trying to understand the claim by some that affordable
3 housing goals cause Fannie Mae and Freddie Mac to
4 acquire loans made for low and moderate-income
5 households that basically went bad. So I have two
6 questions.
7 Were there any rules or regulations about
8 affordable housing that required expansion into the
9 subprime and alt-A markets? If not, then how exactly
10 do you think the decisions of Fannie and Freddie to
11 increase their share of the subprime and alt-A markets
12 were influenced by affordable housing goals?
13 MR. WIECHER: Commissioner Melendez, there
14 is no requirement that either GSE buy loans that are
15 rated below prime. There is a legal requirement that
16 loans of the type they had been making should be
17 considered as part of the market that they are serving
18 in establishing housing goals and, indeed, in the 1992
19 statute, the Federal Housing Enterprise's Financial
20 Safety and Soundness Act, there is a specific
21 provision that grandfathers in the kinds of mortgage
22 products they had been making prior to that statute.
23 They are not subject to review by either HUD or OFHEO
24 other than on safety and soundness grounds or down the
25 road.

1 So there is no requirement there. They
2 were buying A- and alt-A loans as of the mid 1990s.
3 And so those were counted by HUD in the affordable
4 housing goal in defining the market that they were
5 serving in order to determine what would be the
6 appropriate targets under the goals. Those were
7 included as loans that they were buying and could
8 presumably be expected to continue to buy.
9 The data that I was quoting in my
10 testimony I think shows that the decision to increase
11 their activity in A- and alt-A was a decision
12 undertaken in the interest of profit maximization in
13 the same way that that decision was undertaken by
14 other types of lenders. And they increased their
15 activity sharply in 2002, '3, '4, and then pulled
16 back, making whatever prudential judgments they
17 thought were appropriate. And I think that is fairly
18 clear from the data.
19 ACTING CHAIRMAN KIRSANOW: Any other
20 questions? Commissioner Taylor?
21 COMMISSIONER TAYLOR: No, no questions.
22 ACTING CHAIRMAN KIRSANOW: Chairman
23 Reynolds?
24 CHAIRMAN REYNOLDS: Yes?
25 ACTING CHAIRMAN KIRSANOW: Any questions?

1 CHAIRMAN REYNOLDS: No.
2 ACTING CHAIRMAN KIRSANOW: Mr. Staff
3 Director?
4 STAFF DIRECTOR DANNENFELSER: Yes. Thank
5 you.
6 We talked earlier about relaxation of
7 underwriting standards in the first panel. And I
8 believe it was Marsha Courchane said that she thought
9 the affordable lending goals for Fannie and Freddie
10 probably had more to do with more lending to low and
11 moderate-income homeowners.
12 Was there a separation in terms of the
13 risk that the loans being made by community banks
14 could then be passed on to someone else and that once
15 they sold to someone else, that there was no longer
16 the risk?
17 Was there a situation where people were
18 making many loans and that there was a great deal of
19 pressure to have more loans made but without the risk
20 of the people who originally made the loans? And to
21 what extent were Freddie and Fannie involved in that
22 situation?
23 MR. POLLARD: I guess I would answer that,
24 again, in this market, as mortgages were seen as the
25 safest investment across the board by everyone, there

1 became an increasing demand for mortgages. The market
2 that developed outside of the enterprises was showing
3 mortgages with higher yields because they were
4 charging more. And that made those attractive
5 investments.
6 So that builds a cycle of people saying,
7 "Well, we would like to buy some more." That then
8 says to a lender, "I can go out and try and market
9 some more of these loans." And, of course, I am a big
10 believer that a percentage of this is also fraud, but
11 that they would go out and market and get a broker or
12 their own people to go out and have programs saying,
13 "Come on in. And let's see."
14 So I don't know. You can say that
15 sometimes a lot of people view it it's the people at
16 the front who start the motivation. There's also the
17 people at the back who are buying securities and want
18 to invest who say, "Gee, there is money available for
19 this."
20 I would note that at some point rates are
21 actually going down in the prime market. And some of
22 the rates for the subprime were somewhat lower, but
23 they were still higher than the prime, obviously,
24 because people knew there was a risk.

1 In fact, when you buy a mortgage-backed
2 security, private label security, from the Wall Street
3 firms, that's why they had tranches. There's BBB and
4 all the way up to the AAA because they're breaking it
5 down by FICO score and the risk.
6 So everybody knew there was some risk in
7 these. The enterprises in working even with us as
8 safety and soundness were saying, "We're getting the
9 higher part of this that seems to have less risk, not
10 no risk. It's not prime. It's clearly not prime."
11 And so in terms of what drives it, again,
12 I am hard-pressed to pick X. That is going to be my
13 problem. I think you could tell from my beginning
14 remarks.
15 I think it's a function of people wanting
16 to buy paper in global markets and domestic markets,
17 people prepared to underwrite it outside of the Fannie
18 and Freddie system, Fannie and Freddie then coming in
19 and saying, be it for affordable housing, be it for
20 market share, be it for some of these, like decent
21 securities -- they were rated AAA -- you know,
22 whatever, a mix of motivations that Fannie and Freddie
23 get into.
24 What prompted this market, it's hard for
25 me to pick that. This drove it. This got everybody

1 doing subprime and everybody getting into it.
2 Homeowners were desperate to get into homes before
3 they got completely out of their reach.
4 Unscrupulous people came to them and good
5 people came to them, perhaps trying to do a good deed
6 for them, getting a home, "We'll put a little bit of
7 extra on your income. You're in. Don't worry. The
8 price goes up. If there's any problem, you can sell."
9 This was the dynamic.
10 And I am talking common knowledge. I am
11 not giving you any secret here today. But it's the
12 reality. So it's hard for me to say that -- I would
13 rather say and I think I said in my statement I think
14 everything is part of this. Affordable housing goals
15 were there.
16 HUD recognized at the time in 2004 that
17 "You might have to look at" -- they didn't say, "Go
18 get bad things." They said, "You may have to look at
19 to get to these higher levels subprime, new types of
20 products, whatever it is, to try and reach the
21 communities."
22 But neither HUD nor Fannie and Freddie
23 told people to go out and make fraudulent loans,
24 inflate people's income, prepare forms that were fake

1 and bad. So I'm not saying fraud is everything, but
2 to me there is a huge factor.
3 So, Mr. Dannenfelser, I'm not sure I am
4 answering your question completely, but it's hard for
5 me to pick the driver. The driver was this. The
6 driver was that. It was a society that looked at
7 mortgages, the safest of investments. And that is
8 where I get to that risk comment I made earlier.
9 So everybody is making money. Rates are
10 going up. Yields are going up. Buy these. They are
11 easy to buy. They are quick. Technology. You know,
12 bankers don't work in the banks. You don't know your
13 customer. They're doing this over the internet. You
14 have to go to your closing.
15 In the old days, it took two or three
16 weeks not to go to closing, to get the mortgage, to go
17 sit down and talk to somebody and show them all the
18 paper and bring them this and bring them that. Then
19 they told you when the closing was going to be.
20 And, you know, there are benefits for
21 technology. We don't want to get rid of it. Now it's
22 15 seconds or I don't know how to do it myself, but,
23 you know, 2 minutes. You're applying. We'll get you
24 the quote. Good-bye. And they show up at the
25 closing. And someone else is there with you.

1 So there's a lot of benefits to what has
2 happened in our society. And I mean they are
3 benefits. We should not lose them. As we look going
4 forward, there have also been some negatives to it.
5 MR. WIECHER: This is John Wiecher. Just
6 a couple of thoughts. One is that the GSEs typically
7 devoted a smaller share of their portfolio to the
8 loans that were in the goals category than other
9 lenders were devoting to their lending activity.
10 This was true of all of the affordable
11 housing goal categories. I mentioned this in the
12 context of first-time home buyers, not first-time home
13 buyers, but it is true in all of the goals categories.
14 The GSEs were, in the jargon that we used, lagging the
15 market. And the statute required them to provide
16 leadership to the market.
17 I think the other lenders, the portfolio
18 lenders, perhaps the CRA lenders, other lenders, who
19 were not portfolio lenders and not subject to CRA,
20 were, in fact, making more loans to low and
21 moderate-income people and more loans to under-served
22 areas than the GSEs were as a share of their business.
23 So I think it's hard in that environment
24 to talk about the affordable housing goals as a

1 problem for generating the problem, generating the
2 situation that developed in 2006 and '07.
3 Beyond that, I think you can see. If you
4 go back -- Mr. Pollard talked in terms of the last few
5 years. But you go back. The home ownership rate in
6 this country turned up beginning in 1994, which is
7 long before any of this problem, this phenomenon that
8 we have been talking about. It started turning up in
9 1994. It went up from 1994 to 2004, from 64 percent
10 of the households in America to 69 percent. That is
11 huge. That is a huge change.
12 We had been a little bit higher than 64
13 percent in the midst of the unprecedented peacetime
14 inflation that we experienced between the mid '60s and
15 1980, when the only hedge you had against inflation
16 for most people was buying a home, owning your own
17 home, thanks to the tax treatment of home ownership.
18 That was the best investment you had.
19 If you knew something about collectibles,
20 if you knew something about objet d'art or Oriental
21 rugs, those were good investments. But most people
22 didn't. And houses were something that most people
23 knew.
24 Even in that environment, the home
25 ownership rate moved up from 62 percent to 64 percent

1 and then came back down again. Beginning in 1994, we
2 had a sea change. And it lasted for a decade. And to
3 my mind, what happened is that is the technology
4 revolution, information revolution, coming to the
5 mortgage market.
6 I was at HUD 20 years ago running a
7 research program. At that point, the best information
8 we had about risk in mortgages was information about
9 the original loan-to-value ratio.
10 If you took out a mortgage with very
11 little equity in the home, there was a better chance
12 that you would default on the mortgage. It was no
13 sure thing or anything along that line. But if you
14 put down 20 percent or more, you were much less likely
15 to default than if you put down 5 percent or less.
16 We didn't know anything about credit
17 scores. FICO didn't exist 20 years ago. Automated
18 underwriting did not exist 20 years ago. It became
19 possible to make better judgements about people's risk
20 based on their actual behavior, rather than based on
21 the initial loan-to-value ratio.
22 It became possible to evaluate a mortgage
23 application much more quickly than it was when you did
24 it by hand. And so you had automated underwriting
25 systems. You had FICO scores. And it became

1 possible, as Mr. Pollard said, to make a decision more
2 quickly.
3 If you were operating by rules, there will
4 be special cases where the rule will put somebody on
5 the wrong side of the dividing line between approval
6 and not approval compared to where they would be if
7 you sat down and went through all of the factors by
8 hand.
9 NFHA, in fact, there was always manual
10 underwriting. It alone was denied on the basis of any
11 kind of automated underwriting system. So there was
12 always that. There was always that risk.
13 That decade, that process of increasing
14 home ownership impact of technology came to the end
15 about the end of 2004. And you can see at that point
16 the home ownership rate beginning to turn down, the
17 number of renters beginning to rise.
18 And you can also see if you go back and
19 look at the mortgages that lenders were issuing, look
20 at the performance, in the first year or so, after a
21 loan was originated, when you would think that the
22 loan was not likely to default, you knew what the
23 borrower's income was, you knew what the market was
24 like.

1 If you look at first-year defaults, they
2 were low in 2002, loans originated in 2002. They were
3 a little higher in loans originated in 2003. They
4 were a little higher than that in loans originated in
5 2004. They were more than a bit higher than that on
6 loans originated in 2005 and a lot more than a bit
7 higher than that on loans originated in 2006.
8 Lenders across the board had started to
9 take more risks. The effect of the major change in
10 the ability to assess risk, that had run its course.
11 But lenders were still looking to make the same kind
12 of profits that they had been seeing, do the same
13 volume of business they had seen in the decade before.
14 And they overshot.
15 I don't see that as systemic. This may be
16 a question about terminology. I see this as an effort
17 to make money and misreading the situation when the
18 situation had changed.
19 ACTING CHAIRMAN KIRSANOW: Commissioner
20 Gaziano?
21 COMMISSIONER GAZIANO: Yes. I thank you
22 all, too.
23 I am going to focus maybe on a
24 philosophical question that was raised in the last
25 panel. Mr. Husock said that it is really not a good

1 thing for low-income families to be induced, whether
2 it's societal pressure or not, into home ownership.
3 And then there are, as we know, countervailing sort of
4 social arguments about home ownership.
5 And so I want to make probe that a little
6 bit with a hypothetical, to what extent we should
7 socialize loan risk a little bit on the margin, you
8 know, with flexible, more flexible loan standards, to
9 increase slightly at least low-income home borrowers.
10 My hypothetical is simply this. We all
11 learned of the more sophisticated tools of FICO
12 scoring and such that allows us to maybe determine
13 better who is going to be able to repay the loan or
14 not.
15 If we could imagine whatever and we profit
16 maximize or draw the line, we could imagine that they
17 make their best effort at drawing the line, should the
18 government help socialize the risk so that, at least
19 some people a little below that imaginary
20 profit-maximizing line can get into a home or are we
21 really better off and society and potential home
22 buyers really better off not getting home mortgages
23 and waiting a little while maybe until they're more
24 mature and they've built up a little bit more income?
25 What is your all's view on that?

1 MR. WIECHER: This is John Wiecher again.
2 As Mr. Kirsanow mentioned and as I
3 mentioned, I served as FHA Commissioner from 2001 to
4 2005, which puts me in charge of the FHA home mortgage
5 insurance program, among other things.
6 FHA is a socialization of risk or from
7 borrowers. The mission of FHA, going back to the
8 1930s, has been to help families become homeowners and
9 to do that without the federal government losing
10 money, to take a little bit more risk than the private
11 sector is able to take but in taking that risk, not to
12 go too far and start losing money.
13 When I was at HUD in 1989, it appeared
14 that FHA had overdone it in the 1980s in the oil patch
15 problems. And FHA was very close to having a negative
16 net worth.
17 And Congress, acting very promptly on the
18 basis of that information, introduced a new premium
19 structure in order to recapitalize FHA. And that
20 worked quite well.
21 FHA has traditionally required a three
22 percent down payment. That is a statutory minimum.
23 And that has meant that FHA is taking more risk than a
24 private lender is taking, than Fannie or Freddie is
25 able to take or any private lender that you could

1 mention. And there will be more defaults. There are
2 more defaults in FHA loans than there are in the
3 conventional market, in the prime market.
4 The policy decision has been that it's
5 worth trying to promote home ownership. It's you
6 don't want any more defaults than you can help.
7 Defaults are not good. They're not good for the
8 individuals affected, the families affected. They're
9 not good for the neighborhoods.
10 There are always defaults, even the best,
11 the lowest-risk. But you have a system where the risk
12 is socialized. And the program has made money and
13 steadily since it was established.
14 In recessions, like this recession, it
15 does worse. And that I am sure is going to be true in
16 this recession. It has been true in other recessions.
17 COMMISSIONER GAZIANO: It is not going to
18 make a profit?
19 MR. WIECHER: I would not expect it to
20 make a profit on the business that it is doing now.
21 And the FHA defaults tend to peak in the third to
22 fifth year after the loan is originated, before you
23 built up much equity. But there has been time for
24 your economic circumstances to change and for it to go

1 for a job loss for a family or something along that
2 line.
3 And I think you will see more defaults in
4 the loans that were underwritten a few years ago than
5 you would have seen --
6 COMMISSIONER GAZIANO: If you don't mind
7 me asking one clarification?
8 MR. WIECHER: Sure.
9 COMMISSIONER GAZIANO: It seems to me that
10 the private market, profit maximizers, will on average
11 aim to reach every single home buyer whom they think
12 can add a penny of extra profit.
13 What I think you are saying -- I just want
14 to make sure I understand it -- is that FHA or other
15 government enterprises is willing to reach a little
16 bit lower and perhaps take risks where they know on
17 average there might be a loss but they can take some
18 of their profit from some of the creamier home buyers.
19 And that is how they still, you believe, on average
20 turn a net profit over time. Is that how it works?
21 MR. WIECHER: Up to a point. Nobody who
22 borrows from FHA is creamy as a borrower. The --
23 COMMISSIONER GAZIANO: Slightly creamier,
24 a few pennies taken here.

1 MR. WIECHER: Two percent is on average,
2 it's two percent, and sometimes it's one percent.
3 It's not quite skim.
4 But I think that nothing protects FHA's
5 market share. There has been a limit on the maximum
6 mortgage amount under FHA mortgage. But that doesn't
7 stop anybody, Fannie, Freddie, anybody, from making a
8 loan that would be eligible for FHA if they think it
9 is profitable. And they do.
10 What FHA has had, what VA has had is the
11 backing of the government, which enables it to take a
12 little bit more risk. And the requirement that if
13 they take that more risk, they not lose money.
14 And there is a little sliver of the
15 market, sometimes a bigger sliver, sometimes a smaller
16 one, but they consider it on that basis. And they do.
17 And that's the purpose. And that's where the risk has
18 been socialized.
19 And that seems to me to be an appropriate
20 public policy answer to the question you asked.
21 ACTING CHAIRMAN KIRSANOW: Is there anyone
22 else who wants to --
23 MR. POLLARD: I was going to say as
24 counsel is in charge of helping my agency meet the
25 policies set by Congress, I probably won't comment on

1 that, maybe from one of my classes at Georgetown or
2 UVA.
3 I think one of the things you should note
4 is that in the affordable housing program, people
5 think of this as just stand-alone houses. It does
6 look to manufactured housing. It does look for
7 rental. We look at multi-family programs that the
8 enterprises have.
9 I am not answering your question, but what
10 I am trying to say is there is interest already in
11 that. The second thing I would say is that, as I
12 noted, we are going to be undertaking a rulemaking.
13 And if the Commission has views that it
14 would like to put in for our consideration, that would
15 be fine. But, I mean, our policies, we are operating
16 with the laws that are set.
17 MR. SENHAUSER: Can we speak?
18 ACTING CHAIRMAN KIRSANOW: You can speak.
19 MR. SENHAUSER: All right. Bill
20 Senhauser, speaking for myself because the conservator
21 speaks for Fannie Mae.
22 I look at this as sort of there are two
23 buckets here. I think one is a terms and conditions
24 bucket and that we have been talking a lot about
25 price, but, you know, the touchstone going forward, I

1 think, needs to be suitability and sustainability.
2 Someone has to be incented to pay very close attention
3 to the facts and circumstances of the consumer and
4 needs to have a federal or state or local or all three
5 incentive to care.
6 And so the most important thing going
7 forward in terms of the federal role, it seems to me,
8 is setting some standards through Fannie Mae and
9 Freddie Mac or otherwise, that are totally focused,
10 like a laser beam, on sustainability and suitability
11 of home ownership.
12 Now, the price question I think you can
13 say either you're going to through CRA say because you
14 have a bank charter you are going to have to give away
15 a little money to get more people in homes or you can
16 make it explicit, like the Treasury Department has
17 done with the HASP program, which is to take people's
18 DTI down. The Treasury is going to pay some money.
19 So that is my answer as a human to the
20 question that you posed. Is that responsive?
21 COMMISSIONER GAZIANO: It is. It is.
22 MR. SENHAUSER: Okay.
23 ACTING CHAIRMAN KIRSANOW: Commissioner
24 Yaki?
25 COMMISSIONER YAKI: Thank you.

1 Actually, I am looking at the time. And I
2 really want to listen to the third panel. But I just
3 want to say there is some kind of a very interesting
4 irony here of when we talk about FHA and sort of the
5 social spreading or government policy spreading risk
6 in terms of FHA-underwritten mortgages.
7 And, yet, you must look at what we are
8 doing right now on Wall Street and think to yourself,
9 "Well, now we are taking a big risk in terms of our
10 taxpayer funds on extremely toxic securities right
11 now."
12 So I just wanted to make that point that I
13 hope we move on to the next panel.
14 ACTING CHAIRMAN KIRSANOW: Mr. Tsien?
15 MR. TSIEN: I just wanted to give an
16 update on the facts on some data that Secretary
17 Wiecher used. He had mentioned the first-time home
18 buyer rate for the GSEs in 2003 range was about 20 or
19 25 percent of government and the minority
20 participation rate for home purchase loans was 13 to
21 14.
22 We had a change of leadership in 2004. It
23 was clear part of that message was we had to change
24 our performance on those dimensions. So I would say
25 we just filed our annual housing report for 2008. I

1 would be happy to send you a copy. I think we sent
2 2007 because it wasn't available yet.
3 Our first-time home buyer rate is 35
4 percent. And our minority participation is 25. So
5 progress has been made. More progress obviously needs
6 to be done. We have to rethink some of the tools we
7 have used because things that we thought were
8 progressive and innovative in an uprising house price
9 environment have proved to be riskier than we had
10 anticipated, not just for us as investors or companies
11 but also for owners. So there needs to be progress
12 made. We need to pause and think about the kinds of
13 tools we're going to get into in the next plateau.
14 I just want to be clear that, Mr.
15 Secretary, we have made progress. We took that
16 guidance to heart.
17 MR. WIECHER: Thanks. But may I say one
18 thing in response?
19 ACTING CHAIRMAN KIRSANOW: Sure. Go ahead.
20 MR. WIECHER: I am glad to hear that, Bob.
21 I am no longer a secretary, and I speak even less for
22 anybody than Bob and Bill do. I speak only for
23 myself.
24 (Laughter.)

1 MR. WIECHER: I am glad to hear that
2 because that was the first time the annual housing
3 activity's report will have reported first-time home
4 buyers and minority first-time home buyers. The data
5 has not been -- they are public. And we did the work
6 in 2004. We put it together partly from GSE data and
7 partly from HMDA data.
8 So it's good to have that information. I
9 am delighted to hear that. I look forward to seeing
10 the report.
11 ACTING CHAIRMAN KIRSANOW: Commissioner
12 Taylor?
13 COMMISSIONER TAYLOR: A quick question.
14 It sounds like the goals were articulated. And it
15 sounds like we now have reports breaking down the data
16 by race and ethnicity. Are the goals connected to
17 race and ethnicity at all?
18 MR. WIECHER: No.
19 MR. SENHAUSER: That would be unlawful.
20 MR. WIECHER: One point to make. This is
21 John Wiecher again.
22 There is a goal that is based on
23 geography, the under-served area goal. And that is
24 based partly on the minority composition of the census

1 tract, but it is not based on the race of the
2 borrower. It is based on the location of the loan.
3 There have been cases and, indeed, at one
4 point there was a story with a lovely picture of a
5 mansion in Cincinnati, a story in the Post about a
6 million-dollar home that counted toward the
7 under-served area goal because it happened to be in
8 the census tract that the boundaries as drawn by the
9 Census Bureau included a small area of very nice homes
10 with a much lower-income area adjacent to it.
11 And the locational goal of anything can
12 happen, but there are no goals based on the race or
13 ethnicity of the borrower and no goals based on
14 whether the borrower is a first-time home buyer,
15 repeat home buyer, or whether you are making a loan to
16 a rental property or a refi.
17 ACTING CHAIRMAN KIRSANOW: Well, this has
18 been highly informative. I, in fact, had a couple of
19 questions. But, again, in sensitivity to the time, I
20 think I am going to have to defer them.
21 I want to thank the panelists very much.
22 The record remains open for 30 days, as I mentioned at
23 the outset. If you have anything else you would like
24 to contribute, feel free to do so at the address we

1 provided earlier; that is, this address, 64 9th
2 Street, to the Office of General Counsel.
3 And, with that, we will close out this
4 panel.
5 (Whereupon, the panel was excused.)
6 ACTING CHAIRMAN KIRSANOW: Take a
7 20-minute break and convene the third panel on
8 predatory lending.
9 (Whereupon, a luncheon recess was taken at
10 12:47 p.m.)
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1 A-F-T-E-R-N-O-O-N S-E-S-S-I-O-N

2 (1:10 p.m.)

3 ACTING CHAIRMAN KIRSANOW: I think we are
4 all set. Okay. Good enough. Again, I apologize for
5 being late. I am ten minutes late.

6 PANEL 3 - PREDATORY LENDING AND THE MORTGAGE CRISIS

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

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

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

23 I will recite your biographies. As I
24 mentioned previously, many of you have impressive
25 biographies. So if I were to read them all, we would

1 be here until 3:00 or 4:00 o'clock before we begin
2 testimony. So I am just going to talk about the
3 salient features of your biographies as pertains to
4 your testimony here today.
5 On the first subpanel -- in fact, we have
6 got some recidivists here, at least one -- our first
7 witness will be Eileen Harrington, who is Acting
8 Director of the FTC's Bureau of Consumer Protection.
9 The bureau's mandate is to protect
10 consumers from deceptive, unfair, or fraudulent
11 practices. Its actions include individual company and
12 industry-wide investigations, administrative and
13 federal court litigation, rulemaking proceedings, and
14 consumer and business education.
15 Mr. Barry Wides was supposed to be here.
16 I don't see him here yet. He had testified in the
17 previous panel. So I will skip his bio.
18 And also Mr. Brown is here. I will skip
19 his bio.
20 But we also have Mr. Leonard Chanin. He
21 is the Associate Director of the Division of Consumer
22 and Community Affairs at the Fed. He is responsible
23 for implementing and interpreting several consumer
24 protection laws, including the Truth in Lending Act,
25 Equal Credit Opportunity Act, Home Mortgage Disclosure

1 Act, Truth in Savings Act, and Fair Credit Reporting
2 Act.
3 Welcome to everybody. And we will begin
4 with Ms. Harrington.
5 MS. HARRINGTON: Thank you, Mr. Chairman
6 and members of the Commission.
7 PANEL 3A
8 MS. HARRINGTON: As the Chairman said, I
9 am Eileen Harrington. I am the Acting Director of the
10 Bureau of Consumer Protection at the FTC. And I am
11 very appreciative of the opportunity to talk with you
12 this afternoon about the FTC's role with respect to
13 predatory lending and related issues.
14 I first want to remind you that the
15 commission has submitted a written testimony for the
16 record. My oral statement and any answers that I may
17 give this afternoon represent my views and not
18 necessarily those of the commission.
19 The Federal Trade Commission is the
20 nation's consumer protection agency. It has broad
21 enforcement responsibilities under the Federal Trade
22 Commission Act.
23 The FTC deals with issues that touch the
24 economic life of nearly every America. It is the only
25 federal agency with both consumer protection and

1 competition jurisdiction in broad sectors of the
2 economy.
3 We enforce section 5 of the Federal Trade
4 Commission Act, which broadly prohibits unfair or
5 deceptive acts or practices in or affecting commerce.
6 The commission also has responsibility for enforcing
7 statutes that address specific aspects of lending
8 practices, including the Truth in Lending Act, the
9 Home Ownership and Equity Protection Act, and other
10 statutes.
11 And, in addition, the commission enforces
12 a number of other consumer protection statutes that
13 govern financial services providers, including the
14 Fair Debt Collection Practices Act, the Fair Credit
15 Reporting Act, the Equal Credit Opportunity Act, the
16 Credit Repair Organizations Act, and the privacy
17 provisions of the Gramm-Leach-Bliley Act.
18 Although the commission has the authority
19 to take action against a wide array of acts and
20 practices in the financial services arena, as we often
21 say, practices that occur during the entire life cycle
22 of financial transactions, the commission lacks
23 jurisdiction over many financial service providers
24 which are exempt from the FTC's jurisdiction. Banks,
25 thrifts, and federal credit unions are specifically

1 exempt from the Federal Trade Commission's
2 jurisdiction under the Federal Trade Commission Act.
3 The FTC's jurisdiction under the FTC Act
4 extends only to non-bank financial companies,
5 including non-bank mortgage companies, mortgage
6 brokers, and finance companies.
7 The commission's actions to protect
8 consumers of financial services are an essential part
9 of our consumer protection work. Unfair, deceptive,
10 discriminatory, or otherwise unlawful lending
11 practices result in significant injury to consumers
12 every year. These illegal practices, especially in
13 connection with subprime lending, have a
14 disproportionate effect on lower-income and minority
15 communities.
16 To fulfill its consumer protection mission
17 in the financial services area, the FTC engages in law
18 enforcement, consumer education, regulatory work, and
19 policy research.
20 The commission has pursued law enforcement
21 actions focusing on all aspects of mortgage lending,
22 including advertising and marketing, approval and
23 pricing, and servicing by mortgage lenders, brokers,
24 and loan servicers.

1 Several of these landmark cases have
2 resulted in large monetary judgments, collectively
3 returning approximately $345 million to consumers over
4 the past decade.
5 The FTC's actions have challenged
6 deceptive or unfair practices without regard to the
7 race or national origin of the victims of these
8 practices.
9 Nevertheless, because many minorities were
10 subprime borrowers, the FTC's cases have provided
11 redress to many minority borrowers who were victims of
12 unfair or deceptive practices.
13 Additionally, as we have seen the recent
14 rapid increase in mortgage delinquencies and
15 foreclosures, the FTC has intensified its efforts to
16 protect consumers in financial distress, including
17 protecting them from mortgage foreclosure rescue
18 scams.
19 We began a year ago by forming task forces
20 in seven local and regional areas with our state and
21 other federal counterparts. The FTC to date has
22 brought eight cases. And we have many more in the
23 pipeline.
24 And we have worked closely with our
25 partners and other enforcement agencies to assign

1 targets, identify targets, and make sure that the
2 authority with available resources and the best reach
3 goes after targets.
4 Another focus of FTC law enforcement is
5 discrimination in mortgage lending. Since the Equal
6 Credit Opportunity Act was enacted, the commission has
7 brought over three dozen cases against large subprime
8 lenders, major non-mortgage creditors, and smaller
9 finance companies, alleging ECOA violation.
10 Although most of the FTC's lending
11 discrimination cases have involved the unlawful denial
12 of credit, most recently the FTC's enforcement is
13 focused on the pricing of mortgage loans. And, for
14 example, in December of 2008, the FTC reached a
15 settlement with Gateway Funding Diversified Mortgage
16 Services and its general partner, Gateway Funding Inc.
17 The commission alleged that Gateway
18 violated the ECOA by charging African American and
19 Hispanic consumers higher prices for mortgage loans
20 than non-Hispanic white consumers. The alleged
21 pricing disparities were substantial, statistically
22 significant, and could not be explained by factors
23 related to underwriting risk or credit characteristics
24 of the applicants.

1 The FTC settlement bars Gateway from
2 discriminatory lending practices and requires it to
3 implement a fair lending training program, a
4 comprehensive data integrity program designed to
5 ensure accuracy and completeness of loan data, and a
6 fair lending monitoring program.
7 Additionally, the settlement imposed a
8 judgment of $2.9 million, all but $200,000 of which
9 was suspended based on the company's inability to pay.
10 The FTC is using this money to redress African
11 American and Hispanic consumers who were harmed by
12 Gateway's practices.
13 Law enforcement is the primary means that
14 the commission uses to combat mortgage lending acts
15 and practices that harm consumers. At the same time,
16 to empower consumers to better protect themselves from
17 potentially harmful conduct in the first instance, the
18 FTC engages in extensive consumer education related to
19 mortgage lending.
20 All of the commission's consumer
21 protection materials, including many released in
22 Spanish as part of the FTC's Hispanic Outreach
23 Program, are available to the public on the FTC's Web
24 site, by calling the FTC's Consumer Response Center,
25 or through 10,000 partners that we have in the private

1 and public sector all over the country who distribute
2 our materials.
3 For example, in tandem with a recent law
4 enforcement action against foreclosure rescue scams,
5 the commission initiated a stepped-up outreach
6 initiative. We are involved in federal, state, and
7 local task forces, as I mentioned.
8 Our people are out giving seminars in
9 local communities along with our state enforcement
10 colleagues and others to work with consumers one on
11 one who are at risk of foreclosure to make sure that
12 they are steered in the right direction and not the
13 wrong direction for help.
14 In addition, we warn consumers about the
15 red flags for scams. And to inform them about
16 legitimate resources available to them, the commission
17 has undertaken a variety of other outreach
18 initiatives, including radio public service
19 announcements in English and Spanish to stations in
20 cities hardest hit by mortgage foreclosures and
21 distributing an article adapted from its mortgage
22 foreclosure scam consumer education brochure to a
23 national syndicated news service, which, in turn, sent
24 it to more than 10,000 community newspapers across the
25 nation for inclusion in publications.

1 Finally, the commission engages in public
2 workshops and other research efforts so that it may
3 better understand particular consumer protection
4 issues in the changing marketplace and advocate for
5 policies that promote protections for consumers, such
6 as policies that foster better informed mortgage
7 borrowing.
8 One of our more significant recent
9 research projects was an empirical study assessing the
10 effectiveness of mortgage disclosure documents that
11 mortgage originators are required to provide to
12 consumers under Truth in Lending and RESPA. That
13 project concluded that these disclosures were not very
14 effective.
15 Have you all closed on a mortgage any time
16 recently? We are not very effective in helping
17 consumers of subprime and prime mortgages understand
18 the terms of mortgages. Consumers could benefit from
19 changes in current disclosure requirements. And the
20 FTC has been advocating aggressively for those
21 reforms.
22 Lastly, the Congress just gave the Federal
23 Trade Commission some additional regulatory authority
24 in the Omnibus Spending Act of 2009. The FTC
25 generally does not have authority to issue rules under

1 the Administrative Procedures Act but, rather, has to
2 use quite cumbersome procedures that are in the FTC
3 Act itself under those normal procedures in the FTC
4 Act that takes four years or more for the FTC to issue
5 a trade regulation rule.
6 We have asked for broader Administrative
7 Procedures Act rulemaking authority for all of the
8 financial services area. The Congress has just given
9 us authority in the spending bill to do Administrative
10 Procedures Act rulemaking relating to mortgage lending
11 and mortgages.
12 And we will be using that authority. We
13 should have new proposed rules out for comment within,
14 as the statute giving us the authority requires, 90
15 days, probably sooner than that.
16 And we will be using that new authority to
17 initially target practices that are most harmful right
18 now. We are not going to take a backward glance at
19 what was harmful last year and the year before that
20 isn't happening right now yet, but we want to address
21 the practices that are harmful right now first.
22 So thank you very much for the opportunity
23 to be here. And I look forward to your questions and
24 to hearing my colleagues.

1 ACTING CHAIRMAN KIRSANOW: Thank you, Ms.
2 Harrington.
3 Mr. Brown is up again.
4 MR. BROWN: Here I am. Mr. Chairman and
5 members of the Commission, thank you for having me
6 back after having me here this morning, after we had
7 some spirited conversation, which is a good thing.
8 I am happy to be here to talk about
9 predatory lending and the FDIC's response. In recent
10 years, many consumers took advantage of low-income
11 interest rates and new mortgage products to push the
12 home ownership rate to almost 69 percent.
13 Product innovation and the expansion of
14 mortgage credit have been generally positive social
15 developments. Yet, as we know, for a significant
16 segment of the subprime market and an increasing
17 percent of the prime market, we have seen a troubling
18 trend. Many borrowers have accumulated debt
19 obligations that put their financial health at risk,
20 the situation exasperated by the current economic
21 crisis and rising unemployment.
22 Rather than building wealth, borrowers
23 across the nation are struggling to keep their homes.
24 Many borrowers, particularly low and moderate-income

1 individuals, have little financial cushion in the
2 event of personal emergencies or economic downturns.
3 In addition, many borrowers have been the
4 target of practices that are highly troubling, if not
5 predatory. Repeat refinances have taken equity from
6 people's homes. And adjustable rate features have
7 challenged the ability to continue making payments.
8 In previous years, many of these borrowers
9 could have refinanced their mortgages or sold their
10 homes at a profit to repay their debt in full. Now,
11 as home prices have stagnated or declined in many
12 areas of the country, more borrowers find themselves
13 trapped in mortgages they cannot afford to pay.
14 Abusive lending practices that result in
15 home ownership that builds debt, rather than wealth,
16 harm not only individual consumers, but they undermine
17 important societal benefits of home ownership.
18 Defining predatory lending. There is no
19 universally accepted definition of predatory lending
20 or a simple checklist. Products and loan terms that
21 may be appropriate to one type of borrower in a
22 particular circumstance may be inappropriate under
23 other circumstances.
24 Nonetheless, in 2001, expanded guidance
25 for subprime lending was issued by the banking

1 regulators. And they identified the characteristics
2 most often associated with predatory lending as making
3 unaffordable loans based on the collateral of the
4 borrower, rather than on the borrower's ability to
5 repay, inducing a borrower to refinance a loan
6 repeatedly in order to charge high points and fees
7 each time the loan is refinanced, which is also
8 referred to as loan-flipping, and engaging in fraud or
9 deception to conceal the true nature of the loan
10 obligation or ancillary products from an unsuspecting
11 or unsophisticated borrower.
12 Additionally, over the past several years,
13 the banking regulators have published a number of
14 examiner and industry guidance documents worrying
15 about the deteriorating underwriting standards. In
16 October 2006, the agencies issued interagency guidance
17 on nontraditional mortgage products to address
18 concerns about offering interest-only and payment
19 option ARMs to borrowers for whom they originally were
20 not designed.
21 The MTM guidance only reminded bankers to
22 carefully manage the risks associated with these
23 products. It also emphasized that consumers should
24 provide with clear and accurate information about

1 these products at the time they are choosing a loan or
2 deciding which payment option to select.
3 In January of 2007, the FDIC issued its
4 supervisory policy on predatory lending to reaffirm
5 that such activities are inconsistent with safe and
6 sound lending and undermine individual, family, and
7 community economic well-being.
8 The policy describes the FDIC's
9 supervisory response to predatory lending, including a
10 list of policies and procedures that relate to
11 consumer lending products.
12 The agencies issued a statement of
13 subprime lending in July of 2007 also. The statement
14 focused on certain adjustable rate mortgage products
15 marketed to subprime borrowers. It emphasized the
16 potential for these products to become predatory if
17 institutions did not have strong risk management
18 compliance programs.
19 The statement explained that institutions
20 marketing these mortgage loans face an elevated risk
21 that their conduct would violate the FTC Act's
22 prohibition against unfair, deceptive acts or
23 practices, which the FDIC and the other banking
24 agencies enforce.

1 Examination and supervisory actions. As
2 the federal regulator of state non-member banks, the
3 FDIC aggressively addresses predatory lending through
4 examinations and supervisory actions.
5 When examiners encounter unsafe and
6 unsound lending practices, we take whatever
7 supervisory action is necessary to effect correction.
8 The FDIC employs a cadre of specialized examiners in
9 fraud, risk management, consumer compliance, and the
10 Bank Secrecy Act, who regularly examine insured
11 institutions to ensure compliance with state and
12 federal laws and regulations, including all consumer
13 protection laws and the safe and sound operation of
14 FDIC-supervised institutions.
15 The FDIC also utilizes the data provided
16 under HMDA, devoting significant resources to
17 analyzing data to identify differences in prices of
18 mortgages along racial, gender, and ethnicity lines.
19 The FDIC investigates all circumstances of
20 discrimination that the HMDA data or our examinations
21 raise. We work closely with the Department of
22 Justice, to which we refer all apparent instances of
23 pattern or practice discrimination. The FDIC also
24 pursues administrative enforcement actions against
25 institutions for discrimination, where DOJ does not.

1 HMDA pricing data became available for the
2 first time following collection in 2004. And we are
3 processing a number of cases pursuant to the
4 information that we have received.
5 When the FDIC finds practices that violate
6 consumer protection, fair lending, or other laws,
7 including the FTC Act, the FTC Act's UDAP provisions,
8 we take action to ensure that illegal practices cease
9 and that harm to consumers is remedied. The
10 supervisory action taken will depend on the violation,
11 whether consumers or institutions have been harmed and
12 to what degree.
13 The FDIC will also undertake joint
14 enforcement actions with state authorities or with
15 other federal agencies, where appropriate. The FDIC
16 may assess penalties and require consumer
17 reimbursement where unfair and deceptive practices
18 were identified. And it's been done in a number of
19 cases.
20 In addition to our regular examination
21 process, the FDIC investigates consumer complaints.
22 The findings of such investigations may result in
23 supervisory actions if that is warranted.
24 Challenges for reform. Guidelines and
25 other supervisory standards promulgated by the bank

1 regulators apply to only a portion of the market.
2 Widespread credit distress in the subprime market with
3 especially pronounced problems among independent
4 mortgage lenders suggest the need for a comprehensive
5 response that assures that all lenders are subject to
6 a certain baseline of requirements.
7 Moreover, the lack of uniform standards
8 creates negative competitive pressures on insured
9 institutions. It is essential that there be a uniform
10 standard for financial products, whether they are
11 offered by banks or non-banks.
12 I see I am running out of time here.
13 Chairman Bair has been an aggressive advocate of loan
14 modifications, particularly systematic loan
15 modifications. We think that is an important way to
16 address some issues with respect to borrowers that
17 have already been subject to some predatory lending.
18 So that is the important initiative that
19 we are also focused on as well as Money Smart, which
20 is a financial education program sponsored by the
21 FDIC, where we go out, educate people of all ages in
22 all walks of life so that they are much more
23 sophisticated on financial issues and they are
24 prepared to deal with, individuals, for example,
25 abusive lenders.

1 So, in conclusion, the FDIC is very
2 concerned about certain practices in the financial
3 markets. Recent practices have often placed borrowers
4 in products that create financial hardship, rather
5 than building wealth.
6 The FDIC stands ready to work with all
7 partners to ensure that appropriate steps are taken to
8 strengthen supervision and regulation of all financial
9 institutions.
10 Thank you for your time. And I am happy
11 to answer your questions whenever you might have them.
12 ACTING CHAIRMAN KIRSANOW: Thank you, Mr.
13 Brown.
14 And Mr. Chanin?
15 MR. CHANIN: Thank you, Mr. Chairman and
16 commissioners. I appreciate the opportunity to
17 discuss the Federal Reserve Board's rules that
18 prohibit unfair and deceptive practices in the
19 mortgage market.
20 In July 2008, the board adopted sweeping
21 new regulations using its authority under the Home
22 Ownership and Equity Protection Act, or HOEPA, to
23 prohibit unfair and deceptive mortgage practices. The
24 board's rules are carefully crafted to protect
25 consumers from abusive or deceptive acts and practices

1 while keeping credit available to qualified borrowers
2 and supporting sustainable home ownership.
3 Today I will describe the scope of the
4 board's rules and outline the new consumer
5 protections. The board's rules apply to all mortgage
6 lenders, not just to depository institutions, such as
7 banks.
8 The rules are also comprehensive in their
9 coverage of the mortgage market. One set of the rules
10 would apply to the vast majority of mortgage loans
11 secured by the consumer's principal dwelling. Other
12 parts of the rules would apply to higher-priced
13 mortgages. It is to the set of rules for the
14 higher-priced mortgages that I will turn first.
15 To ensure that the protections remain
16 robust, as loan products and lending practices change,
17 higher-priced mortgage loans is defined broadly. The
18 threshold is intended to cover the entire subprime
19 mortgage market for consumer primary dwellings.
20 There are four practices banned or
21 regulated by the rules. The first three are directed
22 at risk that consumers will be unable to repay their
23 loans.
24 First, to help ensure loans are
25 affordable, lenders are prohibited from making a loan

1 without regard to the consumer's ability to repay the
2 loan from income and assets other than the home's
3 value.
4 A lender complies, in part, by assessing
5 repayment ability based on the highest scheduled
6 payment in the first seven years of the loan. For
7 example, if a loan has a lower initial payment, the
8 lender is required to underwrite the loan using the
9 later higher payment.
10 The second rule deals with stated income
11 loans. Lenders are prohibited from relying on income
12 or assets that they do not verify. This rule seeks to
13 ensure that income and other financial information
14 lenders use to evaluate consumers is accurate.
15 For example, the rule prohibits making
16 stated income loans and requires lenders to rely on
17 third party information, such as an employer letter,
18 W-2 form, or tax return.
19 The third rule deals with escrow accounts.
20 To sustain home ownership, borrowers need to pay
21 property taxes and homeowners' insurance, in addition
22 to their mortgage payments. The rule requires that
23 the lender establish an escrow account for the payment
24 of property taxes and homeowners' insurance for first
25 lien loans. This seeks to ensure that borrowers are

1 not misled by monthly payment amounts that exclude
2 these costs. The lender may offer the borrower the
3 opportunity cancel the escrow after the first year.
4 The final aspect of the board's subprime
5 rules address prepayment penalties. The rule bans any
6 prepayment penalty if the consumer's payment can
7 change during the initial four years of the loan.
8 For other higher-priced loans, a
9 prepayment penalty period cannot last for more than
10 two years. This seeks to ensure that consumers are
11 not trapped in higher-priced loans and can refinance
12 those loans if their payments may increase.
13 The HOEPA rules also prohibit several
14 practices that apply to all mortgages secured by
15 consumers' principal dwellings. One area of risk for
16 consumers is appraisal fraud. Inflated appraisals
17 harm consumers who overpay for housing and may lead to
18 further harm if consumers borrow based on the belief
19 that they have more equity than they really do. The
20 rule prohibits a creditor or broker from coercing or
21 encouraging an appraiser to misrepresent the value of
22 a home.
23 The rule also prohibits three servicer
24 practices, which apply to entities that consumers make
25 payment to and that process such payments.

1 Specifically, the rule prohibits a servicer from
2 failing to credit a payment to the consumer's account
3 as of the date the payment is received.
4 The rule also seeks to ensure consumers
5 can promptly obtain payoff statements if they wish to
6 refinance their loan by requiring servicers to provide
7 a payoff statement within a reasonable period of time.
8 Finally, servicers are prohibited from pyramiding late
9 fees on a loan.
10 The board also made several changes to its
11 advertising rules to ensure that lenders do not engage
12 in deceptive and misleading practices, such as
13 suggesting that loans are government-issued or
14 guaranteed if they are not.
15 Finally, creditors are required to provide
16 consumers with disclosures about the credit terms
17 within three days of application for all mortgage
18 transactions to ensure that consumers can better shop
19 and understand the transactions.
20 These rules are generally effective
21 October 1st, 2009 except for the escrow provisions,
22 which are effective on a later date.
23 In conclusion, the board's rules are
24 designed to protect consumers where they face the most
25 risk. The rules seek to ensure that loans are

1 affordable and that consumers are not locked into
2 unsustainable loans.
3 Thank you for the opportunity to discuss
4 the board's rules with you today. And I look forward
5 to answering your questions.
6 ACTING CHAIRMAN KIRSANOW: Thank you very
7 much. We will now go to questioning from
8 commissioners. I'm sorry. That's correct. I
9 apologize for that. We will begin questioning at the
10 conclusion of subpanel B. Everyone was up in arms
11 about that.
12 So if you can give up your seats and
13 subpanel B approach? And we will listen to your
14 testimony and then have questions.
15 It appears we have got everybody seated.
16 And I will read your bios in order. And then we will
17 begin the testimony with Ms. Rice as soon as I have
18 completed all of your bios. Again, these are the
19 truncated versions of your bios.
20 Ms. Rice is Vice President of the National
21 Fair Housing Alliance. She oversees the alliance's
22 resource development, public policy, and enforcement
23 initiatives.
24 Ms. Rice previously served as CEO of the
25 Toledo Fair Housing Center, where she development and

1 implemented the State of Ohio's first predatory
2 lending remediation program and worked to help pass
3 anti-predatory lending statutes.
4 Next we have James Carr, who is Chief
5 Operating Officer for the National Community
6 Reinvestment Coalition. He is also a visiting
7 professor at Columbia University and an advisory
8 committee member of Federal Reserve of the San
9 Francisco's Center for Community Development
10 Investments.
11 Next is Brian Brooks, managing partner of
12 the D.C. office of O'Melveny and Myers. Mr. Brooks'
13 experience in the fair lending area includes defending
14 the nation's largest automated underwriting system for
15 disparate impact claims, representing several of the
16 nation's largest mortgage originators and servicers in
17 shared lending investigations and litigation brought
18 by states' attorneys general and representing mortgage
19 investors in administrative disputes brought before
20 the U.S. Department of Housing and Urban Development
21 under the Fair Housing Act.
22 And last we have got Ken Markison,
23 Associate Vice President and Regulatory Counsel at the
24 Mortgage Bankers Association, where he works on a wide
25 variety of mortgage lending issues.

1 Mr. Markison joined the Mortgage Bankers
2 in July 2004, following his retirement from a 33-year
3 career with the federal government. At the time of
4 his retirement, he served as Assistant General Counsel
5 for Government-Sponsored Enterprises in the Office of
6 General Counsel of the Department of Housing and Urban
7 Development.
8 I welcome all of you, look forward to your
9 testimony. And, as I said, we will defer questions to
10 the conclusion of your testimony, when we will ask
11 again. It was a logistically challenging feat of
12 asking the previous panel to join us so that we can
13 question you all at the same time.
14 Commissioner Yaki?
15 COMMISSIONER YAKI: Yes. Commissioner,
16 Mr. Chair, I just wanted to say that I want to thank
17 the staff for this. I am going to be leaving in the
18 middle of this presentation. I will be obviously
19 looking at the record and the testimony closely. I
20 just want to thank the staff for this.
21 And it's no insult to you folks. I just
22 have a plane to catch.
23 ACTING CHAIRMAN KIRSANOW: It's his
24 private plane.
25 (Laughter.)

1 COMMISSIONER YAKI: If it were my private
2 plane, I wouldn't have to worry about when I get
3 there.
4 ACTING CHAIRMAN KIRSANOW: Ms. Rice?
5 PANEL 3B
6 MS. RICE: Mr. Chairman and members of the
7 Commission, thank you very much for this opportunity
8 to speak to you this morning or this afternoon now, I
9 guess.
10 Bloomberg estimates that American
11 taxpayers will spend close to $10 trillion to address
12 this financial catastrophe that many have attributed
13 to failures in the subprime market and, in part, to
14 predatory lending practices.
15 We have seen in the media the terms
16 "subprime" and "predatory lending" being used
17 interchangeably. However, the two terms are not
18 synonymous.
19 Subprime lending is supposed to be a
20 market for borrowers who do not meet prime credit
21 standards. Unfortunately, it has not been used this
22 way. At the National Fair Housing Alliance and in my
23 work in Ohio, we have seen predatory lending practices
24 in all segments of the lending market: conforming,
25 nonconforming, conventional, nonconventional, prime,

1 and subprime. However, in more recent years, a
2 preponderance of the predatory lending cases that we
3 have seen have involved the subprime market.
4 So what is predatory lending? You have
5 heard a couple of speakers in the previous panel talk
6 about some of the attributes of predatory lending. I
7 won't go through the problem of repeating all of
8 those, but basically predatory lending is putting the
9 best interests of the lender before those of the
10 borrower. And it's the practice that results in harm
11 to the borrower.
12 Characteristics such as yield spread
13 premiums, basing eligibility for the loan on the
14 property value or equity in the home, as opposed to
15 the ability to pay, not escrowing for taxes and
16 insurance, and originating a loan that is
17 unsustainable for the borrower are all characteristics
18 of predatory lending.
19 Predatory lending has existed for decades
20 and, arguably, for centuries and is largely possible
21 because America has a bifurcated lending system. It
22 always has, even as we look back to the Reconstruction
23 era with the advent of the Freedman's Bank system.
24 Restrictive covenants and other
25 discriminatory practices in the housing and lending

1 markets contributed significantly to the segregation
2 of America's neighborhoods. Indeed, America's
3 neighborhoods and communities are more segregated
4 today than they were in 1920.
5 Lending, as it evolved, it relied on
6 property valuation methodologies and other
7 underwriting methodologies. These methodologies
8 simply reflected discriminatory beliefs at the time.
9 I include in my statement and in my
10 PowerPoint presentation several excerpts from real
11 estate valuation manuals. I will quote from one,
12 "There is one difference in people, namely race, which
13 can result in a very rapid decline in neighborhoods.
14 Usually such declines can be partially avoided by
15 segregation."
16 Homer Hoyt and Arthur Weimer in their
17 appraisal treatise "Principals of Urban Real Estate"
18 warned that persons other than of the Caucasian race
19 will negatively impact property values. They promoted
20 and supported the use of restrictive covenants, even
21 after the Supreme Court had ruled them
22 unconstitutional.
23 The establishment of the Homeowners' Loan
24 Corporation in the 1930s helped dramatically to make
25 home ownership available to Americans by lessening

1 lending standards and making it easier for people to
2 qualify for mortgages. But the Homeowners' Loan
3 Corporation also practiced discrimination.
4 For example, it created a series of
5 color-coded maps indicating the level of risk
6 presented by each neighborhood. And, of course, the
7 level of risk was correlated to the level of the
8 presence of African Americans and Latinos in those
9 communities.
10 The FHA and the VA also, of course, were
11 programs that were sponsored by the federal government
12 that also made home ownership more accessible by,
13 again, lowering mortgage standards for homeowners and
14 for borrowers.
15 Homer Hoyt, whom I mentioned earlier,
16 joined the FHA as its principal housing economist.
17 He, of course, brought his jaundiced views to the FHA.
18 One of the FHA's appraisal manuals states
19 that "If a neighborhood is to retain stability, it is
20 necessary that properties shall continue to be
21 occupied by the same social and racial classes."
22 The FHA in keeping with Homer Hoyt's views
23 also promoted the use of restrictive covenants. As a
24 result, fewer than one percent of all African

1 Americans were able to obtain a loan from the FHA
2 program from 1930 to 1960.
3 Ironically, in response to outcries of
4 this discrimination that was present in the FHA
5 program, in the 1970s and 1980s, FHA was actually used
6 as a vehicle for predatory lending practices due to
7 lax regulation and lax oversight. In fact, appraisal
8 fraud was replete in FHA during that time.
9 Substantial lending deregulation in the
10 1980s greased the wheels for lending in minority
11 communities desperate for credit because of historic
12 redlining practices.
13 We have talked a lot about the loosening
14 of underwriting standards for borrowers but have not
15 heard a lot about the loosening of underwriting
16 standards for lenders and, in particular, investors.
17 Bankruptcy remoteness, liability and asset
18 protection, the ability to move assets off of
19 corporate balance sheets have all contributed
20 dramatically to the attractiveness of the subprime
21 market to investors.
22 In fact, I can remember talking to
23 lenders, one lender at the Royal Bank of Scotland, who
24 said they would take a portfolio, a $100 million
25 portfolio, of fully amortizing prime, fixed rate

1 mortgages. And they had a $100 million portfolio of
2 exotic mortgages. And they would get much better
3 pricing for the exotic mortgage portfolio.
4 So when you have investors who are willing
5 to pay more for exotic mortgage portfolios, of course,
6 you know what kind of loans are going to be marketed
7 by loan originators.
8 When I first started working on predatory
9 lending issues in the 1990s, the subprime market was
10 largely funded by private investors and the junk bond
11 market.
12 But since that time, trillions of dollars
13 have pulled into this area. And, as a result, what we
14 have seen is FHA, Freddie Mac, and Fannie Mae lending,
15 those entities losing market share precipitously as
16 the subprime market has grown voluminously.
17 Our organization has long pushed for more
18 GSE traditional lending in under-served markets,
19 largely because we had seen that where there were high
20 penetration levels of traditional GSE lending, there
21 much lower foreclosure rates.
22 And, indeed, in jurisdiction after
23 jurisdiction, we see patterns, a very high correlation
24 between the racial composition of the neighborhood and
25 levels of subprime lending.

1 Simultaneously, where we see high levels
2 of subprime lending, we also see much higher levels of
3 foreclosures. And I have included several maps in the
4 presentation that showed the correlation and the
5 juxtaposition between high levels of minority
6 residency and also high levels of subprime lending.
7 And you also see that where there are very, very high
8 levels of subprime lending, the foreclosure rates are
9 much higher.
10 A couple of disturbing facts I would just
11 like to highlight. African American and Latino home
12 buyers face a statistically significant risk of
13 receiving less favorable treatment than comparable
14 whites when they ask mortgage lending institutions
15 about financing options.
16 In fact, the National Fair Housing
17 Alliance conducted a systemic lending testing project
18 in the mid 1990s in which we matched African American
19 potential borrowers to white potential borrowers.
20 In our match pair tests, the African
21 American tester always had a better financial profile
22 than the white tester. And we saw very, very high
23 rates of disparate treatment. In fact, for some
24 classes, the disparate treatment was as high as 66
25 percent.

1 African Americans and Latinos are much
2 more likely to receive a subprime loan than their
3 white counterparts according to HMDA data. Roughly 54
4 percent of African Americans and 47 percent of Latinos
5 received subprime loans, compared to approximately 17
6 percent of whites.
7 Even higher-income African Americans and
8 Latinos receive a disproportionate share of subprime
9 loans. Borrowers of color are more than 30 percent
10 more likely to receive a higher-rate loan than white
11 borrowers, even after accounting for differences in
12 creditworthiness.
13 In fact, one of our Ohio member
14 organizations just recently completed a lending
15 analysis in which they found that high-income African
16 Americans and Latinos were more likely to receive a
17 high-cost loan in the State of Ohio than low-income
18 whites.
19 What we have also seen is that subprime
20 costs do not support the level of risk. Indeed,
21 Fannie Mae and Freddie Mac have reported that some
22 subprime borrowers qualified for prime loans even when
23 they received subprime loans.
24 The Wall Street Journal recently
25 commissioned a report in which they found that for

1 some subprime mortgages, as high as 61 percent of
2 those borrowers would have qualified for a prime
3 mortgage.
4 I am just going to spend one minute, if
5 you will allow me, to talk about the impact. And I
6 won't go into recommendations. If you have any
7 questions about recommendations, I would be happy to
8 answer those in the Q&A.
9 African Americans owned 15 million acres
10 of land in 1920. Today they hold just over 1.1
11 million acres. Wealth of whites has been cumulative
12 over the years because of some of the programs that I
13 have mentioned previously, but it has also compounded.
14 And, of course, it is much more diversified.
15 Because of that, about two-thirds of net
16 wealth for African Americans and Latinos is comprised
17 of their home equity. The percentage is much lower
18 for whites. For every one dollar of net worth held by
19 whites, Latinos have 12 cents and blacks have about 9
20 cents. If home equity is excluded for every dollar of
21 net worth held by whites, Latinos have eight cents and
22 blacks have five cents.
23 And I will conclude my comments there.
24 ACTING CHAIRMAN KIRSANOW: Thank you.
25 Mr. Carr?

1 MR. CARR: Good afternoon, Mr. Chairman
2 and other distinguished members of the Commission, my
3 name is Jim Carr. And I am the Chief Operating
4 Officer of the National Community Reinvestment
5 Coalition.
6 NCRC is an association of more than 600
7 community-based organizations across the nation that
8 promote access to basic banking, including credit and
9 savings, in order to create sustainable, affordable
10 housing, job development, and vibrant communities for
11 America's working families. On behalf of our
12 coalition, I am honored to speak with you today.
13 The U.S. economy is unraveling at a pace
14 unseen in decades. The more than 650,000 jobs lost
15 last month has contributed to a growing concern that
16 the unemployment rate could rise to 10 percent or more
17 before the economy rebounds.
18 At the center of the economy's instability
19 is the foreclosure crisis that has claimed three and a
20 half million homes over just the last two years and
21 threatens the loss of an additional eight to ten
22 million homes to foreclosure over the next five years.
23 The loss of wealth associated with the
24 collapse of the housing market is staggering. More

1 than $5 trillion in housing equity has virtually
2 evaporated since the foreclosure crisis began.
3 The Dow Jones Index has been literally cut
4 in half, further contributing to a vicious cycle which
5 is now in play, of decreased consumer confidence,
6 substantially reduced spending, lowered productivity,
7 rising unemployment, and additional foreclosures.
8 The magnitude of the economic decline has
9 led many observers to conclude that the current crisis
10 is an equal opportunity nightmare. But reality paints
11 a different picture.
12 While few have been able to escape the
13 financial pain completely, African Americans, Latinos,
14 Native Americans, and many Asian subpoplations are
15 bearing the brunt of this national epidemic.
16 Today, as the national unemployment rate
17 is just above eight percent, African Americans and
18 Latinos are already mired in double digit job losses.
19 The unemployment rate for African Americans is just
20 under 14 percent, for Latinos more than 11, and for
21 non-Hispanic whites a little more than 7. For young
22 black males, that rate is 25 percent and climbing.
23 Before the current crisis, African
24 Americans and Latinos held on an average a mere $10 of
25 wealth and $12, respectively, for every $100 of saving

1 for the typical non-Hispanic white household. What
2 that means in reality is that they are much less
3 prepared to weather this current economic decline
4 because they have many fewer savings to rely upon.
5 And, as a result, a major share of the black middle
6 class is at jeopardy.
7 These severe disparities of wealth and
8 economic attainment are a direct result of more than a
9 century of denial of equal rights and opportunity for
10 people of color in this country. And the
11 disproportionate impact of the foreclosure crisis on
12 African Americans and Latinos will further expand the
13 racial wealth gap.
14 African Americans and Latinos were the
15 disproportionate targets for unfair, deceptive, and
16 reckless lending practices that triggered the
17 foreclosure crisis and imploded the credit markets.
18 In recent years, more than half of all
19 mortgage loans to African Americans and 40 percent to
20 Latinos were high-cost subprime. This
21 disproportionate reliance on high-cost subprime loans
22 is translating into exceptional foreclosures for
23 African Americans. As Lisa has stated, the home
24 ownership rate for African Americans has already
25 fallen by more than two percent.

1 According to a recent survey by the
2 mortgage bankers, the foreclosure start rates for
3 subprime adjustable loans were 3 and a half times
4 greater for adjustable prime loans and 19 times
5 greater than that for fixed rate prime.
6 But, even if borrowers with high-cost
7 loans were able to avoid foreclosure and maintain
8 their homes, they do so at a huge cost. The typical
9 subprime loan is roughly 300 to 400 basis points above
10 prime. That means a borrower could easily pay about
11 75 percent to more than the total cost of the original
12 loan, just in the interest rate spread.
13 Obviously if that interest rate spread is
14 due to the consumer being steered into a loan that
15 they could have avoided, then that is an extraordinary
16 amount of intentional wealth stripping.
17 The situation is so dire, in fact, within
18 the African American community that the policy group
19 United For a Fair Economy estimates that African
20 Americans could potentially face the greatest loss of
21 wealth since Reconstruction.
22 Unfair, deceptive, and reckless lending
23 practices increasingly permeated the financial system
24 over the past decade. This crisis was not about
25 financial institutions being pressured by the

1 Community Reinvestment Act to make loans to low and
2 moderate-income borrowers who could not afford them.
3 According to the Federal Reserve Board,
4 only six percent of high-cost problematic loans to low
5 and moderate-income borrowers were covered under CRA.
6 Most subprime loans were securitized by Wall Street
7 firms which had no CRA obligations.
8 Moreover, less than 10 percent of subprime
9 loans originated between 1998 and 2006 were to
10 first-time home buyers. Most subprime loans were for
11 refinancing. And it was refinancing which created the
12 extraordinary and massive house of cards or Ponzi
13 scheme, which ultimately fell apart in 2006 as house
14 prices fell.
15 Minorities were disproportionate targets
16 for subprime loans because they were
17 disproportionately financially vulnerable and,
18 therefore, easier to exploit.
19 Rampant misbehavior occurred throughout
20 the subprime market delivery chain, starting with the
21 broker and moving through to appraisers, the lenders,
22 the bond-rating agencies, and the investment banks.
23 For example, brokers were allowed to steer
24 vulnerable borrowers into high-cost and reckless
25 products. Regardless of their incomes and credit

1 scores, brokers were allowed to accept kickbacks from
2 lenders if they could encourage borrowers to accept
3 loans at a higher rate than was required by their
4 credit and income histories.
5 Lenders accepted no documentation loans in
6 qualified borrowers at teaser rates, rather than fully
7 indexed cost of the loans. Fully aware the consumers
8 would not be able to repay these loans, lenders did
9 not establish escrow accounts for tax and insurance
10 payments.
11 In some cases, they did not inform
12 borrowers about the need to pay tax obligations.
13 Investment banks paid higher fees for high-risk
14 products, thereby incenting lenders to produce
15 high-risk loans. This practice transformed millions
16 of low and moderate-income moderate-risk consumers
17 into high-risk products and consumers.
18 Securitizers were allowed to sell bonds
19 without maintaining some ownership interest and,
20 therefore, some risk or skin in the game. And the
21 bond-rating agencies literally stamped AAA ratings on
22 bonds that were obvious junk.
23 In fact, bond-rating agencies played one
24 of the most critical roles in the growth of predatory
25 lending. If the bond-rating agencies had not been

1 stamping "Investment grade" on junk bonds, the
2 securitization market for subprime loans would likely
3 never have materialized.
4 These practices annoyed more were allowed
5 to flourish for more than a decade before any action
6 was taken to address them. In fact, so prevalent were
7 these practices already in African American
8 communities more than a decade ago that the State of
9 North Carolina passed a statewide anti-predatory
10 lending law in 1999.
11 All of the unfair, deceptive, and
12 predatory practices I just mentioned were well-known
13 and documented for years in thousands of pages of
14 speeches, refereed research article, news accounts,
15 and testimony at state, local, and national levels.
16 None of these issues was beyond the
17 government's ability to regulate or control. But,
18 sadly, no actions were taken to eliminate these
19 practices. And the crisis we are experiencing today
20 is the legacy of that inaction.
21 The impacts on communities of color have
22 been and will continue into the foreseeable future to
23 be substantial. And response, a threefold response,
24 is essential.

1 First, ending the foreclosure crisis is
2 essential to allowing communities to begin to rebuild
3 themselves. Second, channeling funding directly into
4 the communities that were disproportionately targeted
5 for unfair and reckless lending is both fair and
6 appropriate. And, third, passing legislation to
7 ensure that predatory lending is never allowed to
8 occur again is a must. I will focus in the interest
9 of time on the third: eliminating predatory lending.
10 The current foreclosure crisis would not
11 have occurred had Congress passed a comprehensive
12 anti-predatory lending law back in the late 1990s,
13 when it was clear this problem was already apace.
14 A comprehensive anti-predatory lending law
15 would apply consumer protection to several types of
16 financial institutions, including banks, brokers,
17 mortgage companies, appraisers, servicers, investment
18 bankers, securitizers, credit-rating agencies, hedge
19 funds, and other financial companies. In other words,
20 it would cover every financial entity in the process.
21 A central element of an anti-predatory
22 lending law would be strong prohibitions against
23 steering borrowers to high-cost loans who might
24 qualify for prime loans.

1 In addition, an anti-predatory lending law
2 must have a robust requirement ensuring that lenders
3 have assessed a borrower's ability to repay based on
4 the maximum loan rate, instead of a teaser rate, in
5 the case of adjustable loans.
6 No or low-document loans should be banned
7 for high-cost loans. Prepayment penalties and yield
8 spread premiums should be banned. Other practices to
9 be eliminated include purging appraisal and servicer
10 abuses and misbehavior. Investors, lenders,
11 securitizers must be held liable when the loans
12 violate the mandate in predatory lending laws, fair
13 housing laws, and fair lending laws.
14 Due to the unique foreclosure crisis in
15 which the nation is currently mired, a requirement
16 should be imposed on servicers to engage a responsible
17 effort to modify loans that are at risk of default.
18 Finally, comprehensive anti-predatory
19 lending legislation must not preempt state law that is
20 consistent and stronger with federal law.
21 In addition, the National Community
22 Reinvestment Coalition has recommended the
23 establishment of a new cabinet-level agency focused on
24 civil rights enforcement. This agency would report
25 directly to the President of the United States and

1 would be responsible for measuring, monitoring, and
2 eliminating discrimination from the public and private
3 sectors and promote financial inclusion and racial and
4 cultural equality in America.
5 After all, if the Department of
6 Transportation and Highways is important enough to
7 report to the President, isn't equality and democracy?
8 We have no equality and democracy without the
9 enforcement of civil rights laws.
10 In conclusion, it is important to note
11 that the current crisis was not the work of market
12 forces. It was the work of individuals exploiting
13 markets that were willfully and adequately regulated.
14 It was the work of institutions that were allowed to
15 further marginalize the nation's most financially
16 vulnerable families and communities.
17 It was a massive failure to enforce civil
18 rights laws in this country. It was an error that
19 this time is costing the entire country a grave and
20 serious price.
21 America must use this tremendous time of
22 difficulty to emerge better than we were before the
23 crisis. Your efforts to eradicate the last vestiges
24 of discrimination and inequality will be essential to
25 their success.

1 We thank you for holding the hearing. I
2 look forward to working with you in any way we might
3 to achieve your goals and ours.
4 ACTING CHAIRMAN KIRSANOW: Thank you, Mr.
5 Carr.
6 Mr. Brooks?
7 MR. BROOKS: Thank you, Mr. Chairman and
8 members of the Commission, for hearing from all of us
9 today on this important topic.
10 My name is Brian Brooks. And, as an
11 attorney who represents a number of the largest
12 subprime originators, servicers, and investors, I am
13 keenly aware of just how important the topic is.
14 In my profession, there is a saying that
15 says hard facts make bad law. The idea behind that
16 saying is that when presented with a tragic or
17 shocking or just unsympathetic situation, there is a
18 natural human tendency to impose a fix that is good
19 for the particular case but counterproductive across a
20 whole range of other cases that aren't currently
21 before us.
22 I think the financial crisis may present a
23 classic case of hard facts because rising default
24 rates in subprime mortgage pools were one of the
25 principal contributors to the financial crisis. And

1 because the financial crisis itself has turned out to
2 be so severe, there is an understandable clamor to
3 rein in or even prohibit subprime lending or at least
4 large chunks of the subprime lending market.
5 The clamor is bipartisan. Bush
6 administration Treasury Secretary Paul O'Neill
7 recently called for a ban on mortgages for borrowers
8 who cannot make a 20 percent down payment, the idea
9 being that is a sign of financial fragility that
10 predicts default.
11 House Financial Services Committee
12 Chairman Barney Frank has gone so far as to say -- and
13 I am quoting here -- "The assumption that everybody
14 can be a homeowner is wrong."
15 So the idea gaining currency in the land
16 today is that subprime lending is predatory lending
17 and that it should be stopped. I would like to
18 suggest today that the consequences of that approach
19 are likely to be devastating to minority home
20 ownership in the country and that there are better
21 ways to solve the structural problems in the mortgage
22 industry that will not fall so heavily on minority
23 communities.
24 Let me begin, as all of the other
25 panelists on this topic have done, by trying to define

1 our terms. I think everyone so far today has agreed
2 that there is no universally accepted definition of
3 predatory lending. And so as the lawyer on the panel,
4 I will try to give you the shortest definition and
5 that I think makes sense. Let me juxtapose that
6 against two common conceptions.
7 On one end of the spectrum in the debate
8 about what predatory lending means, there are those
9 who suggest that predatory lending is a concept that
10 really is just limited to cases of fraud. And I think
11 all of us, both on the industry side and on the
12 consumer advocate side, can agree that's too
13 parsimonious a concept.
14 But, on the other end of the spectrum,
15 there are those who would define predatory lending so
16 broadly as to encompass any loan that is more
17 expensive or that contains terms that are different
18 from a 30-year fixed rate prime rate mortgage loan to
19 a borrower with perfect credit. And is surely too
20 broad a definition.
21 If all of those kinds of loans are
22 predatory, that suggests we can only make loans to
23 people who have the resources to make a 20 percent
24 down payment, we can only make loans to those who have
25 a perfect credit score and who have an income

1 sufficient to support loans, even in expensive housing
2 markets. It strikes me that can't be right either.
3 So my short definition of predatory
4 lending, which I think ought to have fairly broad
5 support, would include loans that are made without
6 regard to the likely ability of the borrower to pay,
7 presumably motivated by a desire to strip the
8 borrower's home equity instead of earn profits from
9 the repayment of the principal and interest. That is
10 a definition that is sort of an encapsulation of the
11 Massachusetts Supreme Judicial Court's recent decision
12 in the Freemont litigation. It has gained a lot of
13 currency on our industry.
14 And I think it is something that captures
15 the twin concepts that, on the one hand, people
16 shouldn't make loans without regard to the ability to
17 repay but that, on the other hand, there are
18 communities and individual borrowers across the credit
19 spectrum whose access to credit depends on loan
20 structures that are different from the kinds of
21 30-year fixed rate prime loans that have prevailed in
22 this country since the '40s.
23 Now, if you gauge the subprime market
24 against that definition of predatory lending, I would
25 want to suggest that while predatory lending is an

1 important problem, it is a limited problem. And it
2 doesn't come anywhere close to characterizing the
3 broader subprime market. That is for at least three
4 reasons.
5 First of all, while the word on the street
6 if you were to believe what the Washington Post writes
7 every day is that the subprime market has tanked and
8 that subprime loans are all in collapse. The truth is
9 that, even the most significant financial crisis of
10 the last half century, at least, the significant
11 majority of conventional subprime loans, around 65
12 percent, are neither past due or in foreclosure.
13 I also say that the issue of predatory
14 lending doesn't define the subprime market because a
15 significant percentage of subprime loans, around about
16 40 percent based on most credible estimates, were
17 originated for the purpose of purchasing a home, not
18 for the purpose of refinancing an existing loan,
19 meaning that lenders, at least in those cases, have no
20 preexisting equity to strip.
21 And, finally, I say that because the
22 significant decline in real estate prices in many
23 markets has resulted in a situation where lenders
24 typically realize massive losses in foreclosure sales,

1 making an equity-stripping strategy not viable on a
2 mass market basis.
3 The most recent data that I have seen for
4 the five largest subprime originators is that
5 foreclosure sales typically result in a loss of 51
6 cents on the dollar of principal.
7 Now, none of this, I hasten to add, is to
8 suggest that predatory lending as I have defined the
9 concept doesn't exist or that it's not important. It
10 does exist, and it is critical for the stability of
11 the economy and for our civil rights that it be
12 stamped out.
13 It also suggests that most of the subprime
14 market is not characterized by predatory lending and
15 that defining predatory lending in a way that shuts
16 down the subprime mortgage market will inevitably
17 throw the baby out with the bath water.
18 One way I like to think about it is this.
19 If you believe that where the rubber meets the road in
20 the predatory lending debate is the likelihood that a
21 given loan will default, then you are confronted
22 inevitably with a very controversial series of
23 line-drawing problems. What I mean by that is this.
24 Most people don't think the traditional
25 conventional 30-year prime rate mortgages are

1 predatory mortgages. Those are the traditional
2 features of housing finance we have known for perhaps
3 half a century. At the same time, the default rate in
4 prime loans has more than doubled in the last two
5 years alone, from roughly 2 percent at year end 2006
6 to roughly 5 percent with an additional 2 percent in
7 foreclosure at year end 2008.
8 That is a dramatic increase in default
9 rates. And, yet, the mere fact that those loans turn
10 out to be twice as likely to default as we thought
11 doesn't really make anybody think that they were
12 predatory.
13 At the same time, if you look at subprime
14 data, as recently as year end 2006, which was really
15 the peak of the subprime origination boom, the default
16 rate on conventional subprime mortgage loans was about
17 13 and a half percent, a little less than that, with
18 an additional 5 percent or so in foreclosure.
19 Again, nobody suggested at that time that
20 subprime loans were predatory. Instead, the idea was
21 that on a spectrum of credit scores, on a spectrum of
22 wealth distribution, there would be people farther to
23 the left side of that curve that would present a
24 somewhat higher default rate but that an 80 percent

1 likelihood of repayment was a reasonable likelihood of
2 repayment.
3 And in a country that believes letting
4 people take a chance on themselves and take a chance
5 to better themselves, it raises troubling questions to
6 say that that likelihood of success isn't high enough
7 to permit those people access to credit.
8 Why is this a civil rights issue? It is a
9 civil rights issue because the dramatic rise in the
10 minority home ownership rates in the 1990s and in this
11 decade is directly correlated with the growth of the
12 subprime lending market.
13 Indeed, the most recent evidence suggests
14 that, even taking into account the rise in
15 foreclosures that we have experienced in the last two
16 years during the financial crisis, even, then, of
17 those foreclosures, the subprime mortgage market
18 contributed to an overall housing increase of more
19 than 430,000 units.
20 And the relationship between subprime
21 lending and minority home ownership is easy to
22 understand. You have heard earlier evidence that none
23 of us can deny, which is that because of the historic
24 inequality in our society and because of historic de
25 jure and de facto discrimination, wealth and income

1 and credit histories are not equally distributed among
2 all classes, races, and ethnic groups in the United
3 States.
4 I would reach a conclusion somewhat
5 different from those of my fellow panelists. And that
6 is to say that given that direct connection, an
7 approach to predatory lending that would purport to
8 ban loans without 20 percent down payments or loans
9 that are more expensive than traditional prime loans
10 would be the solution.
11 I would suggest that those kinds of rules
12 will fall most heavily on minority homeowners and
13 minority aspiring homeowners in ways that many of us
14 wouldn't be willing to tolerate in a free society
15 committed to goals of equality and social mobility.
16 That is why I believe the goals of
17 mortgage regulation should be to eliminate fraud and
18 to minimize the impact of mortgage defaults on the
19 broader economy but should emphatically not be to
20 prohibit specific mortgage structures developed by the
21 market to meet the demand for credit among borrowers,
22 especially minority borrowers, who lack the wealth,
23 income, or credit history necessary to qualify for
24 traditional credit products.

1 In the interest of time, I will point the
2 Commission members to my written testimony, which
3 contains a useful chart from the Fed, which shows the
4 average distribution of all of those things, income,
5 credit score, and asset values, across white and
6 non-white populations, all of which I think
7 demonstrates fairly powerfully that a decision to
8 exclude those kinds of products designed to cater to
9 those populations would result in reduced access to
10 credit in very troubling ways.
11 I also suggest in the written testimony an
12 approach to mortgage regulation that is designed to
13 achieve the goals of enhanced access to credit for
14 those with credit impairments without drying up credit
15 for those who need it the most.
16 My proposal is based on the idea that, as
17 others have suggested, it makes a lot of sense to
18 treat subprime lenders more like banks. Banks, as
19 many of you know, are subject to risk-based capital
20 requirements, pursuant to which they must hold a
21 specified amount of capital in respect of their
22 assets, weighted by the risk of those assets. And the
23 purpose of those requirements is to ensure that banks
24 receive capital, reserve capital, to cover foreseeable
25 losses.

1 There are no such reserve requirements for
2 non-bank organizations. And most subprime loans in
3 the United States, as you have heard, were originated
4 by mortgage companies that didn't operate under bank
5 charters. Yet, the structure of the subprime mortgage
6 market presumes that they should operate in many ways
7 like banks.
8 They are the most common form of pooling
9 agreements that govern these mortgage securitizations
10 you have heard about. The lenders held the ultimate
11 responsibility to repurchase any loans that were
12 originated through fraud, to repurchase loans that
13 evidenced early payment default. And it had other
14 risk factors.
15 And, yet, when the defaults came and the
16 investors looked to the lenders to make good those
17 losses in these mortgage pools, the problem was that
18 many of the largest lenders went bankrupt. And there
19 were no assets to look to to make those whole.
20 My suggestion, which is laid out in more
21 detail in my written testimony, would suggest a fairly
22 straightforward regulatory fix that would require that
23 there be risk-based capital reserves for non-bank
24 mortgage lenders, just as there are for banks, with
25 the result that they would remain an incentive to make

1 loans to credit-challenged communities in ways that
2 don't lead to massive macroeconomic distress, as we
3 have all experienced today.
4 I thank the Commission very much for the
5 opportunity to discuss these issues with you and look
6 forward to your questions. Thank you.
7 ACTING CHAIRMAN KIRSANOW: Thank you, Mr.
8 Brooks.
9 Mr. Markison?
10 MR. MARKISON: Good afternoon, Mr.
11 Chairman and members of the Commission. Thank you for
12 inviting me to join this distinguished panel and to
13 participate in this discussion.
14 MBA appreciates the opportunity to provide
15 its perspective on these issues and looks forward to
16 working with the Commission on them going forward.
17 MBA has long regarded abusive lending and
18 abusive lenders as well as abusive mortgage brokers as
19 a stain on the mortgage industry and illegal
20 discrimination as wholly unacceptable.
21 Loans are and should be provided to
22 consumers and priced by lenders based on legitimate
23 business concerns. Non-prime lending based on the
24 loan's risk is appropriate and does not equate with
25 predatory lending.

1 The Home Mortgage Disclosure Act enables
2 the public and regulators today to review lender
3 performance in serving borrowers fairly. And MBA has
4 been proactive in facilitating its implementation.
5 The sunshine shed on the industry has
6 helped facilitate fair lending. MBA believes that
7 greater consumer protection and, even better, fair
8 lending performance could be achieved if a uniform
9 national mortgage lending standard were established
10 and a new federal mortgage regulator established to
11 regulate independent mortgage bankers and brokers.
12 New, more consistent national regulation
13 would regularize competition in the mortgage industry,
14 better protect consumers, and facilitate enforcement
15 by both federal and state regulators nationwide.
16 Accordingly, in my time today, I would
17 like to talk about how loans are underwritten and
18 credit is provided to consumers by mortgage lenders;
19 secondly, how HMDA data facilitates public review and
20 enforcement of fair lending by mortgage lenders;
21 third, how issues in the mortgage process can be
22 addressed through much greater transparency; fourth,
23 how a strong uniform national lending standard and
24 more effective regulation for lenders and brokers

1 could improve lending for all; and, finally, what MBA
2 is doing to help effectuate these changes.
3 Lenders make and price mortgage loans
4 based on the risk factors presented by each borrower
5 and the particulars of the loan sought. Relevant risk
6 factors include, but are not limited to, the
7 borrowers' income, credit history, the amount of the
8 down payment, the value of the collateral in relation
9 to the amount of the loan and the availability of cash
10 reserves.
11 Protected class membership is not a factor
12 in loan pricing. Under HMDA, mortgage lenders provide
13 extensive loan-level data annually on each loan
14 origination and denial to the unique and
15 extraordinarily rich HMDA data set.
16 Since 2004, this data included rate spread
17 data; that is, data on whether a loan is higher-priced
18 based upon the regulatory established threshold and if
19 so the amount by which it exceeded the threshold.
20 HMDA data, as you know, also includes
21 race, sex, ethnicity, and locational information. The
22 public has access to the data for each year, giving
23 the public an opportunity to scrutinize individual
24 lenders and their lending performance.

1 While HMDA data does not include all of
2 the factors in making a loan, it provides sufficient
3 information for the Federal Reserve to review the data
4 preliminarily.
5 If the data reveals what may appear to be
6 inexplicable disparities, the matter is referred to
7 the lender's regulator, which will review referrals
8 and scrutinize non-public data, such as credit scores.
9 Notably, the publicly available HMDA data
10 has, in fact, indicated some differences in denial
11 rates and prices of loans between minorities and
12 non-minorities. MBA believes these differences are
13 largely explicable based upon a full consideration of
14 risk factors from nonpublic data. The HMDA process I
15 would emphasize again has proven to be useful means to
16 address any lender problem areas as the law intended.
17 One issue that has been raised in
18 conjunction with reviewing the HMDA data has been to
19 what extent discretionary pricing; that is, yield
20 spread premiums to mortgage brokers and overages to
21 loan officers based on the rates of loans may have
22 resulted in pricing disparities among borrowers and
23 steering of borrowers into higher-priced products.
24 MBA believes the HMDA process and scrutiny
25 by regulators are helping address this concern but

1 that additional steps need to be taken. Mortgage
2 lenders and mortgage brokers differ. And MBA has
3 written extensively on this subject.
4 Lenders lend money, and mortgage brokers
5 arrange loans as intermediaries between consumers and
6 mortgage bankers. My testimony has a correction in
7 that area, but it should read as broker are
8 intermediaries between consumers and mortgage bankers.
9 Regulators required lenders to monitor and
10 address issues raised by discretionary pricing, by
11 loan officers, and mortgage brokers. However, as a
12 practical matter, lenders have less control over
13 brokers concerning their contacts with borrowers than
14 they do over their own loan officers.
15 Lenders underwrite loans after they are
16 initiated by mortgage brokers. It is widely believed
17 that in the last few years mortgage brokers originated
18 roughly 70 percent of non-prime loan. Mortgage
19 brokers, as distinguished from lenders, do not report
20 under HMDA. Brokers do not underwrite loans. They do
21 originate them. A greater understanding of these
22 differences is needed.
23 MBA has long supported clear and complete
24 disclosure of yield spread premium costs to consumers.
25 We think that would be an important step to resolving

1 this concern. We believe that since brokers serve as
2 intermediaries, shop for borrowers, and help place
3 borrowers in loans, the borrower is entitled to know
4 if the broker is receiving a higher commission based
5 on the borrower's rate on the loan.
6 MBA also supports much greater
7 transparency in the mortgage process in general and
8 believes it would help prevent steering. An earlier
9 panelist alluded to the Federal Trade Commission's own
10 study. We agree that there is much that can be done
11 to make the consumer, much more aware of what he or
12 she is paying for their loan.
13 We also think financial education,
14 financial literacy bear an important part of the
15 solution. But let me say quite clearly today's
16 mortgage crisis is indeed unparalleled. We believe
17 that it demands a careful look at the regulatory
18 structure of the industry beyond improvements to
19 transparency and consumer education.
20 We think a fundamental reform of
21 regulation is needed. And that reform should take
22 into account not only the problems that we are facing
23 today but some of the good work that has been done,
24 including that of the Federal Reserve.

1 We believe that new rules can build on the
2 Federal Reserve's requirements and other proposals,
3 including the matter of ability to repay. We believe
4 a rigorous new standard should protect all consumers
5 nationwide. And it should be the standard that state
6 and federal officials enforce.
7 I have listed in my testimony several
8 principles which should guide one's development of a
9 legislative proposal to give the type of consumer
10 protection that we suggest. I refer you to my
11 testimony for the specific principles.
12 Let me say, though, that MBA believes
13 again that a tough new standard with consistent
14 enforcement is the road we should take. This change
15 should coincide with assigning a federal regulatory
16 agency responsibility for regulating non-depository
17 bankers and brokers.
18 MBA is working hard to effectuate these
19 proposals. We know there is a great deal of blame to
20 go around today, but we don't believe that by any
21 measure, the mortgage industry is solely the cause of
22 the problems we face.
23 Nonetheless, we believe that the industry
24 must work proactively on solutions that restore faith
25 in our market and protect the borrowers who are our

1 customers. We profoundly believe that proposals along
2 the lines I have described will achieve these ends.
3 Thank you.
4 ACTING CHAIRMAN KIRSANOW: Thank you, Mr.
5 Markison.
6 At this point I would like the previous
7 panel to come forward and make yourselves as
8 comfortable as possible. And we'll get into
9 questions.
10 You will forgive me, but because of
11 advancing stages of Alzheimer's, I neglected to swear
12 in the panels prior to their testimony. I am going to
13 presume very imperiously that you rendered quite an
14 accurate testimony. And I am going to dispense with
15 the swearing you in for the question and answer.
16 It is a policy that we began under our
17 administrative instructions a few years ago prior to
18 that. At least during my previous tenure on the
19 Commission, we didn't do so. So I don't think it's
20 going to have any consequence.
21 Whatever comments you have will be
22 dutifully included in the record and whatever
23 recommendations and findings we make to Congress or
24 the President on this very important issue.

1 Having said that, we have got Commissioner
2 Melendez with his hand up.
3 III. QUESTIONS BY COMMISSIONERS AND STAFF DIRECTOR
4 COMMISSIONER MELENDEZ: Yes. Again, thank
5 you for being here.
6 We talked to a certain extent about
7 responsibilities of lenders. I want to talk a little
8 bit about the responsibility of borrowers and how we
9 can help that.
10 Can each of you comment more on the role
11 of financial literacy in this mortgage crisis and what
12 financial literacy programs are being conducted by
13 federal agencies? Are there any model programs that
14 are out there?
15 MS. RICE: Well, the GSEs have financial
16 literacy programs. For example, Freddie Mac has the
17 "Don't Borrow Trouble" financial literacy program. In
18 addition, HUD has funded housing counseling agencies
19 to provide housing counseling and loan counseling to
20 borrowers at costs that are free so the borrower does
21 not have to pay for that.
22 Organizations like LISC and Neighborhood
23 Housing Services have programs that also borrowers can
24 go through that are free, supposedly free, where the

1 borrower can learn about the lending process and can
2 hopefully make a wise choice.
3 Our agency has a financial literacy
4 program that we run. We just released the ad
5 campaign. In conjunction with the Ad Council, it is
6 called Questions Protect. You can access the
7 information and the advertisements from
8 questionsprotect.org.
9 And so we have, we hope, a robust cadre of
10 information from the GSEs, from federal regulatory
11 agencies, and from other organizations that provide
12 tools and resources to consumers to help them to
13 better equip them and empower them to shop for the
14 mortgage.
15 Now, having said that, I have to say that,
16 no matter how much education we provide for the
17 borrower, the lender will always have superior
18 knowledge over the borrower. And the lender will
19 always be at an educational advantage over the
20 borrower.
21 So we are never going to be able to
22 educate borrowers enough so that they can wholly
23 navigate every single lending process that is out
24 there and so that they can deal with every single
25 financial product that is out there.

1 If we end up with a scheme that is similar
2 to the model that we have today, we will have
3 literally thousands of loan products that borrowers
4 can avail themselves of. And you are never going to
5 be able to educate consumers about all of those
6 products that are out there on the market.
7 ACTING CHAIRMAN KIRSANOW: If I could, so
8 that the Court Reporter can accurately transcribe your
9 testimony, if you would identify yourselves beforehand
10 because you are kind of out of order right now.
11 MR. CARR: Thank you. Jim Carr. And
12 thank you for asking that question because I think it
13 really is an important one because people really
14 misunderstand and don't really get it, what happened
15 to consumers who were exploited.
16 I just want to build on the point that Ms.
17 Rice made. And that is, financial education is
18 important, but it can't compensate for basic rules of
19 the road. And particularly when we are talking about
20 people of color, we are talking about populations who
21 have historically been legally excluded from access to
22 financial services. And home ownership is one of
23 those major areas.
24 And so if you are not brought up in a
25 house that was owned by your parents, if you don't

1 have uncles and aunts who understand the home-buying
2 process, if you don't participate in the social
3 network that gets it, that knows where to shop, how to
4 shop for a loan, you are at a severe disadvantage.
5 If that is then compounded by the fact
6 that the mortgage entities that are operating in your
7 community all are saying the same thing, they are
8 giving you misinformation, and they are professionals,
9 they are experts.
10 And so the idea that you would get somehow
11 educated through some type of counseling program, even
12 if it were two weeks intensive, that you would know as
13 much about the mortgage finance business as an expert
14 is just not realistic.
15 When I hear that question, it is akin to
16 me to driving a car. Yes, you should have a driver's
17 license, which means you should understand the rules
18 of the road, but there is still going to be a bumper
19 on that car. There are going to be air bags. There
20 are going to be seat belts. And there are going to be
21 laws that say, "You know what? Drunk driving is not
22 permissible."
23 And that is what was missing from this
24 market. It said, "You can get into it, but there are
25 no protections for you." And, as Elizabeth Warren has

1 artfully stated, this market was so deficient in terms
2 of protecting the consumers that consumers had better
3 protections buying a toaster or a microwave oven than
4 purchasing the largest asset the typical American
5 household is going to get.
6 So I just will conclude by saying I
7 believe financial education is really critical and
8 essential. And in my own view, personal view, I think
9 it should be part of the basic curriculum of every
10 child in America to really understand the financial
11 system, including home ownership, before they graduate
12 from the 12th grade.
13 But, having said that, if professionals,
14 expert financial experts, are able to exploit the
15 trust of the consumer, they will be exploited all the
16 time.
17 MR. BROOKS: Commissioner Melendez, Brian
18 Brooks.
19 Let me approach the question in a couple
20 of different ways. First of all, from a lender
21 perspective, financial literacy is critical and a high
22 priority. And, indeed, many of my clients have
23 partnered with, among others, the National Fair
24 Housing Alliance and other leading providers of these

1 kinds of literacy programs to communities that have
2 historically been excluded.
3 These things are very important because
4 one of the suppositions of the predatory lending
5 debate is that somehow lenders want to dupe consumers,
6 that they're hoping they can put one over on consumers
7 that won't get noticed.
8 The way in which home buying is different
9 from toaster buying is that you are signing up for a
10 30-year relationship with the person. And so that the
11 likelihood that there won't be litigation when the
12 borrower learns of the true facts that were
13 misrepresented to it is about zero. That's what keeps
14 people like me in business, is that these people sue,
15 which is one of the problems.
16 Financial literacy is critical. But one
17 thing to think about as we talk about financial
18 literacy is there is a fair body of scholarships
19 suggesting that the problem with the mortgage
20 origination process now is not that there is too
21 little disclosure. It is actually that there is too
22 much and too formulaic of disclosures.
23 Now, there was a joke told earlier by one
24 of the panelists about that what happens when you show
25 up at the closing table and you are presented with a

1 five-inch stack of documents and you're told "Sign
2 here and here and here and here and here and here."
3 And no one reads those things. We all sort of hope
4 that the basic terms are as we have been told, and we
5 move on from there.

6 Alex Pollack, who is a scholar at the
7 American Enterprise Institute and a former President
8 of the Federal Home Loan Bank of Chicago, has been
9 proposing over the last 18 months or so a simplified
10 one-page plain English mortgage disclosure that tells
11 you what you really need to know in short, plain,
12 one-page disclosure language, the idea being that at
13 some level, it's all noise and what would be better
14 is, do people know what their monthly payment is, does
15 it include or not include taxes and insurance, will
16 the interest rate reset to a higher level, and if so,
17 when, and a handful of other key things.

18 So one thing I would suggest as we talk
19 about financial literacy is we need to make it
20 simpler, not more complicated.

21 MR. MARKISON: Ken Markison for Mortgage
22 Bankers.

23 I do believe and so does my organization
24 in the importance of financial literacy. We have made

1 a considerable investment ourselves, and so have our
2 members in conjunction with a variety of groups.
3 I think there is a problem, though. And
4 that problem is that we need some central focus on
5 financial literacy. Again, in my testimony, the
6 suggestion of a new federal regulator I think would
7 help facilitate that. I think it could also be a
8 focus for counseling activities in those cases where
9 counseling is warranted.
10 We share the view that Mr. Brooks has.
11 And I indicated in my testimony transparency is a
12 great problem. We have a distinguished representative
13 from the Federal Reserve. The Federal Reserve has
14 responsibility for disclosures under the Truth in
15 Lending Act. HUD has responsibility for disclosures
16 under the Real Estate Settlement Procedures Act. I
17 was active in the RESPA reform effort when I was at
18 HUD.
19 Today HUD has come out with a rule
20 proposing a new good faith estimate and HUD-1
21 disclosure. Our understanding is that the Truth in
22 Lending Act rules are forthcoming. Unfortunately,
23 these two activities are not joined.
24 And in my thinking, what needs to be done
25 is to have a simple disclosure developed by the best

1 minds in government that coordinates what the legal
2 concerns are, more importantly what consumers need to
3 know.
4 I think what is happening in lending,
5 unfortunately, in the disclosure world is because of
6 the plethora of information provided to borrowers,
7 abusers are able to hide in plain sight. Why?
8 Because consumers confront the pile and don't notice
9 the real trouble.
10 So I think financial literacy is a very
11 serious matter. I am not discounting the need for
12 restrictions. And I have testified in favor of
13 regulation. I think these two components, it's
14 impossible to police every transaction, but if the
15 consumer is well-armed, he can empower himself.
16 ACTING CHAIRMAN KIRSANOW: Mr. Markison,
17 "best minds in government" may be an oxymoron.
18 (Laughter.)
19 ACTING CHAIRMAN KIRSANOW: Ms. Harrington?
20 MS. HARRINGTON: Yes. Eileen Harrington
21 with the Federal Trade Commission.
22 ACTING CHAIRMAN KIRSANOW: Thank you.
23 MS. HARRINGTON: Two quick points. One,
24 we believe that disclosures that are made to consumers
25 should be based in sound empirical research. We think

1 that the disclosures that are being given now in
2 connection with mortgages and other credit products
3 aren't necessarily communicating effectively important
4 information and that before and during efforts to
5 reform disclosures, there should be very good
6 empirical research undertaken to learn how to best
7 communicate material information to consumers. It
8 doesn't take that long to do that. It can be done
9 well. And it can be done quickly. And it should be a
10 high priority.
11 Second on financial literacy, very
12 important, at Federal Trade Commission, we participate
13 through existing programs. We don't have our own.
14 But we are quite active in that.
15 That said, we did a workshop a few years
16 ago on the question of what consumers understood then
17 about these new and novel mortgage products and heard
18 at the workshop consumers really do not understand.
19 People do not understand what is going to happen when
20 these loans reset.
21 And I think part of what we have to take
22 into account is that, even if we have the best
23 financial literacy education program in the world in
24 the United States, which we are a long way from
25 having, sometimes products are so complicated that it

1 just isn't possible for consumers to do a good job,
2 even from an informed place, of understanding well
3 enough what it is that is being sold. We need
4 vigorous law enforcement. And we probably need
5 conduct regulation of the sort that we haven't had
6 before.
7 That is, we're at a point in time, I
8 think, of questioning what has been orthodoxy for
9 quite some time. And that is that information alone
10 is sufficient to protect consumers.
11 ACTING CHAIRMAN KIRSANOW: I'm sorry. I
12 didn't see your hand up.
13 MR. BROWN: Yes. There is not much to add
14 to what has been said so far. I agree with most of
15 the points that financial literacy is no substitute
16 for standards that should be in place. Everything is
17 more and more complicated. And sometimes it is a
18 challenge with the best disclosures to inform the
19 consumer of what they need to know as they enter into
20 an agreement.
21 At the same time, I want to mention that
22 the FDIC's Money Smart program that I had mentioned
23 earlier, which rolled out in 2001, initially focussed
24 on adults. But over the years, what we have done is

1 we have now also focused in on young people in six
2 languages.
3 And one of the great things about it is we
4 go into high schools. We deliver our modules. And it
5 is sort of a snowball effect. The information is
6 passed on. And we are even involved in the high
7 schools in banking programs, where there is a small
8 bank setup. Essentially they have their own sort of
9 bank accounts and transactions. And young people are
10 learning directly about financial services and how to
11 think and what questions to ask.
12 So it is a challenge. Everything is
13 complicated. But at the same time, the best that you
14 can do is at least educate people and teach them how
15 to ask the right questions and how to think and to
16 think about the broader picture and what the effects
17 are down the road. So we think it is a very important
18 program.
19 And, by the way, there is a lot of
20 information on our Web site. If you want more details
21 or if you would like some modules, we would be happy
22 to provide that information as well.
23 ACTING CHAIRMAN KIRSANOW: Mr. Chanin?
24 MR. CHANIN: We, like the FDIC, have a
25 number of consumer education programs. The Reserve

1 Banks provide programs, to schools and assist teachers
2 in terms of communicating financial education. We
3 have a number of programs at the board itself that,
4 either through the Web site or other activities,
5 address consumer education.

6 I'd like to mention a couple of points in
7 terms of consumer understanding. We do extensive
8 consumer testing; that is, we have hired outside
9 consultants and experts to do consumer testing on all
10 of the disclosures that we provide. We did extensive
11 testing on recent changes to our credit card rules,
12 for example.

13 We are in the process of doing extensive
14 consumer testing for mortgages as well. So we have
15 gone through a number of rounds of focus groups and
16 one-on-one testings. And we literally give consumers
17 documents that are used in the marketplace today, ask
18 them what they understand, what they don't understand,
19 and we revise those documents, go back and test them
20 further again and again, changing terminology,
21 changing the format of that information.

22 We also test the timing. When do
23 consumers need this information? When are they most
24 likely to use it? Earlier in the process or later in
25 the process or even after they have closed their loan.

1 We have had for over 30 years a one-page
2 truth in lending disclosure document. So, there is no
3 question about the scope of the document being too
4 long. But we are looking at that document as well to
5 try and ensure we can get better information to
6 consumers for mortgages, both for home purchase
7 mortgages as well as refinancings, home equity line of
8 credit, and the like.
9 And so we will be issuing some proposed
10 rules, likely this summer, that will revamp all of
11 those disclosures to try and ensure that consumers
12 better understand these products.
13 The other thing that I would add is there
14 are differences in how consumers shop in the mortgage
15 market. We have found in testing, and other studies
16 have found, that consumer behavior differs in the
17 prime market and subprime market.
18 The prime market is far more competitive,
19 both in terms of lender activities as well as to some
20 extent consumer shopping. The subprime market simply
21 doesn't function quite as well.
22 So one of the things that we have done I
23 mentioned earlier, is to enact the substantive
24 provisions that regulate the most significant issues
25 we have seen in the subprime market because it appears

1 that disclosures alone will not help consumers in that
2 marketplace.
3 ACTING CHAIRMAN KIRSANOW: Back to Mr.
4 Carr.
5 MR. CARR: Thank you.
6 I just want to make two quick comments.
7 One is that I want to address the idea of increased
8 disclosure. And it's from our perspective welcome
9 news to hear the idea that more disclosure is
10 important and necessary.
11 But I just want to point out that
12 disclosure doesn't substitute for banning practices
13 that have just shown themselves to be exploited,
14 period.
15 The reason for that is that the disclosure
16 can come in many forms. And if it comes in the form
17 of a size 8 type print, like a credit card, on page
18 28, it won't do any good. That consumer will never
19 understand it if they ever are able to read it.
20 And so I think it is important to
21 recognize that to the extent that we have populations
22 who have been historically marginalized, it really is
23 incumbent upon all of us to work together to figure
24 out how do we get them into home ownership in a way in
25 which they understand the obligation that they are

1 taking on and they actually perform on it because, in
2 fact, if we had had the home ownership rate continuing
3 to go from 2004 straight up to today, we would be a
4 much healthier nation than we are right now.
5 The other thing I wanted to say is the
6 idea that the litmus test for whether a loan was
7 exploited is whether you sue. It shows sort of a
8 disconnect between the populations that we are talking
9 about.
10 Most of these households that we are
11 talking about, low and moderate-income and minority
12 communities, they don't have a lawyer. And even if
13 they knew a lawyer, they don't necessarily have the
14 funds for a lawyer.
15 The National Community Reinvestment
16 Coalition actually operates a home ownership
17 sustainability fund. Here is what they tell us when
18 they call. They're confused. They're concerned.
19 They're frightened out of their minds. They are also
20 embarrassed. They feel shame that somehow they
21 allowed themselves to get caught up into something.
22 They are losing all of their wealth. They
23 are being thrown out in the street. Their children
24 are having to relocate. They don't know what to do.

1 They are not thinking about suing. They are thinking
2 about surviving.
3 And so I think it is really important and
4 incumbent upon us to understand that the population we
5 are talking about for purposes of the Civil Rights
6 Commission are not wealthy doctors and lawyers who
7 happen to be of the majority.
8 We are talking about people who are doing
9 the right things in the right ways and trying to enjoy
10 the American dream that has historically eluded them.
11 And they are dealing with financial intermediaries who
12 are not treating them in a manner that is supportive
13 of them actually achieving that dream.
14 ACTING CHAIRMAN KIRSANOW: Ms. Rice?
15 MS. RICE: Thank you. I just had a
16 comment related to the education issue.
17 We have done consumers a disservice.
18 Consumers have been taught for years and years and
19 years that they should use the APR as a shopping
20 instrument. And the government has taught consumers,
21 nonprofit organizations. So there is enough blame to
22 go around.
23 We all thought that the APR would be a
24 very helpful resource for consumers. The problem is
25 that in this marketplace, the APR really is useless.

1 It doesn't serve any useful purpose. And it is not a
2 good shopping instrument.
3 So there is a lot of confusion out there,
4 even in terms of the education that we have already
5 done, what little bit of education we have been able
6 to do for consumers.
7 So not only do we have to undo some of the
8 things that we have educated consumers to do and their
9 family members have told them "Pay attention to the
10 APR." But we know that the APR really isn't a useful
11 shopping instrument for consumers in today's
12 marketplace.
13 ACTING CHAIRMAN KIRSANOW: Mr. Markison?
14 MR. MARKISON: Yes. If I may add? It's
15 Ken Markison.
16 MBA and I believe seven other trade
17 associations wrote last month to the Secretary of
18 Housing and Urban Development and asked that the RESPA
19 effort and the TILA effort, under these two important
20 laws that require disclosures along the lending
21 process, be linked and that disclosures be simplified
22 in real terms. So to your point, consumers could
23 understand.
24 We are happy to provide that letter for
25 the record. It is one step along the way of seeking

1 this outcome, but we feel very strongly that that is
2 the right approach for the consumer and for the
3 industry as well.
4 ACTING CHAIRMAN KIRSANOW: Commissioner
5 Gaziano?
6 COMMISSIONER GAZIANO: I had a specific
7 question for Mr. Brooks and then maybe a more general
8 question for all for you. I wanted to thank you, Mr.
9 Brooks, for trying to define predatory lending in a
10 useful way.
11 I think your prepared testimony suggests
12 that even in an application, it is then hard to get
13 your hand around. But you do have an estimate of
14 fraud, am I correct, of half of one percent of a
15 certain type of loan?
16 Could you give us any estimate or guess or
17 whatever based on your definition of predatory lending
18 and how many of a particular class might fall into
19 that category?
20 MR. BROOKS: Sure. Well, the most useful
21 way I think to answer your question is to think about
22 the particular kinds of loan products that are offered
23 and then figure out which ones are most susceptible to
24 fraud.

1 The number one culprit is I think easy.
2 And that is stated income loans. So these are the
3 kinds of loans that were quite widespread between
4 roughly 2004 and 2007 and are now being banned under
5 the new Fed regulation that takes effect later this
6 fall.
7 Now, you could debate who was committing
8 the fraud there. I would say that there were probably
9 three different kinds of fraud happening. There were
10 certainly cases where you had either brokers or
11 lenders who were eager to get a fee they could sell on
12 that. That certainly happened.
13 But there equally unquestionably examples
14 of individual borrowers who were hungry to take
15 advantage of a rising real estate market, looking to
16 get rich.
17 And there were people like that who made
18 up incomes. And at the same time, there were real
19 property scams of the kind that the FBI has been
20 investigating. So that is clearly very significant.
21 You know, the other principal kind of
22 fraud I think that drives the numbers that you saw in
23 my written testimony are instances which groups like
24 Mr. Carr's group are probably called bait and switch
25 schemes. It is a common theme that I have seen in the

1 world of litigation and enforcement actions are
2 allegations that a borrower was told that he was going
3 to get either a fixed rate loan or a loan at a
4 particular interest rate.
5 Then he shows up at the closing table and
6 is presented with a different kind of loan. Now, it's
7 not that he's not aware at the closing table that it
8 is different from the owner loan, but in that moment
9 of duress, he doesn't see an alternative. And so he
10 signs that. And that is often reported.
11 So the FinCEN statistics that I talk about
12 here I think are largely driven by those kinds of
13 scenes. There will be other things in the markets,
14 but the point that I try to make there is to say that
15 we should eliminate fraud and that's a critical
16 initiative, but that once we are done eliminating
17 fraud, once we are done with that important job, there
18 remain real economic differences of the kind you have
19 heard from the other panelists in terms of wealth and
20 credit score and income that will still result in
21 significant disparities across racial and ethnic lines
22 that will need to be addressed through innovative
23 mortgage structures.
24 COMMISSIONER GAZIANO: Sure. And my more
25 general question really relates to your previous

1 discussion. I don't know. I'm certainly very
2 interested in promoting financial literacy as well,
3 but I certainly don't think that we need to promote
4 the same level of financial literacy as the lenders to
5 -- and I think back to my car-purchasing decisions.
6 I don't know anything about the
7 manufacturers or whatever. But if I comparison shop
8 with all of the dealers in town and tell them that I
9 am doing it and haggle back and forth, I don't care
10 what the true is. Someone pays sticker price, and
11 then they pay for clear coating and other sort of
12 stuff. I get a lot less than sticker price.
13 By the same token, I recently refinanced.
14 And I am not very sophisticated but probably more
15 sophisticated. I wanted a 30-year fixed price, no
16 prepayment penalty. But I told the brokers, "I am
17 shopping around." And I caressed them. And I didn't
18 know until closing the lawyer told me what a great
19 deal I did. And I don't need to know any of that.
20 Is that an approach that -- I mean, are
21 there too many exotic loans out there that people are
22 attracted to to make that kind of an approach useful?
23 Can we not get people to like comparison shop between
24 brokers to get a better deal?
25 MR. CARR: Jim Carr.

1 First of all, yes. There are too many
2 products on the market for the wrong people. So 10
3 years ago or 15 years ago, I would have said no, not
4 at all because what is wrong with stated income for
5 certain types of self-employment, et cetera, et
6 cetera?
7 The problem is that they had been so
8 abused that they just need to be removed because the
9 lending industry has shown it can't behave with these
10 products or at least they should be precluded for
11 certain types of households that you know just don't
12 need them.
13 Now, one of the other things that is
14 really interesting is most people when they enter the
15 housing market for a prime loan actually are meeting a
16 very competent, thoughtful, respectful professional
17 who actually explains to them how the market works.
18 And the most of the sort of the push and gib, the push
19 and gib is we can give you an eighth lower or a
20 quarter higher or a quarter lower, but we are really
21 better to go with because we are better, this, that,
22 and the other.
23 But most people get first-rate service
24 from the mortgage finance industry. The unfortunate

1 part is they didn't get it from the brokers in the
2 subprime market. That's where the problems were.
3 So the question and the challenge is, how
4 do you convert them into being like their peer real
5 estate agents in the prime market? And one of the
6 ways that we have recommended is fiduciary
7 responsibility. If they know they are legally liable
8 to tell the truth and give that consumer the best
9 advice they can, they have all of a sudden become a
10 mortgage professional working on the same side.
11 Then issues such as what is compensation
12 become less important because we now know that they
13 know that they can be severely taken to task legally
14 for misrepresenting themselves. And if we have that,
15 for example, for a lawyer, why not for that person who
16 is helping you invest in the most substantial asset of
17 your life?
18 All I'm saying is the market needs to
19 change. There needs to be an incentive change that
20 actually drives the industry to want to bring the best
21 advice and information to the table exactly as they do
22 when you go for a prime mortgage.
23 COMMISSIONER GAZIANO: I can see some
24 potential problems with that. I wondered if some --

1 MR. BROOKS: Well, I will just quickly say
2 I agree with a lot of what Mr. Carr said except the
3 very first thing he said. I am always very nervous
4 when people tell me that there are too many products
5 out there for the wrong people. That sounds and has a
6 command and control, central planning, almost
7 paternalist flavor to it. And that takes me back to
8 what I said at the very beginning of my presentation,
9 which is that hard facts make bad law.
10 For every kind of controversial mortgage
11 structure, for high loan-to-value loans, for high
12 debt-to-income loans, for zero down payment loans, for
13 adjustable rate mortgages, and for virtually every
14 other product, you can come up with compelling and
15 even heart-rending stories of fraud and abuse.
16 At the same time, what the data suggests
17 is that the majority of folks in all of those
18 structures were people who didn't qualify for a
19 different kind of mortgage. And that's why they got
20 that loan in the first place.
21 Now, that is not to belittle the 20
22 percent of people, if it is that many, who were duped
23 into taking the loan, but for the other 80 percent of
24 people, which is what policy-makers really need to
25 think about, they were afforded access either to home

1 ownership in the case of purchased money mortgages or
2 to other important planning issues in their lives.
3 And in cases I have been involved in,
4 those have included college educations and major
5 medical expenses and children's weddings, and the
6 like. And in a free society, it is a big deal for us
7 to say, "You know what? That product for the 80
8 percent of you who are in the product for the right
9 reasons is just too costly because of the 20 percent
10 of people who aren't." To me that is a very dangerous
11 policy proposition.
12 ACTING CHAIRMAN KIRSANOW: Mr. Markison?
13 MR. MARKISON: Yes. Just to go back to
14 your original question, I think you are quite right.
15 I think shop until you drop is not a bad credo in this
16 market as in the car market. I think a good approach
17 is to go to different brokers and different lenders.
18 What I indicated in my testimony is there
19 is a difference, I think, functionally between brokers
20 and lenders. Lenders make loans. Brokers do
21 frequently hold themselves out as shopping for the
22 borrower to get them the best loan.
23 And therein lies the rub because the
24 incentives may include a payment to the broker based
25 on the rate of the loan. What we said is that this

1 sort of problem -- has to be addressed in disclosure.
2 And I think that --
3 COMMISSIONER GAZIANO: It is disclosed,
4 isn't it?
5 MR. MARKISON: Well, it isn’t clear.
6 COMMISSIONER GAZIANO: It was in my loan.
7 So --
8 MR. MARKISON: Well, it is the --
9 COMMISSIONER GAZIANO: And I didn't care
10 about the kickback --
11 MR. MARKISON: Yes.
12 COMMISSIONER GAZIANO: -- because I got an
13 eighth lower by using them.
14 MR. BROOKS: Not a kickback.
15 (Laughter.)
16 MR. MARKISON: Not a kickback in the legal
17 sense. I do know what I'm talking about.
18 Functionally the payment is for services, it's
19 originating a loan.
20 COMMISSIONER GAZIANO: Yes.
21 MR. MARKISON: Having said that, because
22 the payment influences the brokers' behavior, it
23 should be crystal clear to the borrower. I think the
24 second step is that, rather than cede your shopping

1 responsibility to anyone, you should do what you did
2 and shop for yourself. That is what we have said.
3 I share the concern about removing
4 products from the market. I think that is a problem,
5 particularly when a borrower is trying to negotiate
6 the market with very high prices and you are trying to
7 put a home within his reach.
8 I think when products adjust quickly, you
9 need to know it. And it needs to be very clear to you
10 so that you can make a choice that doesn't end in
11 foreclosure.
12 ACTING CHAIRMAN KIRSANOW: Mr. Chanin and
13 Ms. Rice? And Commissioner Taylor has a question.
14 MR. CHANIN: I wish you were the typical
15 consumer. And I think, in theory, that shopping could
16 solve most of these problems.
17 COMMISSIONER GAZIANO: Can't we teach
18 that? That's all we need to teach is my point.
19 MR. CHANIN: Yes, yes. What we found is
20 there are so many obstacles. So, for example,
21 consumers approach their financial institutions and
22 they feel that they trust that individual to give them
23 the best advice and look out for their interests
24 sometimes.

1 The other thing, we found through testing
2 is that consumers don't understand that the rate that
3 bank A offers on a 30-year fixed rate loan is
4 different than the rate that bank B offers; that is,
5 that there are differences in the market rates that
6 apply, even if the consumer has the same profile; that
7 is, same credit history and the like.

8 And so that is a big hurdle to overcome to
9 try and educate consumers that you do need to look at
10 different lenders to shop because the rates you get
11 will be different.

12 Consumers oftentimes look at the monthly
13 payment amount. And that is what we are finding.
14 That is important, obviously, in terms of day-to-day
15 actions, but they also need to look at other factors.

16 So we are trying to address those issues,
17 doing a lot of consumer testing to try and see where
18 we can pinpoint the best place to succeed, but it is a
19 challenge.

20 I think we will have some successes in
21 some areas but not for everyone in the marketplace.
22 It's not realistic to think that we are going to touch
23 all points in terms of consumers improving their
24 shopping behavior.

1 We also found that there is kind of a
2 disbelief in some points. When we tried to test yield
3 spread premiums, where brokers get compensation based
4 on a higher interest rate, consumers didn't accept it.
5 That is, they said, "Well, wait a minute."
6 There were two problems. One is, how can
7 the interest rate be related to a dollar amount? And
8 then, secondly, they didn't accept the fact that the
9 interest rate the broker was quoting them included a
10 fee that, in essence, got pushed back to the broker.
11 So there are a lot of complexities in the
12 products in the marketplace that consumers don't
13 understand. And I think ideally the goal is to try
14 and remove some of the complexity and use terminology
15 that consumers understand, but that is a tall
16 challenge.
17 ACTING CHAIRMAN KIRSANOW: Ms. Rice?
18 MS. RICE: Hi. I just wanted to address a
19 couple of things. I think Brian mentioned earlier
20 that NFHA has worked quite extensively with a lot of
21 subprime lending shops, some of them after they were
22 targeted or had to settle with the state AGs.
23 We were working with them on three main
24 issues. One, changing their platforms so that they
25 could offer low-cost mortgages because they recognized

1 that they had a huge cadre of borrowers who really did
2 qualify for lower-cost mortgages, but they got the
3 higher-cost mortgages; number two, changing their
4 advertising to not focus on the monthly payment but to
5 focus on other more substantive features of the loan.
6 But, number three, -- and that is the
7 point I want to focus on -- was giving the consumer
8 direct information about loans for which they
9 qualified because in many instances, the subprime
10 wholesalers were sort of hamstrung and many by their
11 own conventions.
12 Because the mortgage broker would submit
13 an underwriting package to them, the automated system
14 would automatically shoot back to that mortgage
15 broker, "This particular borrower is qualified for
16 these ten different products."
17 The mortgage broker doesn't give the
18 consumer the ten different products. They choose and
19 pick which one they think is best. And a lot of times
20 it's the product that is most aligned with their own
21 financial incentives. And that is the one that they
22 give to the borrower.
23 So these subprime wholesalers were saying
24 that perhaps their borrowers, their customers were not
25 getting the best product or the best priced product.

1 So we were working with them on ways, you
2 know, getting around some of the contractual issues so
3 they could directly communicate with consumers about
4 all of the different other loan products and loan
5 terms and conditions for which the consumer qualified
6 but never was told about.
7 ACTING CHAIRMAN KIRSANOW: Go ahead.
8 MR. CARR: I just want to make a quick
9 point about shopping. Mr. Carr.
10 And that is that it goes to also the
11 fundamentals of the market in which you are located.
12 Probably the majority of people who are looking to buy
13 a home get their real estate advice from the real
14 estate agent.
15 Where do they get them? They get it from
16 the sign out in front of the "For Sale" house, the
17 place they wanted to buy. Once they do that, they are
18 in that network.
19 So if what is operating in your
20 neighborhood is a subprime mortgage broker operation,
21 that mortgage broker is not going to send you to a
22 low-cost loan. And they are not going to give you any
23 information about how to get out of that market you
24 are in.

1 And so it is not just a matter of people
2 don't want to shop. It's a matter of people don't
3 have the opportunity to shop because of the way the
4 financial markets work. And the lack of, again, going
5 back to something I said earlier, the lack of access
6 to those financial resources and information as well
7 as market providers who may not be operating in those
8 markets.
9 ACTING CHAIRMAN KIRSANOW: Commissioner
10 Taylor?
11 COMMISSIONER TAYLOR: I wanted to make
12 sure I understood two statements: the one from Mrs.
13 Harrington that you were inclined to favor
14 conduct-based restrictions.
15 In my mind, I always think disclosure is
16 all, virtually all, but I heard you say it may not
17 now, such society with such complex financial
18 instruments that disclosure is insufficient. Even if
19 the consumer were to understand it, in some cases they
20 simply can't. And, therefore, the restrictions need
21 to be more conduct-based.
22 So I wondered, would you elaborate on
23 that? Specifically what conduct would you restrict?
24 What conduct would you outlaw? I would like to hear
25 that.

1 And, second, I would like to hear if you
2 would outlaw it for all individuals or whether you
3 would only outlaw it for communities more likely to be
4 targeted?

5 And I would like to turn that second point
6 to Mr. Carr to really ask if you were serious when you
7 said that there were perhaps too many products out
8 there.

9 And what I heard you say -- and I don't
10 want to put words in your mouth -- a statement-only
11 product may be viable for someone who is a trust fund
12 baby who claims they are an artist. Correct? But it
13 may not be viable for that African American talented
14 artist because that's what I heard.

15 And is that what you were saying, that you
16 would restrict the lending institution's ability to
17 give that statement-only loan or any other product to
18 certain minority groups but you would allow those
19 products to be used in other groups?

20 That is what I thought I heard you say,
21 and to me that is an important point. That is from a
22 policy perspective if that is what we are talking
23 about: banning products or permitting certain
24 products but only for certain people.

1 MR. CARR: Mr. Carr. No, absolutely not.
2 I could understand your anxiety if that's what you
3 thought I was stating or implying, which I was not. I
4 was talking about the markets.
5 The high-cost market is a market that
6 tends to serve individuals who have certain financial
7 characteristics, which suggest that certain products
8 just don't make any sense for them. Stated income
9 don't make sense for individuals.
10 And, of course, the proof is hard facts.
11 I like that term, the "hard facts." The hard facts
12 are having these products available to these consumers
13 without appropriate regulation has literally brought
14 down the entire financial system. And the point --
15 COMMISSIONER TAYLOR: It is an important
16 point. I am going to stop you because there is a
17 difference in my mind between those products being
18 targeted and sold unlawfully and simply being made
19 available to everyone.
20 So I guess my question is if you have what
21 you would probably describe as a toxic product being
22 offered to someone with full disclosure, there is no
23 confusion in that case, there is no one being misled,
24 no one is being deceived, would you allow that toxic
25 product to be sold to all communities?

1 MR. CARR: I think that there are certain
2 products that just don't make sense for certain types
3 of consumers. And I believe that those high-risk
4 consumers, just those very exotic, confusing, and
5 complex products are inappropriate because the
6 consumer simply can't understand them.

7 Any time you have got the up-front fees,
8 the closing costs, the origination costs, and then you
9 add to that the starting interest rate, the step-up
10 interest rate, on and on and on, it's all but
11 impossible unless you are a financial whiz to really
12 understand how to value that mortgage.

13 So all I am suggesting is don't force that
14 consumer to have to go through all of that. The
15 30-year fixed rate mortgage is what made America a
16 solid, powerful home ownership society with the most
17 stable house price appreciation as the most secure
18 asset in this country. And it lasted for over 60
19 years that way.

20 Then, all of a sudden, we started getting
21 really sophisticated. Well, we don't need to be
22 sophisticated. That young artist that you were
23 referring to, a 30-year fixed rate mortgage is a good
24 product for them.

1 Now, a lower down payment? Maybe. With
2 the appropriate consumer education? Absolutely. Much
3 better to put them in a product in which they fully
4 understand what their responsibilities are and they
5 can pay it than giving them something that actually
6 leads them to believe they can actually afford it and
7 then it turns out they can't and it destroys them
8 because that is exactly what happened in this market.
9 Again, what I say is the hard facts -- I
10 love that phrase. The hard facts are that those
11 products don't work for certain consumer groups. And
12 we have had so much of a demonstration of nearly
13 destroying the financial system. That should be a
14 clarion call.
15 Get rid of them and go back to the basics:
16 FHA, fixed rate; VA, fixed rate; Fannie-supported,
17 fixed rate. That's where we went wrong. Bring those
18 loans back but for more sophisticated, higher income,
19 higher credit score, et cetera, allow the market to
20 have its flexibility.
21 ACTING CHAIRMAN KIRSANOW: Mr. Brooks?
22 MR. BROOKS: Well, this is obviously where
23 the rubber meets the road. I'm glad we got to this
24 question. Here is the thing. For the 60 years that
25 Mr. Carr is referring to, the 60 years of the 30-year

1 fixed rate mortgage loan, as the single product
2 standard that exists in the United States, we
3 subsisted with a home ownership rate of around about
4 40 percent.
5 And starting in the late 1980s, early
6 1990s with the advent of these products that some
7 people call exotic, we saw roughly a 29 percentage
8 point increase in the total home ownership rate and a
9 significantly higher rate of increase in the home
10 ownership rate among minority borrowers.
11 Now, it's true that because of the
12 developments of the last couple of years, a couple of
13 percentage points have now been shaved off that rate.
14 So we're a little off the peak. But we are
15 dramatically above the home ownership rate that we
16 lived with when we had the 30-year fixed rate
17 mortgage.
18 When I was in law school and I took a
19 course in banking law, one of the requirements if you
20 can believe this at the University of Chicago was that
21 we watch "It's a Wonderful Life," not for the
22 entertainment value but because of the important
23 lessons it taught you about the mortgage market.
24 You may remember that there was Mr.
25 Potter, and then there was Jimmy Stewart. Mr.

1 Potter's bank only made the 30-year fixed rate
2 mortgage to prime borrowers, and Jimmy Stewart lent to
3 the rest.
4 The hero of the story, of course, is not
5 Mr. Potter. It's Jimmy Stewart, who made home
6 ownership available on terms that weren't available at
7 the bank. These are critical facts to think about.
8 And I guess the last point I would make is
9 this. It is easy today in 2009, when what people are
10 talking about are today's foreclosure rates, to talk
11 about what a critical problem high foreclosures are.
12 And they are a critical problem.
13 But it is very easy to forget the critical
14 problem that confronted America in 2003 or 2002. The
15 critical problem then was median wage earners in the
16 population centers on both costs could not buy the
17 median house because of 30-year fixed rate mortgage
18 terms. They simply couldn't.
19 And so the development of these other
20 products, like the adjustable rate mortgage and the
21 zero down mortgage, which was what I used to buy my
22 first house, were necessary to step onto the ladder.
23 And, as I point out in my written
24 testimony, significant numbers of people who took
25 those loans out as their first loan, refinanced into

1 30-year fixed rate mortgages later once they had
2 benefitted from home equity buildup in their first few
3 years of their mortgage.
4 So you are making a choice between
5 preferring the problems of today or preferring the
6 problems of the early 2000s. But make no mistake.
7 There is a trade-off.
8 ACTING CHAIRMAN KIRSANOW: Mr. Markison?
9 MR. MARKISON: Yes. I simply want to
10 underline the trade-off. It is an important one. I
11 think the trade-off very clearly is that fixed
12 products will not result in all borrowers qualifying.
13 In a rising real estate market, borrower
14 numbers grew. Borrowers' situations change. There
15 are many borrowers today who are benefitting from a
16 five-year or a seven-year adjustable product. I think
17 we have to be very careful when we remove products
18 from the marketplace for all borrowers.
19 I think that is why issues like
20 documentation, disclosure, assuring that the borrower
21 has a reasonable ability to repay over what could be a
22 predicted period that the borrower is in a loan, these
23 are important concerns. I think that road of looking
24 at these issues offers more promise to keep our home

1 ownership rates up than simply taking products
2 wholesale off the market.
3 ACTING CHAIRMAN KIRSANOW: I am going to
4 get to you, Mr. Carr, Ms. Harrington in a second, but
5 I just want to note that it is currently 3:20. I
6 would like to start to wrap this up. This has been
7 very good. It gets better as we go along also.
8 I would also like to just make one
9 comment. I am not sure why we come down on this. I
10 am absorbing all of this. Generally, as my fellow
11 commissioners would know, I am pretty much a free
12 marketeer, actually more than an anarchist.
13 (Laughter.)
14 ACTING CHAIRMAN KIRSANOW: Having said
15 that, though, although I might come down slightly on
16 the side of, say, Mr. Brooks or Mr. Markison in that
17 regard, when I hear some of what you say -- and,
18 again, I am not taking a position -- when I hear some
19 of what you say, it almost seems as if home ownership
20 is deemed right; whereas, we have got other products.
21 And I think Mr. Carr would concur that
22 there is nothing wrong with being a renter. There is
23 nothing wrong with subleasing. There are other things
24 available. And is it that imperative to have
25 alternate products, exotic products to get people into

1 homes when there is the down side of, well, this is
2 very complicated?
3 I know that when I bought my first home --
4 you know, I have been a lawyer now for 30 years,
5 despite my extraordinarily youthful and virile
6 appearance.
7 (Laughter.)
8 ACTING CHAIRMAN KIRSANOW: When I bought
9 my first home, it was very easy. I understood what
10 was going on. About six or seven years ago, my wife
11 decided it's time to expand the house, despite the
12 fact that the kids left and were in college. I didn't
13 understand that, but I'm not the boss.
14 Nonetheless, when I looked at the
15 documentation placed before me, I was completely
16 befuddled, a state I find myself in quite often but
17 not when I am reading documents that I am supposed to
18 understand.
19 So I wonder whether the trade-off of
20 having 60 percent or 64 percent of the people in their
21 homes versus maybe a lower percentage of people who
22 are in homes that they can afford and they understood
23 what the terms were -- I'm not sure where I come down
24 on that. It was just a comment.

1 I will let you comment upon that comment,
2 but first we go to Mr. Carr.
3 COMMISSIONER GAZIANO: Yes. I thought it
4 was Mrs. Harrington.
5 ACTING CHAIRMAN KIRSANOW: I'm sorry.
6 Maybe it was Ms. Harrington.
7 MS. HARRINGTON: I just wanted to answer
8 Commissioner Taylor's question. And that is that what
9 I said is that I think that there has been for a long
10 time an orthodoxy that as long as all material terms
11 and conditions are disclosed, everything is all right.
12 And I think that orthodoxy has failed and is failing.
13 And I think that we are already seeing the
14 Fed has done a couple of things recently that
15 certainly go beyond disclosure. In the credit card
16 area, there are new regulations that address fees and
17 prohibit basically certain high-fee credit card
18 products, the kind of product that the FDIC and the
19 FTC recently sued a card marketer and issuers that
20 were very active in the subprime market over.
21 In that case, there wasn't an issue about
22 whether the defendants had complied with the Truth in
23 Lending Act. They had. But they were still,
24 nonetheless, deceiving prospective cardholders.

1 And they charged fees that basically ate
2 up two-thirds of the line of credit. And it was a
3 $300 credit limit. The fees that were charged chewed
4 up two-thirds of the line of credit. And we
5 challenged those practices. And the Fed has recently
6 issued new regulations that go beyond disclosure.
7 And the same with the HOEPA regs and the
8 recently modified HOEPA regs. There are certain
9 practices. There is conduct that is prohibited there,
10 you know, making mortgage loans, subprime mortgage
11 loans, without regard to the borrowers' ability to
12 repay.
13 I think we would agree strongly that that
14 is conduct that should not be permitted, even if all
15 of the terms and conditions are fully disclosed.
16 ACTING CHAIRMAN KIRSANOW: Mr. Carr?
17 MR. CARR: Mr. Carr.
18 Yes. A few things. One is the home
19 ownership rate was not 40 percent of 1980s was
20 probably in excess of 60 percent.
21 ACTING CHAIRMAN KIRSANOW: I think the
22 comment was -- I don't think it was. Was it 1980?
23 MR. BROOKS: Well, I mean, first of all, I
24 was talking about over the last 60 years.
25 ACTING CHAIRMAN KIRSANOW: Right.

1 MR. BROOKS: And, in point of fact, in the
2 1980s, it started in the mid 40 percent and went up to
3 about 69 percent. I think two years ago was the peak.
4 MR. CARR: First of all, I'm under oath.
5 (Laughter.)
6 ACTING CHAIRMAN KIRSANOW: Actually, you
7 are not.
8 MR. CARR: Okay. Good. Well, in that
9 case, let me --
10 (Laughter.)
11 MR. BROOKS: I think it was at 20 percent.
12 (Laughter.)
13 MR. CARR: At any rate, what is important
14 to recognize, the fixed rate mortgage is the gold
15 standard today. And the fact that exotic mortgages
16 were being introduced into the system on a home
17 ownership rate was going up is a very different
18 statement from saying it went up because of exotic
19 mortgages. It didn't. It went up because of the
20 standard gold plates of fixed rate mortgage.
21 And everyone who is in the market who has
22 any good common sense knows that is the mortgage to
23 get. If you can get it at 5 percent, fix that baby
24 for 30 years, go for it.

1 Having said that, adjustable rate
2 mortgages are also in my view pretty standard
3 mortgages. So I don't mean to imply -- and if that is
4 what was being perceived -- that adjustable rate
5 mortgages shouldn't be allowed in the subprime market,
6 absolutely not.
7 When I say, "exotic," I mean things that
8 have no dots, piggybacks, and all the rest of this
9 nonsense that goes into a loan that perceives, gives
10 the perception of making it affordable, but it really
11 is heading straight to foreclosure. So that is not
12 what I intend.
13 Another comment and a final comment is
14 just the issue about the Jimmy Stewart and Mr. Potter.
15 Those banks weren't giving loans to blacks. And I
16 think it is important for us to remember that because
17 that is one of the reasons why the markets are so
18 dysfunctional because it was legal not to do that.
19 And as we think about how to correct the
20 market failures and go forward, we need to recognize
21 that everyone didn't have access to a Jimmy Stewart
22 character, who was giving them the best information.
23 They taught it to their children. They passed it down
24 to their grandchildren, et cetera, et cetera.
25 Instead, they were looking for loan sharks.

1 And that is what happened with the brokers
2 entering that market in the mid 1990s just wearing
3 pin-striped suits this time supported by Wall Street
4 but, nevertheless, equally exploited.
5 And as we go forward to restructure this
6 market, we need to understand that many of those
7 consumers in the subprime market have never had a fair
8 chance to access mainstream sources of credit. And
9 acting and talking as if they have really just ignored
10 the reality of that legacy of discrimination that
11 really must be addressed as we reshape the functioning
12 of the financial system.
13 ACTING CHAIRMAN KIRSANOW: I will let Mr.
14 Brooks go. Then I have one question of my own. And
15 then we are going to have to close up so that we can
16 have our -- Linda has got a flight. A few of us have
17 flights.
18 Mr. Brooks?
19 MR. BROOKS: Well, I will make this very,
20 very quick. I just want to address your earlier
21 question about whether home ownership is a right. I
22 don't think and wouldn't argue that home ownership is
23 a right, but what I was --
24 ACTING CHAIRMAN KIRSANOW: You're from a
25 Chicago school.

1 (Laughter.)

2 MR. BROOKS: What my view is and what I
3 think the evidence shows is that societies with high
4 home ownership rates are wealthier societies than the
5 societies with low home ownership rates.

6 We know this from a variety of sources.
7 The one that is most persuasive and interesting to me
8 comes from a study I did two years ago of the Latin
9 American mortgage market, which is quite interesting
10 to study.

11 In Latin America, that is a very sclerotic
12 consumer finance structure. The result is that home
13 ownership rates are very, very low.

14 Even not being under oath, I won't
15 speculate as to how low they are, but I can tell you
16 that in Mexico, as of the most recent World Bank data,
17 2007, there was a 5 million-unit housing shortage.

18 And the reason for that was that Mexico
19 had never developed a robust securitization market.
20 And, accordingly, the only lender, the only
21 significant lender, of any scale was the Mexican
22 government-run pension system, which would only make
23 loans to people who had a certain -- when they
24 measured down there, it was a certain number of
25 average monthly minimum wages.

1 So there was a gigantic overhang of lack
2 of housing wealth, which is, according to the IMF and
3 World Bank, one of the drivers of immigration
4 northward from Latin America.
5 In the United States, this evidence that I
6 point to in my prepared statement is that for every
7 dollar of housing wealth added to the U.S. economy,
8 consumer spending increases in sixth sense.
9 So it's not that it's a right, but if one
10 of the things that we are trying to do is to make poor
11 people wealthier and make society wealthier for all of
12 the goods that come from that, housing is one of the
13 most important components.
14 ACTING CHAIRMAN KIRSANOW: One question
15 that I have is for Mr. Markison, actually.
16 I don't recall exactly how you said this.
17 This is more of a housekeeping matter. I just want to
18 be sure that we are correct on this.
19 At one point I think you were addressing
20 the data related to disparities in lending to
21 minorities versus whites and that there were certain
22 metrics that could account for that. But then there
23 were certain other metrics that you said that the
24 differences in the HMDA data are explicable by other
25 factors.

1 What other factors would those be besides
2 the credit rating, income, whatever they may be?
3 MR. MARKISON: What I was trying to
4 distinguish between was public HMDA data that are used
5 by the Federal Reserve and the public to look at
6 lenders' behavior. It includes income. It includes
7 race, property location.
8 In the regulatory model today, the Federal
9 Reserve looks at those public data and then makes a
10 judgment based on public data controlling for income
11 and public factors, choice of property, size of loan,
12 and race whether that there are disparities that they
13 would refer to the regulator for that particular
14 lender.
15 That regulator can get much more than the
16 public data. The can get credit scores, the full raft
17 of non-public factors that were considered in making
18 loans.
19 In that process, what I was suggesting was
20 it takes HMDA data, uses it for one of its purposes,
21 which is enforcement. And then essentially the
22 regulator enriches the public data set and digs
23 deeper.
24 ACTING CHAIRMAN KIRSANOW: I think I
25 understand. Unfortunately, I think I am going to have

1 to bring this to a close. It has been a pleasure
2 listening to all of you. This has been highly
3 informative. This is one of our lengthier hearings,
4 but I think it is necessary. The record will remain
5 open for 30 days in case you want to supplement it.
6 For the things that you have heard during the
7 commentary period that you would like to elaborate on,
8 feel free to do so.
9 (Whereupon, the panel was excused.)
10 ACTING CHAIRMAN KIRSANOW: And I will
11 entertain a motion to adjourn.
12 COMMISSIONER TAYLOR: So moved.
13 ACTING CHAIRMAN KIRSANOW: Second?
14 COMMISSIONER GAZIANO: Second.
15 (Whereupon, the foregoing matter was
16 concluded at 3:30 p.m.)
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