THE FEDERAL RESERVE BOARD

BUILDING SUSTAINABLE HOMEOWNERSHIP: RESPONSIBLE LENDING AND INFORMED CONSUMER CHOICE

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(Whereupon, the proceedings commenced at 8:30 a.m.)

GOVERNOR OLSON: We will begin. We have all but one of our panelists. I understand one of the panelists, Ira Goldstein, is in route, and we have two of the four representatives from the Fed system. I'm sure the other two will be here shortly.

Let me, first of all, thank Philadelphia Fed for hosting these meetings this morning and providing us with the facilities. These are extraordinarily useful sessions. We finished the session in Chicago on Wednesday, and we're happy to be here today.

We've got -- just to talk through, if I can, in order to make the best use of the time, we've asked each of the panelists to give us a five-minute opening statement, and after the five-minute statement, what you will get, and would you show them the signs, so that they know. The first is one minute, the second is, time is up. There's not a lot of ambiguity in those, and we tend to enforce those pretty rigorously, and because of that fact, what we've discovered is that we still, with an hour and a half on this panel, have ample time for discussion and ample time for dialogue.

This panel will go until 10:30. We will take a break and come back and have a panel from 10:30 to noon. We'll break for lunch. And then other another panel and, very importantly, beginning at 3 o'clock, we have what we call an open mike, and people can, who would care to do so, who have a statement they would like to make, are invited to participate at that time, and people will have a three-minute opportunity to speak if they would like to.

Also, for everybody, panelists and open mike participants, if they would like, they have up to August 15th, a time allotted to them, to give an additional written statement that will become part of the permanent record. And we look forward to a very full exchange.

This is part of a -- this is a -- I think it was 2000, Sandy, that we did the first HOEPA hearings. After, it was determined -- and of course those hearings resulted in the HOEPA regs that were implemented in 2002. A tremendous amount of change has taken place in the mortgage industry since that time. And as a result, we have a number of reasons for holding the hearings today.

Number one, is that we want to examine the extent to which the 2002 HOEPA regs are adequate, are appropriate, or should they be revised. We also are going to use these hearings to determine the extent to which the channels which mortgages come through are impacting the mortgage process. It is our intent to look and to use these hearings to determine whether or not there ought to be an amendment for Reg Z as part of this. And the more soft results we hope to come out of this would be the -- we would look for areas where -- we, the Federal Reserve, could provide additional education, or, if necessary, additional study.

From the Federal Reserve we have a couple people here, Sandy Braunstein, Director of Consumer and Community Affairs; Leonard Chanin, who is the Associate Director of Consumer and Community Affairs; and Mike Collins is with us, from the Philadelphia Fed.

We identify, or at least I identify, four separate important groups that have ownership in this process and are important to the entire mortgage industry, and to the economy for that matter. Number one, very importantly, is the consumer. In a free society, in a free economy, there's an underlying presumption that the consumer is responsible for their actions, and the consumer undoubtedly, unquestionably, has been the beneficiary of many of the changes, many of the improvements, that have been taking place in this industry. It is remarkable, not simply in the mortgage industry, but all credit products for that matter, all financial products, the consumer has benefited enormously by the improvements and the access, but it has been a mixed blessing.

Another group that has a responsibility of course, is the providers and the contacts to this meeting, that would be the mortgage providers. I have told this story other times; let me tell it again, because I think it brings home, to me, at least, an important point. Some of you know I spent a good share of my life in the banking industry. At no point was I primarily a mortgage lender, but I think that over the course of a 16-year banking career I think I was involved in closing more than a hundred mortgage loans, and yet, even with that background, I have never been involved in the closing of my own loan where I haven't felt, somewhat, at a knowledge disadvantage, with respect to the process, because it was a very daunting process. It requires a lot of paperwork, a lot of signatures, a lot of documentation, and there is an extraordinary knowledge asymmetry. I think that what that means, is that there is a very significant responsibility that the mortgage lenders have to not take advantage of that knowledge asymmetry and all of us to try to work to find ways to reduce that, or, at least, deal with that. I don't think that there is a way; it is impossible that you would ever close that gap entirely, but there is a recognition that that gap exists and we need to deal with it.

The third group that I think has a very important role and interest are the community groups and consumer advisory groups. We have noted, and many of the people involved in mortgage lending have noted, that the best access to the minority communes are through the community activists and through the community organizers. That group provides an access that provides the ability to help close that information gap and make us aware of where there are individuals or institutions, at times, who are taking advantage of that knowledge asymmetry, and so I think that that partnership is an important one.

The fourth group, of course, is the regulators and that's why we're here. I have said at one point in my life I, also, was involved in advising financial institutions on regulatory affairs and I know from that long experience that there was no group that was more at the forefront of both developing the education and the regulatory construct as was the Federal Reserve. And some of my colleagues, Sandy, in particular, who has been doing it for many, many years, take that role very seriously.

Because we still have one chair empty, we will go counter-clockwise in this meeting. We'll ask you to begin, introduce yourself, introduce your group, speak for five minutes, be mindful of the time, and don't worry, we'll help you if you go over.

Peter Zorn.

MR. ZORN: I'm Peter Zorn. My background, to be explicit, is, I'm an economist and researcher. My experience that I'm speaking from is from years of looking at the HMDA data as well as detailed underwriting data, in terms of credit modeling. Also, surveys that we have taken for impaired credit and focus groups associated with the surveys and just being in the industry, as it were, in the secondary industry for the last 15 years or so.

I'd like to make just a couple of brief observations. I guess the first, with regards to things that I observe, hypotheses of why they are what they are. The first is minority borrowers, I guess, stating a point that's well-known, are more likely to pay more for mortgages. What do I mean when I say that? One way of characterizing that more explicitly, is that if you look at APR distributions about minority borrowers, you will see that that distribution is shifted to the higher APR for minorities as compared to non minorities.

So, then, the next point I would make would be that differences in those prices, those APRs are greater across markets than within markets. So another way of making that point is, if you look at subprime borrowers in the APR distribution of subprime borrowers, you would see a difference in those distributions for minorities and non minorities. That is, in general, minorities would have a slightly higher set distribution of APRs than non minorities.

But if you made a different -- looked at different distributions, if you look, instead, at the APR distributions of minority borrowers in the prime market versus the subprime market, you'd see a much -- substantially larger difference in distributions. That is, there's a much bigger difference -- the difference between minority borrowers in the prime markets and the subprime market, minority borrowers, in the subprime market, pay substantially more than in the prime market, and that difference between minority borrowers in general, the bigger difference, would be in the subprime market between minorities and non-minority borrowers.

So that leads to, sort of, another observation, which is the, sort of, market segmentation matters. Does it matter whether your in a prime market or a subprime market, which leads to my next observation, which is that risk explains a lot, but certainly not all of those differences. And by "risk" I mean, all the risk, credit risk, interest rate risk, prepayment risk, associated with mortgage lending. One way to put a little more explicit flavor to that observation is that if you do statistical estimations of APR -- I try to explain APR as a function of a lot of variables, product characteristics, borrower characteristics, underwriting characteristics -- what you end up with is, explaining much, again, but not all, of the differences in APRs, so that there is an unexplained difference between minorities and non minorities, but it is dramatically reduced.

So, then, I will stop and say that this is an essential tendency. So I concede, again, I'm an economist and a researcher, so I look at central tendencies, so that is the point I want to make here, which is, this is a broad central tendency, not that there are not differences that exist for individual borrowers, and minority borrowers can, and sometimes do, pay rates which are higher, and that can't be explained by these models or these stories. So the question would be, why? And so, for me, at least part of that explanation is the channel by which borrowers do get their mortgage, and so if we conduct, sort of, another experiment, which is to try to explain APR differences between minority and non-minority borrowers by channel.

So let's look at subprime borrowers. Well, I'll stop I guess. Thank you very much.

GOVERNOR OLSON: Peter, I can assure you that, I for one -- you're right at the heart of the issue, which is how do we explain the APR differences among minority and non-minority borrowers and what does that mean.

Ira, thank you for joining us. In order to make full use of all of the time, we got started right at 8:30, and we're a little bit ahead of the 9:00 start for this panel, but it will give us the full opportunity. But we will be back, and we'll want to come right back to that issue, because there probably is no more -- singly more important issue that we can discuss.

Our next speaker is Doug Duncan, and for those of you that think that something has gone wrong in your internal body antennae has just flipped you over and you are now listening to Garrison Keillor, it is because Doug and I are from the same hometown in Minnesota and we all sound like Garrison Keillor from up there. So Doug, if you do keep your accent in check, and introduce yourself and then speak for five minutes.

Just as a reminder, this panel group is asked to speak on the subprime market and how consumers shop for credit.

MR. DUNCAN: Thank you, and indeed all our children are above average.

Good morning. I'm Doug Duncan, the Senior Vice President of Research and Business Development and Chief Economist at the Mortgage Bankers Association. Governor Olson and other members of the Federal Reserve Board, I appreciate the opportunity to participate in this very important panel.

MBA members are proud of their participation in the subprime market and would like to share that success with you. I want to make three points.

First, market compression in subprime rates closer to prime rates, lowering the cost of mortgage credit for subprime borrowers. Second, foreclosure and delinquency rates are not indications of predatory lending but of the ever improving precision of lenders' ability to assess risk; and third, if we want to enable borrowers to protect themselves in getting the best deal, we have to do the following: Improve borrower education in the mortgage process; make simpler, more meaningful disclosures; and shop, shop, shop, or impress upon the consumers the need to comparison shop for mortgages.

The subprime market has evolved dramatically in recent years providing significant benefits to consumers. There's little distinction, today, between prime and subprime, no credit score threshold, or interest rate, or other low term specifically defines a loan as subprime.

Fixed rating examines the securitized loans data and noted that the spread is being weighted average on loan pools identified by the issue as prime. It is only 200 basis points lower than pools identified as subprime. In 1999 that spread was about 300 basis points.

There are two major factors accounting for this. First, compressionate credit spreads across fixed income markets has driven down the cost of subprime credit, and second, competition has lowered the cost of subprime credit. This blurring in the line indicates sustained increased competition, which improves service and access and lowers consumer cost. I caution against over regulation in the market, as it could eliminate the benefits subprime markets offers to consumers.

I'd also like to touch on defaults and foreclosures in the subprime market to discard the notion that default and disclosure rates are "too high" and indicate predatory lending. It's important to note that marketplace growth, when interpreting delinquency and foreclosure numbers. According to the 2000 HMDA data, there are 8.3 million loan applications. In 2004, the HMDA data showed 9.8 million loan applications. With market growth and constant foreclosure rates, the number of foreclosures will increase.

However, too frequently, some market analysts point to the increased foreclosures as a problem, when it simply reflects a constant or even declining foreclosure rate in the context of market growth. Subprime borrowers are riskier candidates for credit, as demonstrated by their past performance, so lenders charge them more on a mortgage to offset the risk of nonpayment. This increased risk bears itself out in greater default and foreclosure rates than in the prime market.

In the fourth quarter of 2005, the prime market had a foreclosure rate of 0.4 percent, and the subprime market had a rate of 3.3 percent. Compare that to the foreclosure inventory rate of subprime loans of 2001 peaking at 9 percent. These numbers tell a good story about the demand of risk and the wherewithal of subprime borrowers.

While mortgage markets are plunging for consumers, borrowers find it challenging to understand the mortgage process. While overhauling our education system to make financial literacy a priority, it is a long-term goal. We think three short term steps must be taken to help improve borrower understanding.

First, borrowers have to educate themselves in the mortgage process. Second, consumers need simpler, more user friendly disclosures about mortgage loans that will help them shop, and then, third, consumers need to shop from lender to lender.

Our research shows that homebuyers, particularly first-time homebuyers, rely on a trusted advisor, who may have an adverse incentive, to help them through the home buying mortgage process. These new buyers, especially minority first-time homebuyers, either contact only one lender or are referred by a realtor to only one lender. While shopping for a mortgage, experienced borrowers are more likely to seek additional rate quotes.

We welcome your questions relating to any research we've conducted on topics, such as predatory lending, HMDA, prepaid penalties, and what consumers understand about their credit, particularly renters, and we just did a recent survey on that. That concludes my comments, and I look forward to working with you, and I'll be happy to answer your questions.

GOVERNOR OLSON: Doug, thank you very much. The need for simpler disclosures is one that we all agree, it's hard to disagree with that. The problem is, I think we need to come back and talk about where that responsibility is and how we can work together.

Janice Bowdler, same rules, same drill. Introduce yourself and your group, and you have five minutes for your opening statement.

MS. BOWDLER: Good morning. My name is Janice Bowdler and on behalf of the National Council of La Raza I would like to thank the Federal Reserve for hosting another round of HOEPA hearings. I feel honored to be part of such a distinguished panel.

As a founder of housing counseling, NCLR has been working with the mortgage industry for nearly ten years to increase Latino homeownership. From our perspective, the question of how the consumers choose their loan products is not only timely, it's critical.

Borrowers rely on the mortgage financing to build home equity that will provide a financial safety net through retirement. However, inefficiencies in the marketplace are causing adverse market segmentation.

NCLR intends to submit a more in-depth written statement, but today I will briefly describe how the structure of today's mortgage market channels Latino borrowers into the subprime products; how these borrowers are then steered toward loans that are profitable for the lender, rather than suitable for the consumer; and how both lenders and consumers rely on mortgage brokers to serve as market intermediaries.

Let me begin by describing how Latinos are fairing in the mortgage market. Non-traditional credit histories and a variety of underwriting variables common among Latino borrowers often require manual underwriting. For example, 22% of Latinos do not have credit scores. In a world of automated underwriting, manually underwritten loans are an unwelcome increase in time and resources.

Not wanting the added burden, lenders ration the number of such loans they process and excess demand is then de facto channeled into the subprime market.

Subprime lenders have the same profit motivations as prime lenders, but risk-based pricing allows greater pricing and product discretion, which, in turn, allows lenders to price a loan at any risk level. The model focuses on placing clients in products that are highly profitable for the lender rather than suitable for the borrower.

The evidence here is clear. Latinos are 30 percent more likely to receive loans that meet the HOEPA rate spread than whites when purchasing their home. They are twice as likely as whites to receive payment option mortgages.

NCLR's experience with the market busts the myth that such products are the only ones available for these hard to serve borrowers. 88 percent of NCLR housing counseling clients are below 80 percent of area median income, and many require manual underwriting, but all receive prime products. Instead, lenders are looking to cut costs, please investors, and increase their profits.

The same motivation forces lenders to rely on mortgage brokers. Mortgage brokers function as intermediaries who help lenders reach deeper into certain markets, and they help them save costs by reducing branch and retail expenses.

Consumers also rely on mortgage broker services, especially Latinos. Bilingual and bicultural brokers promote themselves as advisors Latinos can trust to find them the best deal. However, lender-offered incentives, known as yield spread premiums, entice brokers to push the cost of the loan higher. Coupled with non-traditional lending products, YSP adds another layer of subjective pricing to very risky products. As will be discussed later, there is valid concern that this is a formula for foreclose and equity loss.

NCLR values the role of the intermediaries, as can be seen by our support of housing counselors. However, this means that consumers shop for mortgages based on relationships, rather than on products and pricing. Unfortunately, many consumers do not understand the broker is an independent agent. The broker is not professionally or legally required to find the borrower a suitable loan. Many are unaware of the presence of a YSP in their loan, making it virtually impossible for even a well-educated borrower to weigh its costs and benefits.

What's more, recent research by the Federal Reserve concluded that low-income, lesser-educated recipients of ARMs did not fully understand the way their loan functioned or the impact of rising interest rates.

Many efforts exist to increase borrower's awareness of their mortgage options and risks. Of these methods, housing counseling is the most effective. Unlike brokers, housing counselors do not have a financial interest in the terms of the borrower's loan, but, unfortunately, not every consumer has access to their advice before closing. Moreover, their hard work is lost without reinforcement of strong protections and accountability standards.

To summarize, the structure of today's

market is not serving Latinos well. It creates incentives for directing otherwise creditworthy families to subprime, expensive and risky products. Latino families are forced to rely on subjective pricing models because of inadequate service by the prime markets. And finally, the lack of professional and legal accountability standards for brokers and lenders leaves families vulnerable.

NCLR would like to make three recommendations to improve the structure of the marketplace for Latinos and other underserved borrowers: Improve accountability standards; creates a suitability and anti-steering standard for lenders and mortgage brokers; strengthens consumer protections. Set high standards for compliance with the new interagency guidance; ensures victims have access to meaningful remedies. And finally, invest in housing counseling. Public entities and private mortgage companies must invest in housing counseling. It is a meaningful way to bridge the information gaps between underserved borrowers and their homeownership opportunities.

Thank you. I would be happy to answer any questions.

GOVERNOR OLSON: Thank you.

Ira.

MR. GOLDSTEIN: Good morning. My name is Ira Goldstein, and I am the Director of Policy and Information Services for a local organization called The Reinvestment Fund. TRF is the national leader in the financing of neighborhood revitalization, and we have been actively involved in research related to various aspects of the housing market.

Our research in the areas of mortgage lending, foreclosure and predatory lending has been supported through the grants from foundations such as the Ford, William Penn and Goldseker Foundations in Baltimore, as well as contracts that we have with the City of Philadelphia, Department of Banking for the Commonwealth of Pennsylvania, Delaware Office of the State Banking Commissioner and the U.S. Attorney. I've also testified as an expert in several cases brought by the local community legal services and by the Pennsylvania Human Relations Commission, and it's that body of work and experience that I draw upon for my comments here today.

First, I would say that it's my observation that over the course of time, consumers have become increasingly less able to understand the transactions that they are engaged in. I say, "increasingly less able", because, over time, the products themselves become more complex, and how those products behave in relation to market changes is also difficult to understand even for mortgage professionals.

Not only are these products more difficult to understand, they're also more frequently subject to mortgage fraud. Reports from Fitch Ratings are clear on this point, and consumers with whom we work show a limited degree of comprehension about what they're doing in these transactions. And that's even the case after they receive counseling.

The work of Alan White convincingly demonstrates that the reading comprehension levels of borrowers is all too often less than is necessary to effectively understand the transactions to which they are. The consensus is that financial literacy is woefully inadequate. Assuming that a written notice will overcome that, no matter how plain language that is, is plainly naive.

Second, is my personal observation based on interactions with borrowers, counselors, sheriffs, and attorneys, that borrowers are not all economically rational actors. All due respect to the economists in the room. Borrowers in financial difficulty are, oftentimes, in denial and they don't exercise all the options that are available to them. They disregard or misunderstand notices sent by their lenders and servicers until too much time has passed to recover from their predicament.

On the other hand, we are invariably told by borrowers, counselors, and attorneys that servicers report having absolutely no latitude to make any modifications or forbearance available to borrowers, when they request such action in an effort to become current or remedy some other aspect of the transaction.

Again, resorting to the research of reports of Fitch, that's not true and I'll quote, "Fitch currently rates numerous residential mortgage-backed securities transactions that allow the underlying collateral to be modified if borrowers are having difficulty making their monthly payments. A few transactions," and I understand there are a few, "A few transactions call for the full and immediate removal of modified loans from the pool."

Third, in the subprime market especially, mortgages are sold to consumers through mortgage brokers. In the mind of the borrower, there is no distinction between the broker and the lender. Our experience suggests that it is highly unusual for borrowers to shop for mortgages. Oftentimes, borrowers aren't out looking for money, but money's looking for them.

In Pennsylvania, although it's typical that the borrower pays for the broker's service, the broker does not have fiduciary duty to the borrower. And that is a fact that's not understood by the borrower. In the best case scenario, the broker is a true professional who helps the borrower understand and obtain a mortgage product that best fits their needs; in the worst case scenario, the broker sells the product that is most advantageous to them.

In a significant civil rights case brought by the Pennsylvania Human Relations Commission, under the Pennsylvania Human Relations Act, against a local mortgage broker, we learned that the African-American broker targeted African-American borrowers and sold them remarkably disadvantageous subprime loans that yielded far greater benefits to him than to his customers.

Having testified as an expert in this case, I can tell that you the hearing examiners themselves needed help understanding the complexity of the complainant's HUD-1 settlement sheets and the borrowers seemed to comprehend even less. What was salient to me, in speaking with the respondent broker's customers, was that's borrowers were especially susceptible to this broker's sales pitch because of their desire to help out a fellow African-American.

Fourth, although foreclosures have declined locally from their peak levels in 2002/2003 time frame, there are clear signs in the

90-day delinquency data that there will be an upturn. These foreclosures result in losses for the borrowers and lenders/investors themselves. Research conducted by TRF and EConsult Corporation, commissioned by the Federal Reserve Bank of Philadelphia, demonstrates that there is a statistically demonstrable adverse effect of mortgage foreclosures on local property markets. In fact, after applying an appropriate set of statistical controls, we found that each foreclosure within 1/8 of a mile of a sale and one to two years prior to that sale, reduces the value of the home by one percent. In Philadelphia, the typical home sale has four to five foreclosures within the specified time and distance, and so it is reduced by well more than five percent.

The implication of this is that everyone in the area has lost some of the wealth that they might have otherwise accumulated as the value of real estate appreciates. What's interesting to consider about this, is that even if the lender/investor and borrower agree that they want to compare the risk of the transaction it is borne by others.

GOVERNOR OLSON: Ira, let me stop you there. We'll have plenty of opportunity. I think your experience is relevant, and we'll want to hear more.

Peter, I want to come back to the point that you were making, if you can -- I'm sure you can -- it's the difference, the unexplainable difference, the APR differences that are unexplainable based on risk, and Doug can amplify his comments about the compression that's taking place, but the extent to which you can quantify or clarify how that distinction comes about, particularly in this context we're talking about, the different channels. So it would be interesting to hear any further application you have on that issue.

MR. ZORN: I'll just make a couple points. So, if you look at the characteristics that, presumably, you would like to think as an economist, would explain differential pricing, above and beyond those characteristics that you see in the HMDA data. As you add credit risk variables and loan product characteristics, which will affect prepayment and interest rate risk, then you do explain much of the difference between -- again, on average we're talking about a regression here -- between the APR that we see in the subprime market and within the prime market, but you're focusing within the subprime market. It doesn't explain everything, and one of the things that we haven't -- we looked at other data, which -- these are -- that's the result of analysis that we've done on 2005 origination. So it's fairly recent data.

The other data that we've looked at are older data in the earlier part of this decade, where we have additional information, more about people's financial education, financial knowledge, and actual propensities to shop, to pick up on Doug's point, and as you start to add those additional variables, you start to come close to eliminating, statistically, the differences you see in pricing and channel choice between minorities and non minorities.

So it gets to the point that Doug was raising, why do you see these differences? Certainly, part of it is, in my observation, having to do with how -- people's financial knowledge and sophistication; part of it has to do with their shopping behaviors. That is, I think, generally speaking, subprime borrowers will shop for a yes or a low payment; prime borrowers tend to shop for a low rate or a lower price, which is a different story.

GOVERNOR OLSON: Should we add a behavioral economist to the group?

MR. ZORN: I think that is a possibility. The marketing behaviors as well, I mean, subprime lenders, there's much more push marketing on the subprime side. And then the other part is, there's, I think, traditions, knowledge, exposures. So I think you have people who -- subprime lenders are in certain neighborhoods and are the lenders that people are familiar with, and that creates a momentum and a tradition to follow that path, even if they're not certain it's the right path.

GOVERNOR OLSON: Doug, a couple of points that you made, number one, the compression of the rates between the subprime and prime product, and I wonder how much of that is based on the fact that we're in an overall lower rate environment, but I'm also interested in, if you could amplify if you would, on the explosion in the numbers of applications, and some of the implications of that seems to me that in a time, or unquestionably, we are seeing an increase in the number of products, and to come to a point that Janice touched on a little bit, the difference -- the enhancements that are available because of the additional ways that we have of approving, or at least evaluating, products.

And then, so, we have the two things that are happening simultaneously. We have growth in the marketplace and additional complexity. How do you see that impacting, either the need for education, or the results that we see in terms of foreclosures or delinquencies?

MR. DUNCAN: Let me talk to the spread issue first. The spread issue in the secondary market, those are pretty available publicly and pool differences, price differences have been narrowing. To buttress that, we have a series of subprime companies that provide us with performance data, and over the last five years we've seen -- to use the way economists look at this to see if companies in different market segments or infrastructures are being equally compensated, the risk adjusted rate of return to capital among the subprime lenders has declined continually to where it's almost exactly the same as prime borrowers.

GOVERNOR OLSON: Stick with that, because the subprime and prime borrowers, the rates, if you take the yields, not the yield spread, the yield, and if you adjust for cost, the return on capital is about the same for the prime and non-prime markets.

MR. DUNCAN: That's correct. That was not true five years ago, but it is true today.

GOVERNOR OLSON: Talk about the other side of that, the explosion of the market. Could you repeat those statistics again, the number of applicants.

MR. DUNCAN: We were just looking at the HMDA data for home purchase loans. In 2000, I believe there were 8.3 million applications. These are HMDA data. In 2004, there were 9.8 million applications.

GOVERNOR OLSEN: So you added about a

million and a half applications in that time frame.

MR. DUNCAN: Yeah. At the same time, as you point out, there's been a tremendous expansion in the number of loan products. Our view of how this occurred is a couple of things. One is, obviously, a declining interest rate environment in general. Although, in 2004 rates were up from 2003; they were down from 2000.

In the midst of that, there has undergone a tremendous technological change in the mortgage business. Underwriting tools are available and cut out the most expensive piece of the credit assessment process. The electronification of the entire mortgage process has reduced hurdle costs in the industry. The ability to use sophisticated yield estimation tools by investors has brought in more capital. All of these things have lowered the hurdle cost rate, which would make a borrower who was credit constrained, a viable candidate for a loan.

As the cost structure has fallen within the industry, it's not as though there have never been credit constrained borrowers before; it's just that the cost hurdle to make them profitable to lend to, has fallen, opening the door to those households. At the same time, you have those all implicated products, which absolutely make more critical that there be a high level of disclosure of how loans behave, that is, how payments change. If it is a loan that has payment change, and what the different strengths and weaknesses of the different loan products are for an individual household.

Back on what Peter was saying, the strength of shopping among credit constrained borrowers is not the same as it is among the prime borrowers, so that heightens the need for financial literacy.

MR. COLLINS: Could you tell us how you're defining subprime?

MR. DUNCAN: That's always the question. And there's not a generally accepted definition. What we always do is, we require the respondents to sell to us, that is, the companies who provide us data, do you view yourself as a subprime lender or a prime lender, and then distribute the prime and subprime loans within your portfolio.

GOVERNOR OLSON: Janice, we, at the Fed, have become increasingly conscious of the difference in cost in clearing checks between checks that can be cleared electronically and checks that are cleared manually, and the cost difference is significant, and, of course, you take that and you apply it to mortgage processes, which is back to the point you were making, a very important point, the efficiencies available through the consolidation of credit data, such as a credit score, obviously improve the efficiency of that system; it gets passed down one way or another. And yet, I think the market needs to be aware, not only of the Latino borrowers, but many other minority groups, whose pattern or habits or culture falls outside of the norm, and yet, the availability of homeownership and homeownership mortgage products ought to be available.

Talk more about that issue from your perspective, as to how we can bridge that gap and how we can deal with the borrowers that fall outside of the most efficient channels.

MS. BOWDLER: I think the work on this

has actually been done. The products just aren't used. I know, for example, Fannie Mae and Freddie Mac have products that allow for no credit scores and the documenting of untraditional credit history.

Two other major underwriting barriers are, not being able to verify income or assets and/or not being able to verify employment. For example, it's really common for low wage workers that you might have had consistent employment in two years, but there could be gaps in that if some of that was cash income, especially in the construction industry. So there are products out there that account for that.

GOVERNOR OLSON: We have this dichotomy. On the one hand, you have products that are naturally suited, the stated income products, which fit that, but on the other hand, it's the stated income product which also allows for -- unlike the conforming product, Peter, Freddie and Fannie, that's always sold in the secondary market, you have a product that allows for it, but on the other hand, there's a wide range of -- there's opportunity for abuse with that product, to put it mildly.

MS. BOWLDER: Right. And we see a lot of abuse with that product. I think one of the important things for us is that the products are available to answer the needs of those clients, there's just not much incentive to use them and they cost more. So, our view of proprietary data, through partner financial institutions, shows that they're making this review of data from the northeast, southeast, East Coast corridor. They weren't making more than five loans a market that use nontraditional credit history or have zero credit scores. They're very, very little. When they held them in portfolio, they priced them higher. When they sold them to Fannie or Freddie, they were priced more conventionally, but either way, it still took more work for them to do. They just had no one to tell them to do that. It's easier and more profitable to refer them to the subprime market where they'll get into a stated income loan, or they have somebody there that, maybe, is more willing to take the time to go through the manual process.

GOVERNOR OLSON: Ira, you talked about

the wide range of -- the growing, increasing difficulty of understanding, and there again, you've got multiple factors impacting that. On the one hand, you've got a much wider range of products, which allows for more product and you have a much more avaricious secondary market, we'll want to come back to that with both Doug and Peter, and on the other hand, a larger number of borrowers, many of them first-time, and, perhaps, lesser educated, a lot of societal value in that but also some real risks in that. So could you talk about both sides of that and how you see that?

MR. GOLDSTEIN: On the risk side, I think something that Mr. Duncan said, the cost turner would make cost experience more profitable to lend to has declined, and I think that the last piece of research that I mentioned in my comments is relevant to that, and that is, the costing trend to lend to that group has declined and that is something that, sort of, works out for the borrower and the lender, but that's a risk-adjusted cost, and that means that the lenders are being compensated for the risk of the daily return of that loan. That's a deal between the borrower and the lender. That's not a deal between me the neighbor of that borrower and that lender.

What our research shows is that there is a substantial and statistically significant, if properly done, controlled difference, an adverse effect of when the borrower and lender get into that risk adjusted agreement, assuming the borrower even understands that agreement.

On the upside, definitely, if you look at homeownership rates, and they have increased, if you look at the demographic groups for whom homeownership has increased, there's certainly -- the rates, although not equal, have grown much faster among minority group members, and in local markets like Philadelphia, they're much greater among low-income markets. So the benefits are clearly there. However, the risks are great and, really, should be seen in tandem between those benefits.

MS. BRAUNSTEIN: I'd like to get back to the channels and the shopping a little bit. One of the things that we saw, that everybody saw in the 2004 HMDA data, which was that minorities are more likely to get loans from subprime lenders. And we talked a little bit about this today, but it seemed like Doug, in particular, was, it's the consumers who need to do better about shopping and looking around, but I'd also like to, also, explore the flip side of that. I mean, how good a job are the prime lenders doing, in terms of reaching out to minority communities? Is that part of the issue too? Is it just that the consumers aren't educated enough to go to prime lenders, or are the prime lenders not trying to market those opportunities in minority neighborhoods as well as they should?

MR. DUNCAN: We did a survey of a thousand people who bought homes. This was in 1999, so it's a little bit dated. And in it, we asked a couple things. We asked, "How did you start the process of information gathering?" Because that was a point in time when people were really starting to focus on outreach to minority borrowers, in particular. When we ask companies anecdotally, "How do you market to different minority groups?" They say, "Well, we spend a lot of money on marketing." And so, we say, "But where do you spend it?" Whey say, "Well, we spend a lot of money on marketing." So then, we say, "Well, do you know if anyone's listening?"

So, when we conducted the survey, found some very interesting things. What we found was that if you were speaking to Asians over the television, they weren't listening. If you were speaking to the Hispanics through the newspapers, they weren't reading it. There was, within the Hispanic community, a dramatic difference that that relationship had, within family and church and things like that, on where they gathered their information on the mortgage process. With the African-American community, things like housing fairs on television were more effective. White population was, sort of, all over the mark. Asians very much gathered information through the newspaper.

So we took that back to the industry and said, you need to think about, in your outreach, that you are spending your resources and attempting to reach the customer in a way that the customer isn't listening. So there's been change based on some early lack of investigation.

MS. BRAUNSTEIN: And Janice, can you comment from your perspective. Do you think that's true; has there been change in that?

MS. BOWDLER: I think there has been some change, but part of that is the qualitative piece to what they are marketing. I've been on a little project lately, where I've been gathering all the Spanish language newspapers that I can and listening to the Spanish radio. And for months now, the only thing that's advertised in the Casa Sections of the Spanish language press, are option mortgages, one hundred percent financing, and stated income loans, with your documents, without your documents, with proof of income, without proof of income.

Recently, I've seen several mainstream prime lender advertising -- two, I saw two, but they were advertising these same products. They were not advertising the 30-year fixed products that they advertise in the Washington Post. It's the same on Spanish language radio. Although, it's much more broker focused.

That's anecdotal, but this is also what

I hear from the counselors, whose great competition are the brokers and the subprime lenders, because counselors tell you, you've got to wait six months, and somebody else will tell you, if you want a loan, like other people have said, you can find a loan. What their experience has been, is that they will market to the Latino client, these products that have the lower initial down payments that then rise later, and they're not marketing the same kind of products as they're marketing to the other communities. And they're certainly not marketing the conventional Fannie, Freddie, nontraditional credit history products that are available.

MR. CHANIN: Let me follow something up with Peter. How you view this issue dictates, to some extent, what you view the solution to this issue or problem is. One of the things you mentioned is, the HMDA data clearly shows there's a disparity, in terms of the percentage of minority versus non-minority borrowers and higher priced loans. And you cautiously -- your lawyers must have advised you -- you cautiously said, much of this difference is explained by risk factors.

My question is, can you quantify the percentage of factors that are explained by credit score, loan value, or other materials? Is it 40 percent, or 80 percent, or 30 percent of that data that explain those differences, in terms of rates received?

MR. ZORN: Sure. Let me put some qualifiers in front of this. What I will give you, is on the basis of the data that we are currently using, so this is an A sample, large sample, subprime lenders. But for the data that we're looking at, we can get odds, ratios, APRs down to within, sort of, 1.2. So, starting from the odds ratio of 3 to 1 for differential APRs in raw data, between minorities and non minorities, we can get it down to, sort of, a 1.2 kind of range. Of course, we have ability plus observations, so any difference is statistically significant. I'm not saying that that difference is not, also, economically significant, but it's substantially smaller.

MR. COLLINS: Peter, if I could ask a question. In your look at the higher APRs for minority borrowers, do they have an adequate understanding of their credit profile and credit scores? Do they know whether or not they can qualify for prime credit? If they come in through the subprime channel, do they get to the prime channel? And secondly, getting back to the marketing piece of it, do they approach lenders with the higher rates based on advertising in the market? If they have sufficient understanding, is their financial literacy around credit scores and what they would actually qualify for?

MR. ZORN: I guess the short answer is no, but I guess -- but it's more -- we have no one killer data source. So we've got 2005 data where we've got a lot of detailed credit information, but not survey data where we know a lot about their financial knowledge. We've got financial knowledge and survey data back from three or four years ago. And this is a rapidly evolving market as everyone is describing.

But what's certainly true, is that when you ask people -- so in our survey data, which is several thousand borrowers, and you ask people -- we gave them a little financial quiz, essentially, and asked a bunch of questions that we thought would be relevant for someone who was financially knowledgeable, and then also asked them to self-assess their financial knowledge. We asked them to self-assess their credit, and we pulled their credit. So we had observable objective credit, observable objective knowledge, and subjective self-assessed credit and subjective self-assessed knowledge. What's true was that there was definitely a large number of people who did not have what we consider to be an accurate assessment of their knowledge and an accurate assessment of their credit, and disproportionately that tended to be true of minority borrowers.

We would like to believe that it is disproportionately people who poorly understand their credit, who end up -- so for example, people who believe they are worse creditors than they actually are, who end up in the subprime market. Despite the fact that we've portioned it out, we haven't got it to say that yet, but we haven't got it to reject that either. So, I say that's my personal, maintained hypothesis. I cannot give to you empirical evidence to suggest it. I believe it must be true, but I don't know if it is true or not.

MS. BRAUNSTEIN: We've heard that anecdotally before, that people often -- it's like a self-fulfilling prophecy. They think their credit's worse than it is, and they go to a subprime lender.

MR. ZORN: What we can't show is the people who actually think they have better credit than they do, are very effective in getting prime loans. I don't know what that means.

MS. BRAUNSTEIN: They are very effective?

MR. ZORN: Yes, they are.

GOVERNOR OLSON: They are very effective?

MR. ZORN: Yes, they are. I think my observation on that one is, what it reflects is -- the -- getting back to Doug's point -- right now, you can still observe channels, and this is getting back to Michael's question, what's a subprime lender, what's a prime lender. Like Doug, what we do is ask people to self-assess or we self-assess for them, but we don't do it loan by loan, we do it sub by sub, if you will, and I believe that distinction was greater in 2000 than it is in 2005 and 2006 and is diminishing rapidly. And so part of the story that explains this, is that just because you get a loan from a prime lender does not mean you're home free. It doesn't mean you can't pay a high rate and a rate that's not necessarily, by some other people's standards, the right rate. Because that middle range of A minus lending is increasingly an active and competitive area for both, what we consider, to be prime lenders and subprime lenders.

So, I believe, I mean, it's still okay, in general, I believe, to talk about, isn't it better to get a prime loan than a subprime loan. Again, that's a central tendency. I don't believe it's always true.

MR. DUNCAN: If I could. In looking -- to, kind of, take that point a little further, when we take credit scores from portfolios of lenders who classify themselves as prime lenders and from portfolios of subprime lenders, and there's an overlap in the center. So you would say, gee, well, then, aren't there some of these people that have this credit score, should have gotten a prime loan as opposed to a subprime loan, where their credit score fell. But the credit score is not the sole determinant of how you make the credit decision.

The underlying part of the discussion, is that's, sort of, an implicit assumption that every lender has, what an economist would call, the same objective and the same appetite for risk and they have the same appetite for product diversification or assets in the portfolio. That's an invalid assumption. When we have 8 to 9000 banks out there, each of whom has there specific stockholders' interest in how much risk they want to take in what kind of areas. The idea that two separate institutions would look at the same borrower and come to exactly the same conclusion is probably not accurate. Although, on broad averages, across the entire population of lending institutions, it will come to the central tendency decision.

MR. ZORN: This is, sort of, an interesting experiment, but we had a couple hundred thousand loans, which are the combination of prime lenders, who have reported rate spreads -- that is, loans from prime lenders with reported rate spreads, loans from what we identified as subprime lenders, that were not reported rate spreads. Then you look at the micro score distributions of those two sets of borrowers, they're right on top of each other.

GOVERNOR OLSON: Bring that to a conclusion. What did you learn from that?

MR. ZORN: I learned, isn't life funny. What I think would be the initially -- I also learned that rate spread doesn't really tell you everything you want to learn about price, for reasons that everybody knows, but in some sense, what we thought we were doing when we first did this, was, we looked at what are the higher cost, higher risk loans being made by prime lenders, how do they look compared to the lower risk loans of subprime lenders. And the answer is, from micro score distribution tests, almost identical. So, that is, this gets to the point -- it comes back to that. This is 2005 origination.

GOVERNOR OLSON: Janice, we've been discussing at the macro level, now let me come back and ask -- part of what we're getting at here is the shopping, if you will. I think your perspective would be very interesting in this sense. The mortgage product and the mortgage industry is open to an enormous amount of scrutiny because of the information available. The product is publicly identified, in many respects, the many characteristics, but there is a tremendous amount of other shopping for financial products that don't receive that kind of scrutiny, and I'm sure the same asymmetry exists, in terms of knowledge, but also some of the same confusion. But where do you see -- how does this product differ, for example, from the sale of life insurance or other consumer products, or perhaps, even, other consumer products that are not financial products in terms of A, the marketing or the assistance, or the shopping process in the community?

MS. BOWDLER: I think there's some differences and some similarities. Let me start there. One of the biggest differences is that when you're shopping for a mortgage or when you're not shopping for a mortgage, but obtaining a mortgage --

GOVERNOR OLSON: The mortgage shops for

you.

MS. BOWDLER: When the mortgage shops for me, it's a much bigger decision, and I think people are very aware of that fact, and for that reason seek out more counsel, going back to points that I think all of us have made, that this shopping is much more relationship based. And I think that financial products that rely on brokers, in general, and there's a lot of other financial products, such as insurance or stocks and securities, that rely on that market intermediary function, are shopped for very similarly, based on relationships and less on the actual product. Other consumer products say, remittances, which we know there's a lot of financial abuse there, heavily used in the Latino community, that's more geographic.

GOVERNOR OLSON: What do you mean by "geographic"?

MS. BOWDLER: Whatever's closest or more convenient. So if it's on your way home from work, or if it's close to your house or where you grocery shop, than that tends to be more geographic.

MS. BRAUNSTEIN: And mortgages are not -- you don't think people are going to the folks who are either in the neighborhood or marketing the neighborhood?

MS. BOWDLER: I think they do. But here, I think that relationships are much more important. For example, just to pick up on your question from earlier, you asked if there wasn't some self selection into the subprime market, based on people's perception of their own credit score. I don't think people make that kind of decision. I don't think people think to themselves, especially in the Latino community, I'm a subprime borrower, I need to go find a subprime lender. That calculation doesn't happen.

What happens is, that they know a bilingual or bicultural broker because their sister or their family member, or they go to the same church, or they somehow know each other from some other social connection. So it could be that they also happen to be in the same neighborhood, but I don't think that's always true. For banking that's more true, but for shopping for a mortgage, I think it's less true.

MS. BRAUNSTEIN: Have you found, and any of you can address this, but I know Janice, you said that when you looked at the newspapers and listened to the radio ads, that there were some subprime lenders that were marketing, but they were marketing subprime products. To me, that raised a question. If a borrower goes into a prime lender, even though they're responding to an ad for a subprime product, and when the underwriting takes place, if that lender finds that this person actually could qualify for a prime product, is that kind of referral going on or are they just given the subprime product they walked in from the ad where they walked in the door? Do you have any knowledge of whether that's happening, and any of you can go about this if you know that that's happening in your member institutions.

MS. BOWDLER: I'm going to make a guess. Research came out recently from the Consumer Federation, that I think the number -- don't quote me on the number -- somewhere around 40 percent, that payment option mortgages were 40 percent of the loans last year. So there's been a dramatic increase. I might have that statistical data, but I think we'd all agree that there's been a dramatic increase in those mortgages.

Now, I was part of an FTC panel a couple of weeks ago, where a prime lender presented and explained to us that his underwriting standards for underwriting a payment option mortgage was to underwrite a consumer at the rate that he expected the loan to jump to in that first year. So if you got a 1 percent rate for the first month or maybe six months, however that product was structured, and in that year, if they expected that the product would go to 7 percent, they underwrote to 7 percent.

So my question would be, if that person is an underwritable for 7 percent, all other things being equal, how do they end up in a payment option mortgage versus your standard 30-year fixed for even a fully amortizing ARM. And the only conclusion there is, it's more profitable to be in a payment option mortgage than it is to be in a 30-year fixed. I think profit motivation is very natural and important in this market to do what they need to do, but it tells me that we need some more accountability to offset those motivations.

MR. DUNCAN: I was actually at the same FTC thing, and you're right about the underwriting. I think the initial question was whether or not the consumer could qualify for a different loan, and the lender explained that they underwrote at a fully fixed rate so that even if there was negative amortization, the increase to the maximum over a three-year period, would be a 14 percent increase in the payment from the qualifying level. Then the question was, whether the consumer chose the 1 percent teaser rate because they had other use for those funds in the interim, and if they managed that loan they were well-positioned to make the payments.

It's not true today that all lenders have a specific referral process, but many lenders have a specific referral process internally. So that if a borrower were to come in, selling to us as a subprime and after the qualification process were complete, they were determined to be eligible for a prime loan, they would be referred to a prime channel.

The reason for that is, the comment that I made earlier, about the increased competition in the subprime arena, if you went back ten years ago you would have a lot of independent finance companies. Today it's migrated to many more subsidiaries and diversified financial service companies, which have more serious capital investments and reputational investments in the industry, and those institutions are subject to CRA rules and things like that, and are much more sensitive about the proper classification of borrowers according to their regulations.

MS. BOWDLER: If I could just add one thing to that. We've heard similar things from financial institutions that have both prime and subprime ARMs, or subsidiaries within their structure, that there is this referral method to refer up and not just refer down. And we have partnerships with several -- several lenders through our housing counseling network that meet with lenders on a regular basis and ask them all for example loans where that's happened, and for documentation on policies of exactly how that's supposed to work, and I have yet to see it. So I think there are policies out there that, just like the nontraditional credit company products, I just don't know that they're used.

GOVERNOR OLSON: In fairness, we did hear on Wednesday in Chicago from a panelist where that partnership did work, so we know it does, although I'm sure that there are gaps.

Let me come back to one other element that is really critical to the subprime question. Is the significant change that's taken place in the last four years in the secondary market, especially secondary markets' appetites now for the nontraditional product -- let me pose it, make my point, and then have anybody -- Ira, you've already referred to Adam Smith, so if you want to comment on this as well you're welcome to.

In my early experience the subprime market was geared toward taking the conforming product and that was the product that was available in the secondary market. In recent years, and I think a combination of flat yield curve, very liquid secondary market and a shift, therefore, in investors looking for a risk premium as opposed to a term premium, there has been a lot of appetite for that, for the nontraditional product. And it's not clear to us that the underwriting standards in the secondary market brackets are as tight as it is with the conforming product.

It comes back to a point we were talking about earlier, we may have lost some of the discipline of the underwriting process at the point in which the application is taken, because of the fact that we've had this explosion of interest in the secondary market of the nontraditional product. I'd be interested in any of your comments about that.

MR. ZORN: I would make a personal statement, not speaking for any of the people paying my salary. I, personally, believe credit spreads in the subprime market are too low.

GOVERNOR OLSON: Another way to say that is that they haven't fully priced in the risk associated with this product.

MR. ZORN: Correct.

MR. DUNCAN: I think the root question is whether, in global capital markets, credit spreads are appropriate. In the U.S. -- by "appropriate", I mean, reflecting historical norms. And I think most people, including, back in Chairman Greenspan's tenure, when he reintroduced us to the word conundrum. I think that was a part of what he was expressing. In a market which is very efficient and where capital explosions relate to demand on capital, whatever those measurements are, they will be passed through ultimately --

GOVERNOR OLSON: In the mornings, when I'm a macro economist, I think that's a wonderful thing. Because what it means is, we have reduced the price, to the consumer, of that product. In the afternoon, when I'm looking at consumer interest, I see the other side of it, which is to say that there is a relaxation of the underwriting and it may have put people in products for which they are ill-suited. And in the macro world, we have a significant dispersion of risk exposures, now, in pricing, appropriately or inappropriately. When it comes back to the individual consumer, then it becomes, in that context, irrelevant, because you've got a consumer in a product where they don't belong.

I think this is an area where all of us need to recognize that explosion, that plethora of opportunity, is causing some people to be in inappropriate products, perhaps, and I'd be interested in any reaction as to how we can deal with that fundamental issue.

MR. GOLDSTEIN: My observation, if I could, is that you're exactly correct, that there are a massive number of people who are in products that are entirely inappropriate for them, if, for no other reason than, that they don't understand. They don't know what's going to happen to them a year out, two years out, three years out.

I'll give you a quick story. The sheriff of Philadelphia announced that the number of sheriff sales was going down, and he was pleased to announce that 2005 had substantially less than 2004. And part of his announcement was, he wanted to have some borrowers, some people who had been in trouble, talk about how they had their circumstance remedied, and they were not subject to having their home sold at the auction block in Philadelphia where hundreds of homes are sold on a monthly basis. This is somebody who was in deep, deep, deep trouble, and it took months of intensive effort by local housing counseling, and in the end, when she was trying to express what happened to her, she could neither express what happened to her nor how she got out of trouble, only that she was helped.

So after months of very intensive work between her and a housing counselor, her situation was so complicated that she could still not understand what she had to do.

MR. CHANIN: I want to return to this issue of shopping, which is, if not a solution, part of a solution to this issue of people -- where they're getting a suitable product or looking into suitable products. Obviously, one of the issues that we will have to deal with is, trying to make the disclosures more comprehensible to people and also make them simpler, which is no small task given the complexity of these products.

Aside from that small issue, is the question of how do we ensure or try to ensure that the consumers do shop and, if you will, don't evolve into this notion of a trusted relationship in relying on someone who may not provide all of the information that, ideally, the consumer should get from this person.

So do you have suggestions that we can use or think about, of, how do we get people to shop more so for these products and make sure we get the product that best suits their needs?

MR. GOLDSTEIN: One possibility, I think that the data from mortgages bankers these days and from mortgages brokers suggest, probably, an excess of two-thirds of mortgages that are originated, originated through brokers. And one way to ensure a wide review of that market is to look to, not only incentivize borrowers to shop -- there are clearly incentives for borrowers to shop, because if they do it properly, they'll end up with a better product. But to incentivize or regulate brokers, so that they're truly shopping and acting on behalf of the borrowers themselves.

So if a broker, like the one I described or others that we've had relationships and contacts with, if they're only taking their customer to one lender or two lenders, it's not a matter of the consumer's shopping behavior, in a way, it's more a matter of the broker's shopping behavior.

MS. BOWDLER: I think that's right. I think it would be a mistake to assume, and I don't think anybody here has suggested this, but a perfectly educated borrower is going to regulate the market. It's not going to happen. So, even the most astute borrower who shops, is still going to have missed steps if there's not some protection or suitability standard to back them up.

So, the mortgage market is not -- you're not going to have loan officers or brokers telling families, your situation isn't quite right, you need to wait a year and come back. Well, I have this other product; it's a little more expensive, I can get you in right now. That's always going to be the answer. So, there needs to be something to offset that.

MR. COLLINS: Doug, if you could go back to some of the statistics you cited in your opening comments around foreclosures. I think you had numbers for 2001 and 2005, but at the same time, you stated that there's a lot of conversions in the prime and subprime markets, and a lot of advances in the marketplace since 2001. How do you see the outcomes of the decisions today, as the Governor's indicated, do you have a good sense of whether or not those numbers are comparable?

MR. DUNCAN: Sure. We surveyed delinquencies, about 42 million loans at this point in our data base, on a quarterly basis, and we have been, for about the last year, suggesting that there were about four reasons that we should expect to see delinquencies in foreclosure rates rise.

Those four reasons are: First, any loan peaks in its probability of delinquency in three to five years of its life and less than half of all loans outstanding today are more than three years old. So this puts an upward pressure on delinquencies.

The second thing is that, as after every re-fi, after this re-fi we've seen an ARM boom, and that's because of the way the yield curve works, long rates rise and short rates stay low so consumers shift into ARMs. Then when the short end of the yield curve comes up, then they shift back to fixed-rate products. That's been underway for the last couple of quarters. This ARM process was extended because of the production of the new loans that you referred to, various alternative adjustable processes. ARM loans always have a higher delinquency rate than fixed-rate loans, so the market expects that.

The third factor is the growth of the subprime market, which we're talking about here. Relative to the total portfolio, subprime has grown faster because of those things I talked about earlier, lowering the cost hurdles. All three of these forces will combine with what has been recently rising interest rates to put upward pressure on delinquency.

The primary factor operating in the other direction is the single most important factor in predicting foreclosure or delinquency foreclosure, which is employment. As the economy's been adding two million jobs, roughly, per year for the last two and a half years or so, that puts downward pressure on foreclosure.

This is the number one, most important thing, employment and real income growth. If we were to see a significant climb in employment, we would see a different behavior in delinquencies, but we do expect, over the next couple of years, modest rises in delinquencies, and we saw it in the fourth quarter, modest rise in delinquencies. They went from, in the third quarter, 4.40 percent to 4.70 percent delinquent, but we put a caveat in there because .157 of that increase was Katrina. If we stripped that out, it went from 4.40 to 4.45. The way we stripped it out, we just said, what if they stayed constant at the same rate of increases as every other state. So, as we've been suggesting, we will expect to see modest rises in delinquencies.

One other thing to think about is, as we're trying to determine whether we're at the cusp of a slow down, whether monetary policies are properly positioned, it's also the place where the yield curve has been flat, and that's the inflexion point for the mortgage bracket, where underwriting stresses are the most difficult in terms of predicting into the macro economic environment. So we would expect to see that as something that causes delinquencies and foreclosures as well.

GOVERNOR OLSON: Two questions. One, let me come back to you, Doug, and this is for clarification, and then I want to come back to Ira on the sheriff. We think, in most of the rest of the country, we think of some of these products as being very new. The option Alt A payments, if you will, and the negative AM payments, and they are relatively new in the east, but they're old products, 25 years, in some cases, in the West Coast. So we have a long history of those kinds of products in the West Coast. Do the statistics that you cite -- and we have seen those products -- we have history of those products going through rate cycles, and Peter, you would, perhaps, help with this. What has the market's experience been with those products through rate cycles?

MR. ZORN: You go, and then I'll go.

MR. DUNCAN: Well, the -- I think the difference is the volume of them that's been done relative to the size of the market, and we don't know whether that's going to reveal a performance difference today from what would have historically been the case. Historically, lots of those loans were held in portfolios with regulated lenders.

GOVERNOR OLSON: It's a huge difference.

MR. DUNCAN: That's right. And they performed well in those institutions but the expansion outside of that, leaves open an empirical question which we won't know until it plays out.

MR. ZORN: Our experience is historical experiences. They, in our portfolio, overperform. That is, they are our best credit risk that reflects, I believe, the changes --

GOVERNOR OLSON: Sorting out your insider jargon. The interest lending loans perform better than the other product in terms of their delinquency.

MR. ZORN: Correct. Historically. Which I think has almost nothing to do with how the current --

GOVERNOR OLSON: Okay. Ira, the sheriff. In my lending days, we would do anything to avoid a foreclosure. In a foreclosure, from the time we initiated the foreclosure -- from the time the sheriff got involved in Minnesota, it was a one-year period before we could do anything with that property. The value of the property disappeared, or at least declined. It was enormously expensive.

Foreclosure -- I don't know what the laws are in Pennsylvania, but the laws significantly protected the interest of consumers in that respect and provided the lenders with a significant incentive to avoid the foreclosure process. And now I'm hearing that -- in fact, we heard this on Wednesday, that the initial notice of foreclosure -- by the grace of God I'm not burdened with a law degree, so I don't know the legal terms, but the initial notice of foreclosure, in fact, triggered other lenders to come in, or pass the buck artists, more likely, to come in and provide what they perceived to be solutions, but, in fact, put them in deeper trouble. The Neighbor Works tell us, who have a great service of assisting people who are, perhaps, facing foreclosure, the greatest difficulty that they have is finding the people who may be in need of the counseling. So bring me current, if you will, on how that process works and to who's advantage it works, if anyone.

MR. GOLDSTEIN: I, too, am not burdened by a law degree. I'm burdened by a degree in sociology; it's a different kind of burden.

In Pennsylvania, one gets, first, a notice, by law, by state law, that you are in trouble and that your lender is going to foreclose.

GOVERNOR OLSON: And that's typically with what, a 180-day delinquency?

MR. GOLDSTEIN: It varies dramatically from 90 to --

GOVERNOR OLSON: But the lender definition of going into foreclosure.

MR. GOLDSTEIN: Exactly. They get that notice, and in Pennsylvania, they have an opportunity to apply to a state program, which, under certain circumstances, it will bring them current if they apply and are approved. It's called the HEMAP, Homeowners Emergency Mortgage Assistance Program, and it's been in the state of Pennsylvania for 25 or 30 years. It's designed to get people past the point in time when they are in trouble, essentially, through no fault of their own, and manifest some likelihood of being able to get back on their feet again at some point in the future.

So people make application to this program through an approved state housing counseling agency. If they are approved, the state gives them a loan, which brings them current. It sits out there as a second loan. They make a minimal monthly payment until such time as they can pay, both, their existing mortgage and this other mortgage. That is not available, by the way, to people with FHA loans. It was designed at a time when FHA had a different set of loss mitigation things than they have today.

Assuming that they're not successful there, a piece of paper, a lawsuit, is essentially filed with the prothonotary or the clerk of courts in the various counties of Pennsylvania, and at that point, having worked with the prothonotary somewhat, we find that those lists are oftentimes sold to two parties, one party being attorneys looking to represent people, and secondly to lenders or brokers who are looking to make those loans that you were describing.

That process can stretch out over a year to, maybe, even five years, depending on the kinds of things that people do to defend against the foreclosure, if anything, including an affirmative defense that something went wrong in the transaction or a bankruptcy or something else of that nature. Ultimately -- and during that period of time, obviously, they could make some other kinds of arrangement to become current.

At the end of that process, if the lender succeeds in the foreclosure action, the house is listed for sheriff's sale and then is sent to the auction block, and that could take a year as well. It's not a speedy process. In fact, I would say that Philadelphia and Pennsylvania, generally, is relatively slow in the process, and we've observed, for example, in Delaware or Maryland, our experience in Baltimore is, a year from start to finish; you're out. It's quick and certain.

But that is the way it works in Pennsylvania. And I would say that in terms of the lenders appetite for not wanting to foreclose, I think that that is our opinion too, that there are losses that adhere to the lenders. The question is whether or not the lenders' appetite for not wanting to foreclose gets conveyed to the servicers and whether or not the servicers are using all available options to the borrower.

GOVERNOR OLSON: But I think that that's not -- on behalf of those of us who have been in the lending business -- I think that's not fully appreciated. And I think in most states, this is the case. There is significant consumer protection, that the portfolio lender who forecloses is going to lose money in that process. So there is a strong incentive not to go through that process. It seems to me that there ought to be a conversion of interest, not only the underwriting, but also the avoidance of foreclosure, and there historically has been.

MR. GOLDSTEIN: I don't disagree with that, at all. However, when you look at the lenders who are the most active in the foreclosure listings, not those that are foreclosing, but the lenders who made the loans, that are subject to the foreclosure, those are not, in the main, portfolio lenders.

MR. DUNCAN: One technical point I'll note, we classify states according to their foreclosure laws by the state's judicial process, which is typically more lengthy than those which have a non traditional process, and it's a consistent message that you want to talk to your lender, as opposed to going with one of these other folks.

MR. COLLINS: I think Governor Olson talked a little bit about state foreclosures have a more efficient and fair mortgage marketplace, and I think Janice, you were saying, that a perfectly educated borrower can't regulate the market. There have been some changes in the laws, for instance, one that allows consumers to get a free copy of their credit report, to help shop for credit. Maybe Ira or Janice, can you tell us whether or not that's made any difference in people's ability to shop, or are they taking advantage of the credit report?

MS. BOWDLER: I am going to jump out there and say I don't know if we know that yet, because the free credit reports have only been available for not very long, a year in some places and less in others, because of the time release of that. So I don't really know yet. I know that through our counseling networks, all the clients that come in are entitled to a credit report. It's standard practice to pull their credit reports and go through it with them. And our experience has been that a family still needs help going through that credit report. So, even once they get it, if everything's fine, and they have a great credit report, there's not much of a problem. But if they have credit problems or if they have errors, or identity theft, or any other issues, then they need to seek out other help and the counselors help them with that.

And this is especially true for language minorities. And the system for -- if you speak Spanish or if you prefer Spanish, I should say, there are 800 numbers that are not fantastic, but they're there. If you speak some other language, you may or may not be able to get some help. So I think I've heard a lot from Asian immigrant communities that there's been problems with accessing credit reports there.

So, I don't think that that's been fully beared out yet. I wouldn't expect that just having your free credit report is going to help you shop for your mortgage. Hopefully, it will lead to a better understanding of what your credit score is and how to work within that context. But I think that's still a step or two steps away from shopping for your mortgages.

MR. DUNCAN: We just completed a survey, which we released earlier this week, of 1200 households, which we did not classify by racial or ethnic group, but we classified by renter versus borrower, and we asked exactly that, have you accessed your credit report. We were quite surprised; 75 percent of both owners and renters had accessed their credit report. We asked them, how do you feel about your capability of managing your credit? And owners were a little higher than renters, but not much. They felt like they were doing a good job with this. We also asked them, did you find errors in your credit report? And about 50 percent of those polled found errors. And of those who had found errors, did you correct them? A higher percentage of owners got them corrected than renters.

Our objective was to look at who's going to become an owner and what are their credit characteristics as they approach the process. And 45 percent of those renters said that in the next two years they want to buy a house. And that's, kind of, what we were getting at to get to this question.

GOVERNOR OLSON: Were the errors misidentification or were they credits that had been paid, but not recorded as paid?

MR. DUNCAN: We didn't get that information.

MS. BRAUNSTEIN: In terms of -- getting back, again, a little bit, to the shopping thing, do you find, Janice, or others that may know the answer to this, that people are more likely to try to pre qualify -- if they know they're going to go buy a house, do they go out first and look at where they could potentially get a mortgage, how much of a mortgage they could handle before they go look for a house, or is it more, they go out and look for a house and then, very quickly, try to run around and get a loan in order to buy the house that they identified before somebody else buys it out from under them. Is there, you know, a way that is better which may seem like the first way to do that?

MS. BOWDLER: Again, all of my answers are anecdotal and come from feedback that we get from the counselors. The first thing is, I think that tends to differ by market. In hot real estate markets, like northern Virginia for example, families are very aware of the fact that they're competing for houses and that they need to do something, even if they aren't exactly sure what that is, to secure that house of their dreams that they want. In slower markets, I don't think that's necessarily the case.

I do think it introduces something we haven't talked about yet, which is real estate agents, that are also very relationship-based, and now can do a pre-qualification for you. And so, if you're relying on a real estate agent, which I think a lot of people do, and that's true in the Latino community as well, then they can do a pre-qual there and give you an idea of what you can afford.

Now, what I've heard from some places is that a real estate agent will give you, not a range, but the largest amount you could possibility qualify for. So it's going to be on the high end. And I've heard issues that once it gets down to it, you can't quite afford that much, and you might lose a house. There's issues there. But I do think that people are getting access to pre-qualification but they do it through realtors.

MR. CHANIN: Let me follow-up on this notion of shopping. Do you see any difference in consumer behavior, in terms of shopping for purchase money transactions versus refinancings, either in terms of things that work better for those people, or if those people shop more or less, either of those groups.

MS. BOWDLER: People who get refinances are overwhelmingly more likely to receive solicitations, and be approached, either by real estate agents, by brokers, through the mail, on the phone, and be solicited for these refinances. And we did some survey data where we looked at why people were refinancing.

It's interesting, because the Latino

community refinances less than other communities. And from our perspective, that could be good and that could be bad. It could mean that they are staying put because it's not for them, or it could mean that if they were seared on the front end, that they're not taking advantage of money saving opportunities by refinancing.

Those that refinanced were overwhelmingly likely to respond to solicitations to do so, and they were more likely to be cash out refinanced than just rate re-fis. There is solicitation in the purchase, but if you're a renter, you're out there with that idea that I want to be a homeowner, and I think it's more common that you're solicited by a re-fi.

MR. CHANIN: In that re-fi scenario, the push market so to speak, do you find that people, typically, respond to those offers, or do they make a decision and then go out and affirmatively shop other lenders or other sources or channels?

MS. BOWDLER: I don't think that there's any more shopping in the re-fi level than there is for purchases.

GOVERNOR OLSON: It's my perception that the panel is losing some steam here. We started early and we're ending early, presumably, but I want to make sure, are there any other comments that any of the four of you would like to add as our panelists, and then I can ask my Fed colleagues if there are any remaining questions.

MR. DUNCAN: I had one thing I wanted to follow-up on that Ira made, which was a very important point talking about the cluster foreclosures, and the industry is thinking about that because there is the expectation of a lot of growth in reverse mortgages. For many of the households in those neighborhoods, that's the bulk of their equity. To the extent that those cluster foreclosures weaken the ability of the market to assess true value of that equity, it's going to cut into the ability of those households to access it in the reverse mortgage structure or some other structure. So I didn't want us to lose sight of that significant point.

MS. BOWDLER: I'd like to make a final comment as well. A lot of my remarks, and some of the questions, focused on profit motivations that gear consumers to certain loans, and the question of suitability, and also the role of mortgage brokers, and I just wanted to be clear that we understand that that's the nature of the market and that those profit motivations are the things that provide the mortgages to the families, and that's an important role, and that the markets intermediary is an important role. So we wouldn't want to do anything that damages the industry for being able to do what it is does, but that we need something to offset and counteract those forces to make sure that the consumers are adequately represented as well.

GOVERNOR OLSON: It's a very good point. Anybody else? We'll take a half hour break and we'll get started at 10:45 with our next panel.

(Whereupon, there was a 30-minute break in the proceedings at 10:15 a.m.)

(Whereupon, the proceedings resumed at 10:45 a.m.)

GOVERNOR OLSON: Just as a reminder, one of the important parts of the program are for people who are not on the panels but would like to make a statement. At 3 o'clock, we have an open mike time for people that would like to make a statement. If you would like to do so, there is a sign-up sheet outside, and please indicate your interest or your willingness so that we can give you opportunity to speak.

We now have our panel in place for the second panel. Let me remind everybody of our ground rules. You will give a five-minute opening presentation. You will see -- you will be spared the ignominy of having the buzzer that we had in Chicago. We have a sign that says one minute and your time's up, but we have found, also, that that allows for a significant opportunity, then, for further discussion as a result of making that time available.

I'd like each of you to identify yourself, your group, and then make your opening presentation, and we will go in the same order, counterclockwise, starting with David Berenbaum.

MR. BERENBAUM: Good morning everyone. I'm not going to spend a lot of time introducing the National Community Reinvestment Coalition. I think most of the folks in the room, it's a collegial group, I think we've met each other on many occasions, are familiar with the work that NCRC does. I serve as the organization's executive vice president, in particular, the areas of policy, are direct service initiatives, and are civil rights advocacy.

I'm going to spend my five minutes, today, diving immediately into some work that we've been doing, both through our Consumer Rescue Fund Initiative, as well as through a mystery shopping program that we've just completed in partnership with the United States Department of Housing and Urban Development. The information that I'm about to share with you is included in the remarks, which I believe are on the table outside, and will also be on the Internet later today.

NCRC is extremely troubled by how the mortgage marketplace is not acting rationally with regard to the wholesale marketplace and the role of mortgage brokers. Let me qualify that by saying to you that I believe that a majority of mortgage professionals, although they work in the financial service industry or the appraisal industry, areas of focus today, are professionals in acting responsibly. But that said, in the recent year that we've taken a look at our dataset, under our consumer rescue funding program, a very successful remedial loan program for victims of predatory lending or consumers in hardship, 90 percent of the cases we have looked at where fraud or where there is problematic lending, involved a problematic broker, a broker who was perpetuating the fraud.

That reality prompted us to place a grant into the United States Department of Housing and Urban Development, because we are tired of hearing, it's not us, it's them. They originated the loan. It's at wholesale marketplace, and in fact, 70 percent of the marketplace loans are being originated by mortgage brokers. They are not being regulated appropriately, and that means we have a problem in the system.

Quickly, with regard to our testing results, we sent qualified African-American mystery shoppers or testers and slightly less qualified white counterparts into mortgage brokers across the nation in six studies that are identified in my statement. We control for income. We have them control for credit as far as describing their own situation. This is all reapplication testing.

Here are some of the initial findings. With regard to fees, 74 percent of the white or control testers, were given very detailed information about fees associated with the loan programs that they were being offered. Only 30 percent of the African-American testers were being given information about fees.

With regard to product choice, African-Americans were given rate quotes or rate product descriptions approximately for 1.3 products. These are averages over the 100 tests that we conducted in the six areas. White testers were given approximately 2.6 quotes, in other words, close to 3 loans per site visit.

With regard to fixed-rate loans, 90 percent of the white testers had fixed-rate loans discussed with them, while only 56 percent of African-American testers had fixed-rate loans discussed with them as well. Similarly, with regard to adjustable rate mortgages, 37 percent of white testers had those types of products discussed with them, and only 13 percent of black testers.

Terms and conditions varied greatly between African-American and white testers. On advise of counsel today, because we are filing three complaints, the first being filed today, I am not disclosing the information with regard to pricing and terms, but there were significant differences. 16 percent of the testers, white testers, were referred to banks for loans. Only 8 percent of our testers who were African-American, were referred to banks.

And last, with regard to -- two points -- with regard to referral up, which came up on the first panel, we found that 7 percent of our white testers were told that they should apply elsewhere or were referred up to a private product by a mortgage broker. None of our African-American testers, 0 percent, were referred up in any of our 100 tests. 40 percent of the African-American applicants for mortgages were questioned about their credit history or if they've ever had a foreclosure or bankruptcy.

Only 9 percent of our white testers were asked the same question.

With regard to professional service, on average, white testers spent 39 minutes with brokers, and black testers spent 27 minutes with brokers. I'll leave more discussion about this testing to our colloquy, but I'd also like to point out that predatory or problematic appraisal is a major issue in the marketplace.

And to follow-up on the remarks that the National Council of La Raza made about member groups and partners, what we are finding is that realtors, appraisers, and the entire financial service marketplace, is changing as a result of financial marketization. As a result of that, there is needed change to ensure active enforcement of existing law, as well as to take a fresh look at HOEPA.

GOVERNOR OLSON: Thank you very much. These are critical subjects, because what you're describing is discriminatory and disparate treatment, which are violations of the law. We want to make sure that we give you a full opportunity to address those.

Irv Ackelsberg.

MR. ACKELSBERG: That's my name, Irv Ackelsberg. I want to welcome you to Philadelphia, the cradle of liberty and ground zero in the fight against abuse of subprime mortgage lenders.

What I have to tell you is largely anecdotal. I'm not a researcher, but this anecdotal knowledge comes from my experience in taking, what I believe to be the largest creditor lending practice in the country, eight legal services attorneys focusing primarily on defending individual homeowners in foreclosure. I've personally reviewed hundreds of loan files, deposed numerous brokers, loan officers, underwriters. I studied the practices of the companies who once dominated the market and those that are dominating now. In my few minutes, I'd like to tell you about the typical and routine abuses in the market today post HOEPA.

The subprime market today, at least as it applies to low-income homeowners, remains fundamentally broken as a result of the institutionalization of a new generation of abuses that are not addressed by HOEPA. The current abuses are engineered, in large part, by mortgage brokers, who, for the most part, have no incentives to produce good loans and, instead, contrary to the interest of borrowers and their communities, are mass producing unnecessarily risky loans.

But by pointing the finger at the broker, I want to be clear that I do not believe primary blame lies there. Brokers are, in my mind, little more than sales agents for the lenders who have been to Wall Street, designed the mortgages they want to make, and depend on this army of supposedly independent sales people to sell their product.

I brought with me two illustrations to show you from today's market leaders, Wells Fargo and New Century. The first loan that I've given you is an illustration of a loan that came into our office very recently. It's a loan that was made by Wells Fargo with a broker in March of this year, two months ago. The facts are, this is a very low-income homeowner. She only has $620 a month in Social Security. She has a house that, based on the comps I was able to get out of the computer, are between -- the value of her house is between 15 and $25,000. In March of this year, she agreed to $17,000 in home improvements by a suspicious dealer who told her he would arrange the financing.

This is the loan that she got that you're looking at. A $32,900 loan made possible, I assume, by a fraudulent appraisal arranged by a broker she never met, who was brought in by the contractor. The difference between the amount of credit she wanted and what she got includes payoffs and special subsidized obligations from state and local agencies that she had no interest in paying off, and thousands of dollars in settlement charges, including a fee to the broker she never met. She had absolutely no ability to pay this loan. The starting monthly payment of $286, which does not include an escrow for insurance and taxes, by itself, leaves her only $334 to pay her utilities, her food, her transportation and any other monthly expense. And, if we look further, this was an adjustable rate mortgage. It has a two-year rate of 9.8

percent and then it jumps up to 7 points over line bar, as high as 15.875 percent. So the inability to pay will worsen. Of no regarding Wells Fargo decision to make this loan -- if you look you'll see the application, it increased her $620 income to $779, but even in so doing, they acknowledge -- the sixth page of the documents I'm showing you, a document called Conditions of Loan Approval, they acknowledge that she did not have the residual income to pay the loan.

Now, this lack of general underwriting that you're seeing in this example, is not unusual, it's not in every single one, but constantly, we're seeing loans like this, and made by not bad apples but by market leaders.

I also gave you a summary of New Century securitizations in the first quarter of 2006. Looking at it, the 1.4 billion dollars of mortgage loans in that pool, of which only 10 percent are the 30-year fixed-rate loans that I dare say most consumers believe they're applying for, 45 percent of these mostly adjustable loans are no docs; 45 percent. What Ira Goldstein didn't mention this morning, is, that in the research we have in Pennsylvania, 20 to 40 percent of the subprime loans made in 1998 or '99 were in foreclosure by 2003. So how much more of a crisis are we, in Philadelphia, facing years from now, when all these adjustable, no doc, no escrow, no underwriting loans, start going bad.

We can't depend on the market to bring down foreclosure rates and create incentives for real underwriting, at least not over a reasonable time frame. Too much will be lost. We need the help of the Fed. Thank you.

GOVERNOR OLSON: Thank you, Irv. And thank you for concluding right as the time expired. David Bleicken, same drill, introduce yourself, the group you represent and you have five minutes.

MR. BLEICKEN: My name is David Bleicken. I'm from the Pennsylvania Department of Banking and it's a real pleasure for me to be here and talk with you.

I have a longer statement that I will be glad to offer for the record, so I'll focus my remarks on two areas of concern to the Department of Banking. The first deals with underwriting.

The factors that lead homeowners to foreclosures are complicated. Some are sad, but unavoidable, illness, job loss. Some are criminal, forging documents, inflating appraisals, deceiving advertisements, but some, which leads me to my next point, are subtle. Otherwise acceptable mortgages are being sold to families who simply can't afford them. This is irresponsible in lending.

Irresponsible lending is this: Making a mortgage with no real effort to discern if the borrower can repay the loan. I'm not talking about whatever the first year monthly payment is, I'm talking about making a reasonable effort based on all of the terms over the life of the loan. It seems like a simple concept, but one that's increasingly absent in the structure of today's marketplace. Too often, today, the salesperson has little or no stake in the long-term success of the loan.

When local bankers made loans 30 years ago, there were natural consequences to their underwriting. Even if they didn't expect borrowers to be long-term customers of their institutions, the basic soundness of their portfolios was on the line. Today, someone can make the sale, get a commission and never interact with the borrower or loan again. Chances are, that even the original lender won't hold the mortgage for too long. They'll be included in the pool and sold on a secondary market. Whoever ends up pulling the defaulted paper is so far down the line that they are all too frequently removed in the consequences of the transaction.

The other thing I'd like to focus on today is what the states are doing. The Pennsylvania Department of Banking, we've licensed just over 4,000 mortgage brokers, regulating them under two laws passed by the general assembly. As you may know, across the nation all but two states regulate the mortgage industry. It has been leadership provided by the states, after all, that has resulted in landmark settlements. More routinely, however, states have minimum financial audit standards, conduct background checks, require testing, order refunds, mandate continuing education, and a host of other compliance requirements.

In Pennsylvania, over the past three years, we've seen explosive growth in the mortgage industry. The Banking Department has restructured itself within the powers already given to it, reached out to the general assembly, and worked with other state regulators as part of a national effort. Part of our structuring includes doubling the size of our consumers services staff, doubling the number of our examiners that look at non prospering institutions, like mortgage brokers, creating an investigation unit, and enhancing the scrutiny that we apply to our existing statutes to people who apply to us for a license. In working with both consumer advocates and industry leaders to work on a new set of policy statements and regulations to govern the proper conduct in the business in Pennsylvania, and to define what is illegal, unfair, and unethical.

We already started to see results from our efforts. Last year, we levied $110,000 in fines against mortgage brokers; this year, as of the end of May, we have already eclipsed that number. We also, currently, have 71 brokers under investigation. These statistics are simply products of our new presence in the marketplace.

Of particular concern, however, are provisions focused on licensure. We are working with the legislature on a legislative package that would include, in part, the licensing of individual loan officers. Part of that would require pre-licensing testing and a battery of background checks. To that end, though, we also are working with the Conference of State Banking Supervisors in the American Association of Residential Mortgage Rates on a national licensing database. You may have seen in the news yesterday that the CSBS just signed with the National Association of Security Dealers to host and create this Web site. It should be up and running by January 2008. We are remarkably excited about this. It will enhance our ability to follow people over state lines and to share information with other states.

I do want to emphasize that we do not believe that all mortgage brokers are bad. We believe that the majority of them are honorable people trying to make a decent living in the world. But even one is too many. We are working very hard to protect consumers from those that can do harm. I will end my remarks with that.

GOVERNOR OLSON: Thank you very much, David. Joe Falk.

MR. FALK: Good morning. My name is Joe Falk, and I'm the mortgage broker. I'm chairman of the legislative committee, the National Association of Mortgage Brokers and thank you for allowing us to participate.

NAMB is the voice of the mortgage broker industry. We offer educational courses and certification programs. We adhere to a strict code of ethics and best lending practices. The rise of the mortgage broker industry has expanded product choice distribution channels, adding robust competition and great pricing options for many consumers. We go where others will not.

Unfortunately, this expansion has led to a rise in the number of uneducated and unlicensed originators, bankers, brokers, lenders, all. While states are increasing requirements for brokers -- thank you, Pennsylvania -- they continue to exempt officers of banks and lenders for these important standards. I make this point because consumers do not know the difference between a mortgage banker, a mortgage broker, even a depository banker. There is little substantive difference between them. We're all competing distribution channels.

There are numerous players in the market today. There are many types. There's the mortgage banker type, the mortgage lender type, the broker type, the credit union type, the banker type, the home builder type, the real estate agent type, and the Internet type, and the list goes on and on and on. And sometimes, companies act in multiple capacities, even within their own companies. So I believe that we compete directly with one another. Consumers are best served when all disclosures are the same, no matter what type of company they go to, a consumer goes to, for their individual mortgage loan.

A topic of great debate is compensation. And the truth is, that all originator types receive direct compensation, indirect compensation, or a combination of both. Regrettably, only mortgage brokers currently disclose both direct and indirect payments. With other types, the back end compensation is not disclosed. This gagged approach has created nothing but consumer confusion. To make comparison shopping meaningful, all channels should provide the same disclosures.

As discussed before, we need to focus on the three parties involved in this arrangement: government, industry, and consumers. We have to remember, of course, that consumers are the ultimate decision makers, not the mortgage provider. Brokers do not represent every loan product available, nor do we have the best loan available in any one market. I want to emphasize that point. There is no best result for any individual consumer. It depends upon price, product, and availability, and focusing only on price may not yield the best result for the consumer. Only the consumer can determine what is best for them, and that's why NAMB rejects the concept of fiduciary or agency suggestions that we've heard debated here today.

As for decision making, the role of the consumer is to take advantage of the competitive marketplace place, shop, shop, shop, compare,

compare, compare, and ask questions. And if they don't get answers to their questions, go somewhere else.

The rule of government is to provide rules and regulations and, most notably, enforce them. There's a clear lack of enforcement effort and money on the federal level and on the state level. Sadly, enforcement is lacking. The government should also encourage and fund financial literacy. The consumer has a role to play.

The government should also ensure that the consumer is not exposed to crooks and incompetent people, and it's a privilege, not a right, to be a mortgage broker and participate in our great industry. And as part of that privilege, we believe that all originators should be licensed, educated, and submit to a criminal background check. This is what's called for in NAMB's model state statute initiative, which we have been proposing all across the country. It calls for all originators, not just mortgage brokers, to be licensed, educated and screened for bad acts.

Lastly, the role of the industry is to remain innovative, competitive and knowledgeable. The industry must also be vigilant to comply with appropriate state and federal laws, follow best practices, be honest, and treat people with respect. Thank you.

GOVERNOR OLSON: Joe, thank you very much. Jack Guttentag.

MR. GUTTENTAG: I'm Jack Guttentag. It's a pleasure to be here this morning. I'm a retired and then unretired university professor. My information may be of some interest to you. I run a Web site that provides mortgage information to borrowers. It's mggprofessor.com, mggprofessor.com. I also do an active correspondence with borrowers, and I estimate that since 1998, when I started my Web site, I fielded from 25,000 to 30,000 letters to mortgage borrowers with concerns about one problem or another.

I also started an operation that I call Up Front Mortgage Brokers, which are mortgage brokers that are committed to disclosing their fees to the borrower up front, their total fee, including whatever the broker is paid by the lender, and there's about 150 up front mortgages brokers at the present time.

Now, the philosophy underlying that, is that, as far as borrower welfare is concerned, what's important is that they should be encouraged it visit loan providers that they have good reason to believe will treat them fairly and honestly. It's like the principle of picking wild mushrooms. It's very difficult for an aficionado of wild mushrooms like me to identify all the bad ones out there, because new bad ones keep rising. What we do is, identify the good ones and you stick to those. And that's the principle that borrowers should be encouraged to use when they select a loan provider.

The motto ought to be, don't be selected. Don't allow yourself to be solicited. Do your own selection and go someplace, such as my Web site, and find out the names of loan providers that you have good reason to believe will treat you fairly.

Now, in the case of the subprime market, there are two dimensions of this market or two aspects of it. There's the inside market and there's the retail market. The inside market is where wholesale lenders deliver their prices to brokers and also to small correspondent lenders, who, from this standpoint, are pretty much the same as brokers. This part of this market works very well. It's extremely competitive because the brokers have a financial interest in getting the best possible price from the lenders. The better the price they get, the more money they make on the transaction.

The problems arise at the second level, at the retail level, where the borrower or correspondent lender interfaces with the broker or correspondent lender interfaces with the borrower. Now, there are some bad apples, and you've heard about them. My comments are not about them. My comments are about most of the industry, most mortgage brokers. And my experience with mortgage brokers, and I've corresponded and spoken to dozens, if not hundreds, of them over the last six years, is that the great majority of them are what I call, equal opportunity mark-up maximizers. That's another way of saying that they try to make as much as they can on every individual transaction.

Now, they make more on some than on others. They make more on the naive non-shopping borrower, than they do on the shopper and the well-informed borrower. They make more on African-American borrowers. Not because they are discriminatory, but because in the process of trying to maximize their mark-up, they are more successful in doing it with African-Americans. The reasons for that are pretty well known; I'm not an expert on that.

Not all brokers fit this description of maximizing the market. There is this set that I mentioned at the outset. Up front mortgage brokers, they may be mark-up maximizers, but they will negotiate their fee up front with the borrower. And there's also one correspondent lender, with whom I made a special deal, that also discloses all fees to the borrower, and you can find that on my Web site. Thank you.

GOVERNOR OLSON: Thank you very much, Jack. There's ample substance for to us get back and dialogue on that. That's very interesting.

Coming back to David, you were beginning to talk about a subject that we have not discussed much in our discussions, either, today or on Wednesday, and that's the role of prices. And I know that in previous legislation and previous issues regarding mortgage abuses, if you will, there are mortgage practices. The role of appraisers has been key and sometimes controversial, and could you just amplify what some of your findings are in that regard.

MR. BERENBAUM: Again, as a result of our work, working with consumers through our rescue fund initiative, we first became aware of what was happening to consumers. Historically, 15 years ago, when I first became involved with the fair housing movement, the issue was under evaluation of African-American and low, moderate-income communities. There's still some of that. There has not been the same level of depreciation, but, clearly, the issue now in the marketplace has switched to, in fact, over evaluation, equity theft, and other issues.

And again, I'll qualify my remarks by saying the role of the professional appraiser is to ensure the integrity of the transaction, or a lender, who, also, ultimately, is the securitizer for the consumer against the safety and soundness of the entire marketplace. There's clear guidance and other laws, as well as guidance, and the issue is pressure in the marketplace, a changing marketplace, once again, as well. Because we see more use of ABMs, for example, which are not always as accurate as they need to be for the transactions. I can't tell you the number of situations that we see where we're dealing with a manipulated appraisal, square footage is adjusted, a major problem with the house is omitted, or a condition is not included in the report.

Our appraisers, 70 percent of whom have been polled by October Research, one of the major think tanks in this area, a publication, approximately 55 percent of the appraisal industry says they have been pressured to meet a mark. This destabilizes the marketplace. It creates problems where consumers are in upside down mortgages. This is an issue that's very common. Our members -- I know the legal service community in Pennsylvania has been very active on this issue, but there are hot spots of appraisal fraud across the country, from Las Vegas and Denver to Baltimore and areas of the West Coast.

Our response has been a best practices approach for our new center for responsible appraisal and evaluation. We're signing up appraisers and realtors and mortgage brokers and lenders and securitizers to be part of the process, but, in essence, we're asking people to change the way they've been doing business. Because if they get the deal done, and to some extent, the market is motivated by profit, and often the larger the transaction, the more fees people receive, and we've got to take a hard look at this issue.

GOVERNOR OLSON: Let me shift now to Irv, but let me slide over to the short-term profit maximization, which, I think, was obviously very clear, Irv, in the application that you showed us, and it's the sort of activity that we hear anecdotally is happening, but we also have had, historically, checks and balances in the marketplace that isolate that behavior because there is, in fact, a reckoning. People that cannot pay the obligations that they have to pay ultimately are in financial difficulty in the mortgage and whoever is the portfolio owner of the that mortgage has a loss on their hands.

So, what has happened, in your judgment, to the balance in the marketplace and, number two, you're sitting right next to a guy representing the State of Pennsylvania, why isn't behavior like that simply reported and dealt with?

MR. ACKELSBERG: It's reported. I guess, Governor Olson, the first thing I'd like to respond to, is, this assumption that there is this reckoning, and it was obviously touched on in the last panel, that nobody wants to foreclose and so, obviously, that's not -- we're all trying to avoid that. I think that yes, foreclosures tend to be a loss in that one little case, but that's not the way it's really looked at, because these are little cases in huge pools, and the question is not, are you losing money on this foreclosure, but really, in the aggregate, what kind of losses are you suffering. Because, really, if you're pricing up, and most of the people are paying -- so you're not necessarily losing money. In fact, you can have very high foreclosure rates and make a whole lot of money. This is part of the mystery of securitization that was, really, an amazing discovery for me, because I've been doing this for 30 years.

I come from the days when you got a loan from a local mortgage company or bank, the foreclosure firm was local. It was portfolioed in house. There were all sorts of relationships, all sorts of accountabilities built into that market. And now, I believe that securitization has turned everything upside down and, really, made a lot of the incentives very perverse.

A colleague and I, just yesterday, were looking at the losses, the actual losses, on the subprime pool -- you know, now that there is this data available, we were looking at it. Just out of the blue, we picked a New Century 2001 pool, and what it says, is, that after five years, they foreclosed on about 10 percent of the houses, another 5 percent were in REO, and another 5 percent were in serious default. So basically, you're looking at, roughly, a 20 percent failure rate. But if you look at the cumulative losses, it's only 1.8 percent of the original pool, or about 44 percent a year. So it really is possible to do a lot of foreclosing and make a lot of money.

GOVERNOR OLSON: I can't let that alone. I doubt that that's the case, but nonetheless, there is -- but your fundamental point is exactly right. There is so many changes in the marketplace. There are opportunities for profit maximization at the front end of the process and the intermediate steps, and we're discovering, now, that there are product maximization opportunities in the foreclosure process. All of which is very different; you're correct.

I'm looking at the data that you have in your second handout, and I'd like to have you respond to this if you would. Under the documentation types of the mortgages loans, the stated doc, which would be the lowest doc product, is the group that has the highest weighted average credit score. So presumably the borrowers who have worked and been able to develop the best credit score are the most apt to have low doc products. Is that consistent with -- what does that tell you about the total securitization package?

MR. ACKELSBERG: Well, echoing what happened before, by the grace of God, I'm not burdened with an economic or finance degree. I'm just a small town, humble lawyer.

But I should say that from the standpoint of the real people, and, again, you get into that debate about what reasonable people do from the economist standpoint, and not just what people are doing, but what is happening to them in the marketplace, because, really, our clients are not shoppers. They are people who are being -- things are being done to them in somewhat of a passive way. I can't really explain this.

I can tell you that we have seen loans where the broker is offered, as an option, full doc, no doc. It's a difference of a point. And what it appears is that when a broker doesn't want to be bothered with getting the verification, he can simply agree to a no doc, because what's it to him? I mean, if you have a broker, and we have asked in depositions, in hearings, who do you represent? Who do you represent? Do you represent the lender? Do you represent the borrower? They'll say, no, we represent only ourselves. In that context, I don't know what that means, but no doc just becomes another thing that is put on people whether it's appropriate or not.

GOVERNOR OLSON: I think that is a real issue, but that is reinforced -- if you go down to the second part of that page, types of mortgages loans, again, the adjustable rate IOs, in both cases, are also the loans that have the highest weighted average credit score. So in the main, what we're seeing is, the most sophisticated, if you can use that as a proxy, borrowers are in the low doc and the adjustable rate IO mortgages. But that still doesn't -- your point is still valid, that the wide range of product has allowed, at least in some part, for abuses. We'll come back.

Moving on to David. Let me talk about the disaggregation of the mortgage product. In my day, which is considerably before your day, you're right, mortgages were all portfolio products, and you, probably, as of the time you made your final payment, you may well have submitted that to the person who initiated the mortgage. Over time, the automated process has allowed every part of the mortgage product to be disaggregated, priced, and sold. The net effect of that has been to bring tremendous efficiencies into the product and to make that product available to a wider range of the mortgage process.

It also, as you pointed out, has allowed for profit maximization or for a lack of holistic look, if you will, at the overall implication of that product. I would be interested in your reaction to that trade off. Whether or not -- what that trade off has allowed and the extent to which that trade off has negative ramifications from your perspective.

MR. BLEICKEN: I think the answer to that, sir, would be, it's like anything else in life. We're trying to strike the right balance. We studied mortgage foreclosures in Pennsylvania for the last few years. The Reinvestment Fund did a couple of studies for us.

In response to that, what we're trying do, a couple of things come to mind. Number one, we are putting the final touches on an examination process. To take a look at the default rates of our licensees, both lenders and brokers. The tough nut to crack on that one is the brokers, because some do, but most do not, keep track of the default data. And the trick there is to identify what is a good default rate, what's a bad default rate, and then list a consequence. The incentives approach to that would be initial contact and then, finally, if there's no risk solution to that, revocation.

The other part to that, as I mentioned in my comments, we're working on some draft documents, draft regulation on the proper time to do business, and a draft statement policy. We haven't disclosed it yet, so I'm not at liberty to talk about it in detail, but the issue of providing a rule for what should be done at the front end to avoid the consequence at the back end.

GOVERNOR OLSON: It will be interesting to see that as it unfolds.

Joe, one thing is really clear, that there are bad actors in the mortgage broker business. I think everybody in your panel has suggested that that is not typical. But it is a fact. From the Washington perspective, occasionally the Washington perspective has value, especially when dealing with perception, it takes only a few bad actors to generate a legislative response by the Congress. We see this many times, certainly, in the banking industry and in many other industries. So what are you doing in the way of trying to work within your own industry to develop standards to make sure that the bad actors don't spoil -- don't put us in the barrel, if you will, for everybody else.

MR. FALK: First, we do believe that there is a positive role for government to play. We believe that licensing of originators, all originators, not just mortgages brokers, bankers, lenders, any one who touches a loan application, should have minimum standards of education, submit to criminal background checks, a barriered entry if you will, and continuing education requirements to maintain minimum competencies.

We've been out in the states -- I believe we've been working with the Pennsylvania

Association of Mortgage Brokers to help the states, or entice the states, into understanding that the rise of this industry, this massive explosion of loan originators of all types, has brought with it some folks who may not have the right motive, who ultimately do not follow existing rules and regulations, and David, you briefly talked about it, and quite candidly I'm shocked and concerned about it. And I pledge to work with your group to ferret out the co-issues of fair credit and equal opportunity and fair pricing.

We do believe that there should be a registry of all originators. We've been pushing for this for many years, but only if it's all originators, because the problem in our industry, because it's so fluid, as soon as you identify one production channel for specific rules and regulations or different disclosures, those very distribution channels who seek to take advantage of the underserved, will flip to a different distribution model, will become from a mortgage broker to a net branch operator, or flip to working for a depository institution or a lender.

So our view is, all origination companies should have the same disclosure statutes. We endorse licensing of all originators, and we endorse some kind of a multi-state process to ferret out the bad actors, so they cannot go from state to state.

GOVERNOR OLSON: That's very broad, but within your own industry, do you have expectations for your own industry for what the mortgage broker should or should not do? Do you have a standard of conduct, for example, in the industry?

MR. FALK: Yes, we have a Best Practices Guide for all of our members.

GOVERNOR OLSON: Jack, you are part of the solution, it appears to us, because the opportunity is to shop, to do comparative shopping. Overwhelmingly, what we're hearing is that education and financial literacy is probably the number one defense to a lot of practices, for all the reasons that we were talking about. What kind of a -- number one, are you exclusively on the Internet, and is the Internet, does that, by definition, leave out a portion of the market that you might be able to serve, and is your example being replicated in other markets, for example, or in other groups?

MR. GUTTENTAG: When the federal borrowers ask me where to go, how to get along, I think in terms of two possible channels. One channel is the Internet, and the Internet -- I send them to the Internet because the Internet is the one part of the market where you can shop effectively, get accurate prices that lenders will stand by as opposed to come-on prices, and where they provide information up front about lender fees, third party fees, and the rest of it.

Now, there are a lot of Web sites that do that. There are probably, if you count up all the mortgage Web sites run by mortgage loan providers in the country, they would probably be on the order of 30 or 40 or 50,000. I identified 17 on my Web site that are worth shopping at, in the sense that they provide the information that allows people to identify their own price online.

Now, shopping online requires a certain amount of knowledge, ability, access to a computer, ability to understand some things, so it's not for everybody.

So the second channel has to do with

sending people to a trusted loan advisor, someone they can deal with and have some confidence that the loan advisor will treat them fairly. These are the people that I send to up front mortgage brokers. Now, I can't guarantee the effectiveness of all of these brokers. What I can guarantee is that the brokers will sit down with them and discuss their fee as part of their initial discussions, and a fee will be arranged between the broker and the customer which will cover all the broker services and will include any extra premium that the broker receives from the lender.

So, at that point, the transaction swings from the, kind of, independent contractor model, which in the mortgage broker industry is standard, to a type of agency relationship where the broker is now operating in the interest of the borrower and passes through the best wholesale price that he can find in the market.

MR. CHANIN: Let me follow-up on that in a little bit. Directly or indirectly, the panel has seemed to identify three issues of problems with mortgage brokers. One is, what I'll call, fraud, overstating income appraisal problem and the like; the second is potential discrimination in terms of providing different information to borrowers on a prohibited basis based on race; and third, is this last one that Jack mentioned, and that is, different information being received by a consumer from a broker.

I'd like to focus on that last one. Other than the Internet and these trusted advisors, what other processes can be developed to try and ensure that consumers get, either more information or better information about loan products, different products that might be best for them, and so forth, when they go to a mortgage broker, since, at least, two-thirds or more consumers go to mortgages brokers to get their loan products.

MR. BERENBAUM: I'd like to jump in on that. First, let me say that I think the Federal Reserve can play a very important role in addressing this issue. I have spoken with many state regulators, many professionals in the mortgage industry, in the appraisal industry, everyone universally acknowledges that both federal regulators and state regulators are underresourced and underfunded for enforcement even of existing laws. And we fully support the efforts of all the federal agencies to enforce fair lending laws, to enforce consumer protection laws, but this is a major issue that the Federal Reserve could report this issue out to Congress, that there's a need for more resources as a result of financial marketization.

As well, let me say that lenders, meaning originators, service corporations, and banks, play an important role in this process. Because, in fact, they are the ones, in many cases, working with the wholesale marketplace, with mortgage brokers. Some lenders have placed parameters on the type of product that they will originate with mortgage brokers to control for the compliance issues, whether it be fair lending, predatory lending, or fraud issues that they are seeing in the marketplace. Other lenders are pulling out of markets, altogether. Some are leaving it to Wall Street to buy certain types of credit.

I'll share a quick story. I was recently invited to speak at a Wall Street investment house. There were global real estate securitizers, purchasers from everywhere around the world. They have calculated the loss to their mortgages. It affirms what Mr. Ackelsberg had said. They were not worried about losses. They were looking at their pool. I did not, sadly, get their attention until I said the words, asimee (phonetic) liability. And that is a fact of life, and that is an unfortunate fact of life.

But that said, even in Ohio, where we have a brand new state bill, a meaningful state bill, just signed by the governor, it carves out the entire wholesale marketplace. This is an issue that the Fed needs to make some strong recommendations about. Because we all have an integrated marketplace. We all relate to each other. When I work with a lender who's holding a paper, a responsible lender, I can stall a foreclosure for two years with the lender's cooperation, and thank you to all of you in the room who work with us to do that, to put a consumer -- give them a fresh start. Often, though, when I'm dealing with a Wall Street investment house, that foreclosure proceeds, and the reason that the servicer tells us, the investor is not willing to wait any longer, even if we're saying the consumer's getting a job, even if we're saying there's a predatory appraisal, and then it becomes the last resort of the attorneys. We've got to bring this marketplace together.

MR. GUTTENTAG: The most important source of information to borrowers is what they get from mandatory disclosures. Because those they get with every transaction, and the two sets of mandatory disclosures come from the Federal Reserve and from Truth in Lending. The Fed and Truth in Lending, we'll leave that out for the moment, because they are not represented here. The mandatory disclosures under Truth in Lending are an unmitigated disaster. There's a real question as to whether or not they do more good than harm. The Fed seems to be quite unresponsive to the problems connected with Truth in Lending. It's not a high priority issue for the Federal Reserve. They have much more important fish to fry than this responsibility.

So I've been railing about Truth in Lending for years and years and years. The deficiencies are glaring. They get worse all the time, and nothing seems to be done.

MR. CHANIN: Let me respond to that. The Fed is undertaking for open-end, revolving credit, wholesale review of those disclosures, and we are going to do the same for closed-end credit sometime over the next couple of years. That will include using focus groups, bringing consumers in from various regions throughout the country. So I can tell you, the Fed is very concerned about that. We've talked with consumers, with lenders, with state regulators, with other agencies, etcetera, so we are going to look very closely at all of those disclosures on Truth in Lending to try to see if we can make them more simple, more understandable and more usable by the consumers.

MR. ACKELSBERG: Mr. Chanin, in terms of the question you asked, I actually have three responses I'd like to make. The first is that you listed fraud, discrimination, and the information problem. I would list a fourth, which is, basically, a structural conflict of interest. It's not defined, who this person -- who is this person? The borrower generally believes that this is someone who's there, who has specialized information that's going to help them. There really is a fiduciary kind of understanding the borrower has, to the extent the borrower even knows that he's talking about a broker, because that's the other side of the problem.

In Pennsylvania, a broker doesn't even have to identify himself as a broker; that's not part of the rules. And they all use the name mortgage company in their name.

So who are you dealing with? Most people think they're lenders, but to the extent they think they're financial advisors of some sort, there really is a kind of fiduciary expectation, which, I believe, is exploited, and until this is really pinned down, what the heck is this broker doing there? Who is he representing? I think we're going to have this problem.

The second thing I want to say, is that I believe that this is, in the end, not simply a problem with information. In fact, I would say, in the end, that information isn't the biggest problem. I hope, at some point, we'll get into some differences between the purchase and refinance market, but particularly in the refinance market, you have to understand, people really aren't shopping. That's not people's understanding of what is happening. They're getting windows. This is how you get the windows. Or, this guy tells me somehow combining all my bills is a good idea. Okay, I'll do it. They're not shopping for a product.

So, the whole question of information, I think, has to be really turned and looked at, slightly differently than, I think, the traditional Truth in Lending construct has us look at it. I think what we really need are some rules, because the market is out of control, and some things, we have to agree, shouldn't happen. A lady with $620 a month in income shouldn't end up with the loan that I showed you. But even in terms of information, certainly things could be better. And I think that the interagency guide started moving in the right direction because there was an acknowledgment that, it's not just what you say, but when you say it. You have to understand that -- I mean, the loan application, in almost all the cases I see, aside from the closing, nobody's applying for this loan, really.

So how do you structure a meaningful -- as meaningful as possible disclosure that will reach some borrowers, and it's got to be early on. But remember, state law here doesn't even require the broker to have an agreement. People are signing things at closing, I agree, you can pay this money to the broker. They don't even know what a broker is.

But, certainly, if there could be some early on disclosure about what is actually happening, that would help, but, again, when someone is getting an unaffordable loan, they don't need a disclosure saying, we believe you can't afford this loan. That loan isn't being made, and we need systems to make sure that that loan's not being made and we've got to, echoing David, focus on the secondary market because unless -- we saw what happened with HOEPA. HOEPA has worked. When I started seeing these crazy loans, 10 points, 20 points, all of a sudden, the secondary market is responsible for all borrower claims and defenses. All of a sudden, we started -- now, granted, some of them are Delta funding, 7.9 percent in points, and I believe that if you take the authority that you have, you can civilize this market, because it's desperately in need of civilizing, and once you impose standards that will stick with those loans, just like HOEPA sticks with the loans, the secondary market will do the enforcing for you.

MR. FALK: I'm the only industry panelist here, and I think sometimes I'm living in an altered state, because I'm seeing the most robust mortgage marketplace in the history of our country. I'm seeing the highest level of homeownership in the history of our country. I'm seeing an incredible number of competitors, competing forces, making mortgages loans and providing consumer choice all over the country at record numbers. If we have an ilk, is it such a bad thing to have so many options? Yes, we need to increase the disclosures and deal with nontraditional products, but I would rather have the problem of more disclosures and more information with more products, than restricting products, restricting access to data and restricting the very options that an awful lot of consumers need.

So, for an awful lot of products, I think more products is good, and we as an industry have to do a better job at disclosing them. I'm all for more competition. Welcome to Florida. We have 65,000 mortgage brokers in Florida. So, many, many competitors in the marketplace on every street corner.

I would share with you that adding a fiduciary responsibility or an agency responsibility to the mortgage broker community as a whole, would more confuse the marketplace than it is now. I think that it's healthy for the consumer to understand that the mortgage broker, the mortgage lender, whoever the outlet is, whether it's the builder mortgage company, we are mortgage companies. If you would like to shop for a loan from us, that's great, but we owe you no higher duty than to be honest and to be fair, to follow the rules and regulations, and, of course, follow the RESPA guidelines on Truth in Lending and all of the other factors that are involved.

So, to me, listening to everybody complain about the mortgage broker industry, it's as if we were at a bad time in our economy and distribution channel in the mortgage industry, and I would venture to say we're in a very, very good time with some limited problems.

MR. BLEICKEN: If your original question was, how can we do better with our disclosures, one -- in the proposed rules that we're looking at, one thing I can talk about is, we're trying to do the impossible and boil it down to one page, in the simplest terms.

The second thing is, is there a role for electronic media to play in the disclosure process? People get buried in the paper. So maybe there's a place to use visual, computer-generated images and audio. In the modern age, people will sit through a three-minute audio-visual presentation as opposed to looking through something in the paper.

MR. GUTTENTAG: I agree with Irv that brokers should be mandated to be agents of the borrower. Now, I don't take that position lightly, but I think the major reason is that borrowers cannot shop brokers effectively. I made the point before that the only way to shop effectively in this market is to shop online. You can't shop brokers effectively, and you can't shop lenders -- loan officers effectively. There's just too many errors.

To begin with, the prices in this market are volatile. They change every day. So if you're going to get an apples to apples comparison, you have to shop everybody on the same day, which is very difficult. It's also very difficult to get the correct price. The woods are full of sunshine blowers who quote prices that they have no capacity to deliver, and no intention to deliver, for the sole purpose of getting the buyer in the door and starting them on the process. And then at a later stage, when it's too late for them to go anywhere else, the price will be raised, when the point is reached where the price is locked.

If you try and get an accurate price by calling up lenders on the telephone or calling up brokers on the telephone, you'll get one of two responses. Either, we don't quote prices on the phone; come in and see us, or they quote the price for the absolute most pristine instrument that they have to offer and the probabilities are about 95 percent that that price does not apply to the person making the telephone call.

Those are just some of the reasons why effective shopping in this market is impossible, except online, as I indicated before. Since the majority of people go to a broker and that's the only broker that -- they may flit around from one broker to another, but they're not really shopping. They're looking for a broker, someone that they feel comfortable with, and that is a process that really calls for an agency relationship, not for an independent contractor model, where the broker is getting as much as he possibly can out of that transaction.

MS. BRAUNSTEIN: Irv, I'd like to follow-up with you for a second. You made a statement that HOEPA worked, and I want to bask in that. No, I would like to follow-up on you, but I guess what I'm getting from your comments is, since then, the market has evolved in such a way that it no longer is taking care of all the issues that it could have possibly taken care of six years ago.

So, can you get a little more specific with us, in terms of what kinds of things do you think we should do, that we have not done with it, to address the issues today.

MR. ACKELSBERG: First, let me start with, just, point to the authority of the board, which, it's funny, we get so caught up in the HOEPA framework, that we sometimes lose sight with the rather broad responsibility that Congress did give the board. If you look at section 1639 of HOEPA, and I didn't realize this until I pulled it last night, that it's mandatory, the board regulations, the word, "shall." That's pretty strong. Usually, it's "may," but this says, "shall prohibit extra practices in connection with," and then there's two subdivisions. One is evasions of HOEPA, but the other is, "the refinancing shall prohibit acts or practices in connection with refinancing of mortgage loans the board finds to be associated with abusive lending practices." It doesn't require that -- we're not talking about HOEPA laws. This is a very broad authority that Congress said, you shall perform.

I would say, we've come to the point,

given the fact that the market has evolved and that big problems are no longer the amount of the points or the size of the rate, it's the -- there are structural issues here, in the loan terms, suitability issues, whether this loan makes any sense, or I would say, the real collapse of underwriting, because I don't think this is -- we're talking about a totally changed environment. I think the board has to act where it should act.

I would say, first, within the HOEPA world, the HOEPA framework, the whole question of yield spread premiums needs to be looked at. In particular, what I feel is the most abusive situation, is when the broker is getting paid on both ends. Because when the broker is paid by the borrower, there is at least a monetary reinforcement of the borrower's perception that the broker is working for him. He's thinking, he got me this loan, he's getting a fee, I'm paying for that fee. But when the lender also pays a fee, and the trade, in return for that fee, the rate's going up, I believe that there has been a fundamental interference with at least the perceived obligations of the broker that the borrower has. So one thing that you could do very easily is include the YSP in the HOEPA calculation, at least, where there is also a front end broker fee charge. That's one thing I would say within HOEPA.

Another thing I believe is, that you have to really get a hand on ability to pay. And by "ability to pay", I think we can -- it takes in so many things, and again, I think the interagency guidance is an important first step. Some of these exotic products are completely inappropriate for many of the people that are ending up with them. Someone on a fixed income should not be in an adjustable program, period. It just doesn't make any sense. Maybe we can come up with some example where the person is going to sell their house in two years, but that's not the context of most of these cases. It should not be adjustable.

The no docs are, I would say, a sin. No doc loans, you depose people in the industry, they call them liar loans. That's what they call them. Stated income loans, no doc, why do we have those? We are not talking about coming up with alternative forms of verification. I believe in that. I believe if someone has nontraditional expenses or -- sure you have to find a way to verify that, but verify it. Most of the stated loans we have seen, go to people who can't afford the payment so they make up a babysitting company, or rental income, or something that just doesn't exist, and, again, the applications that they're signing that supposedly state this loan -- it's signed at the closing after -- half the time -- I've actually asked at depositions, do you sign the mortgage first or do you sign the application first? And believe it or not, the mortgage is signed first. They get the mortgage signed, the Truth in Lending signed, and then the application signed. And that's where it states, babysitting.

GOVERNOR OLSON: Irv, the information you handed out contradicts what you just said. Because the information that you passed out said that the stated documentation for the low doc --

MR. ACKELSBERG: This is not a stated loan. This particular example I gave you was a fully documented loan.

MS. BRAUNSTEIN: He's talking about the --

GOVERNOR OLSON: There's another issue that you raised that I think is a very important issue that I think is worth talking about. And that is, the difference between the purchase loans and re-fi market. I think you raised -- that's an issue that we should talk about. Let me start with Joe and then come back to you. As we, in the macro level, look at the mortgage product, and people in this room would be surprised by the amount of attention that the Federal Reserve pays mortgage markets in the real estate industry; it's an enormous engine of economic activity. From our perspective, the re-fi volatility correlates with interest rates in a very significant way, and when interest rates are down, or dropping, the re-fi is very fast. It accelerates during -- as it comes up, and then it drops off dramatically. But I'm interested in your perspective in what happens in terms of the role of the brokers, the volume, if you will, at that time, and Irv, I'd be interested in your perspective, too, about what you see, and the difference between -- if that same phenomena occurs from your perspective.

MR. FALK: When interest rates go down,

there's a flurry of refinancing; as rates start to go up, people in variable rate or hybrid loans, 228s, 525s, ultimately, will try to refinance into a fixed-rate loan. We're starting to see that now. So activity in the small mortgage company business will tend to reflect the macro statistics of volume. As rates go down or go up, you will see variations in refinancing opportunities.

GOVERNOR OLSON: Irv, and then we'll come back to Jack.

MR. ACKELSBERG: First, let me say that from the standpoint, even from the business standpoint, I think that the purchase and re-fi situation is different. I really believe that, in a lot of ways, on the purchase side that what we're seeing are just more and more clever, ingenious ways, of enabling people to buy houses they can't fundamentally afford. That's a lot of what is going on in the marketplace.

In the re-fi, it's very different. I think that the situation's different and the possible solutions are different. I think that in the home purchase situation, we have a better shot at things like counseling having an impact. We have, in the City of Philadelphia, a program of neighborhood based, prepurchase counseling that's been moderately effective. I think that if you can get to the borrower early, and the hook is that this city will pay a little bit of settlement costs. And at one point, there was an inspection. That disappeared, but there's still this $800 settlement grant, a little bit of a hook.

The problem is a lot of times the brokers, real estate and mortgages brokers, will discourage going to the counseling, because they're not eager about what the counselor might tell them, but I still think counseling can help, particularly at the purchase stage. The borrower is in a kind of shopping mode. The difficulty, and this is true whether -- as a consumer buying a house or buying a car. People don't understand that they're buying a thing and money at the same time. They don't understand that you have to shop for both and you're much better shopping separately. People don't understand that. I think when they're shopping for a house, you have a shot at telling -- educating them that they should be shopping for the best deal on the money.

But in the re-fi, you've got to understand that most of these transactions that we see are not people looking for a better rate. That's the old world. That's what re-fi meant before. Is still means that to some extent, but the market that we're looking at here is not about that. The purpose of the loan, every single application that I've seen, says, cash out re-fi, that's the purpose of the loan. The real purpose of the loan, windows, or a broker came and said you'd be better off consolidating your bills. I mean, there's a problem and an offered solution, really, much like financial advice, and I believe that thinking in terms of information and disclosures and education in that context is much tougher, because people don't perceive that they're in a shopping situation. This is what the guy says I have to do to get my windows and it will be good for me. So you really need a different construct than the re-fi.

GOVERNOR OLSON: Jack you wanted to comment on this subject.

MR. GUTTENTAG: I agree with everything that Irv said about this. This is an area that is fraught with bad decisions. I get letters about these issues all the time, and the problem is that the issues are very, very complicated. Oftentimes, the people who are solicited to refinance, and most of them are cash out refinances, occasionally it's a payment reduction refinance rather than a cash out, but, in either case, you often have a very complicated situation because the borrower may have a second mortgage in addition to the first mortgage, and he often has short-term credit card debt, which he wants to refinance, to consolidate, and in fact, the pitch that he gets from the solicitor may be a pitch to consolidate everything.

So you have a very complex situation that really requires a careful analysis of the costs that he's now incurring and frequently they're not even completely sure of what those are, especially if they have an adjustable rate mortgage, they don't know what the rate is likely to be with the next adjustment. They're not quite sure when the next adjustment is. They're complicated situations, and the ones that I have taken the time to look at and to run through my calculators, and I forgot the number of calculators designed to deal with these kinds of problems, oftentimes, most of the time, the deals that are proposed are not in the borrowers interest.

MR. BERENBAUM: Very quickly. Back to stated income for a moment, I think the attorney general's settlement with Ameriquest gets a very big guidance with regard to stated income and could serve as something within 15USC1639. It's a good approach to the issue. Relative to first time mortgage versus re-fi, frankly, we're seeing an explosion of problems with first-time homebuyers, appraisals, a lot of other issues, particularly target that Latino community, first-time homebuyers emerging in the markets, and we're very troubled by that. I think it's an area of future focus for all of the regulators.

And then, I'd like to say, another area, as we're looking ahead now, would be broader steer protections. First, I will never accept, nor do I believe anyone in our society should accept, the fact that African-Americans, Latinos, low-income communities, do not have the same access to credit, are not afforded the same loans that are viable, they're suitable, based on risk. We should have zero tolerance on that. But it's not simply limited to the race issue in this nation. It is much broader than that, and we see elderly and others being steered to products that are very inappropriate. So we need a broader standard and guidance with regard to what is appropriate to all Americans, regardless of race and society.

MS. BRAUNSTEIN: Can I just ask a question. In terms of your testing study, David, that you did, how did you choose the brokers that you approached? Were they ones who advertised heavily in the African-American communities? How did you --

MR. BERENBAUM: It was actually -- I believe very seriously that any private organization acting as a private attorney general needs to be very objective in its approach. We, in fact, polled government agencies, and not all cooperated, but we did receive information from a number.

We looked at fraud hot spots reported

by the FBI and other regulators. A number of industry leaders, "responsible lenders," are still frustrated over what they're seeing in the marketplace, not really brokers, but overall in the marketplace, they're turning over do not use lists very openly, quite candidly, now. And these lists are being openly shared by industry leaders.

And then, also, of course, based on our 600 members, what they're seeing in the community, who they suggest we look at. And then we also looked at market share, when we had larger companies.

MS. BRAUNSTEIN: It sounds like you kind of targeted people that were identified as bad actors.

MR. BERENBAUM: No, no, not in every case. If there was something in a community that people were very openly concerned about, we have a responsibility to our membership to act on it. As it turned out, a majority of our tests did document problems and that's unfortunate. I hope, through collaboration with regulators, states, the industries -- as we began testing 20 years ago, looking at lenders or realtors, I hope when it's five years from now, if more people do mystery shopping, and share in the enforcement of this, in fact, the problem will go down. This is a first impression study.

MR. GUTTENTAG: Have you done anything to try and identify the good guys as opposed to the bad guys.

MR. BERENBERG: We always celebrate the good guys. And the NCRC is sometimes criticized for too closely working with industry. So we work with everyone. We want to see access to credit in our communities.

MR. FALK: My experience with the company that's listed in your circular that's outside is that they're both mortgage bankers and mortgage brokers, so I'm not quite sure what channel of distribution they are, and I'm sure we'll get into more specifics of that when we get together. But on the purchase money market, we're seeing an evolution in the last two or three years with the rise of what I call abusive affiliated business arrangements allowed under the Real Estate Settlement Procedures Act.

What we're seeing in the marketplace

is, builders, developers, or sellers who have affiliated mortgage companies. We're seeing steering and/or required use of those in-house mortgages companies. We're seeing other mortgage companies being shut out for approaching consumers who can, in that case particularly, purchase a particular home, and of course, because they're acting in a lending capacity, the yield spread premium is hidden as an SRP, which ultimately means that there is a premium being earned by the home builders affiliated business arrangement concept that's not being disclosed to the consumer.

So these affiliated business arrangements with home builders and developers and other sellers of property, while fully legal, and absolutely appropriate in many cases, there are instances where these affiliated businesses do cause problems because of required use and what I consider to be hidden discounts.

MR. GUTTENTAG: It can't be required. That would be a violation of RESPA.

MR. FALK: I'll share with you the information we have, where it's absolutely required in the contracts to purchase the properties.

MR. GUTTENTAG: It's a violation of RESPA. In all the cases that I have come across, he has a financial (inaudible) in the form of concession on the house.

MR. FALK: And we do hope that HUDs secretaries will address this issue.

GOVERNOR OLSON: Mike or Leonard or Sandy, any other questions?

MR. COLLINS: I just have one. I think most of the other questions I had have been addressed. This issue of the perception of brokers at the core of some of these issues, today, versus loan officers or banks or mortgage companies, many may think that within banks they've got risk management infrastructure to find the bad people that are making loans over time. In your comments to Governor Olson, you mentioned there's a best practices guide. Does that, in any way, sort of, clarify the role of brokers in your experience as you understand where the complaints are? Can you comment on that a little bit.

MR. FALK: Well, our best practices

deals with questions on how to deal with the consumer and how to promote practices for the mortgages industry that will serve the consumer in an appropriate manner. We are concerned that the best practices are followed, but we also understand that so many different distribution channels have been created today.

We have certain depository institutions that outsource their entire mortgage department to another lender. We have private label institutions, which ultimately outsource all of the distribution channels. We have mortgage companies that act as mortgage brokers in one transaction and then they act as a mortgage lender in the next transaction.

There is such channel confusion in the marketplace, that I am very safe to say that I don't believe that a consumer understands that there's a difference between a banker and a broker and a lender. I think that the consumer walks into a mortgage company and they are offering products, and there's no discernable understanding of a difference in role.

That being said, in the context of

RESPA reform, which is also going on in Washington, it does endorse a full written disclosure as part of the new good faith estimate, to define the role of the mortgage broker so that if someone chooses to act as an agency, more power to you. If you wish to act as an independent mortgage company with no specific duty or authority or responsibility to the consumer other than standard business practice, than that's okay too. Let the models work out the competitive marketplace itself, but in our view, consumers do not know the difference between all these channels because there is little substantive difference.

MR. BLEICKEN: I'd like to add to that if your question was about self-policing. Another part of what we're doing in Pennsylvania, one of the initiatives that I mentioned before, is we will check records, that kind of thing, for the license application, but we will become the proper kind of business when we roll this program out for our mortgage brokers and our mortgage bankers to police who they hire and to police who they do business with, appraisers, settlement companies, things like that.

MR. BERENBAUM: I'd like to add, one area of our best practices that is a gray area, and it's active appraisals and its relationship with mortgage brokers. We are very troubled and we have a light paper at the type center right now. Because of the nature of the marketplace, how it's operating, most mortgages brokers are self-selecting their appraiser for loan origination. That's understandable with the marketplace right now. But that said, those loans are being originated by large banks, financial service corporations. In other words, rather than showing independence in the appraisal process, an objective arm's length transaction, they are relying on APS to double check, and those are highly inaccurate. They're helpful for compliance, but it's not the same thing as ensuring that you have an arm's length distant objective appraisal in a mortgage broker transaction. This is an area of emerging liability for financial institutions, for brokers, and an area of future focus, I hope, for regulators.

GOVERNOR OLSON: We have a couple

minutes only, and does anybody have a closing comment they would like to make? Predictably, you could tell from a week ago, this would probably be a lively panel, and you've each made a very significant contribution. Any final comments that anybody would like to make?

MR. GUTTENTAG: Well, I'd like to leave you with something that David's boss keeps saying when he speaks publicly about this very passionately, the secretary of banking. He says, when you buy stocks, when you buy some kind of a financial product, you, as a consumer, have some protection knowing that legally that seller, that advisor, is required to sell you only a suitable product. When you buy a house, the most important purchase of your life probably, that realtor has certain legal obligations concerning how they represent you and the advice that they give you. The mortgage, the most important financial decision in most families' lives, certainly deserves the same kind of legal protection.

People believe that it's out there somewhere, and they're shocked when they come to the lawyers, at the end of the day to find out, that there really is not much out there, which does give the same seriousness to the mortgage, and I just ask that the board, certainly through the board, I ask Congress, we need -- homeowners need to know that the law is protecting them, and this is a very, very important, probably the most important financial decision of their lives.

GOVERNOR OLSON: Jack, Joe, David, Irv, David, thank you very much for your participation here.

Two points. First of all, a reminder that at 3 o'clock we will have the open mike. Those of you who would care to speak, everybody has three minutes to make a presentation, a comment, I guess, in three minutes, if you would like. Please, the sign-up for that is out in the back. We'll break now for lunch, and we will see people back here at 1:30. We have a very interesting panel at 1:30, talking about the best practices in the subprime marketplace. Thanks again to the panel.

(Whereupon, a lunch break was taken at 12:15 p.m.)

(Whereupon, the proceedings resumed at

1:30 p.m.)

GOVERNOR OLSON: Something we did not announce earlier, but I'm sure will be of interest to the group, Friday afternoon, beautiful day, each of you are getting a special accommodation award for being here today, so congratulations. We're happy to see everybody here.

Also, on a personal note, I would like to thank the City of Philadelphia. Because I was in Philadelphia last night, I was able to watch the Washington Nationals on television. You cannot do that from Washington, D.C., because of restrictions that are violations of fundamental economic principles. So I had to come to Philadelphia to see the Nationals beat the Phillies.

One final reminder, those of you who care to speak when we go to the open mike at 3 o'clock, please sign up just outside the door, near the front door. So far it looks like it's going to be a relatively short session, but we want to make sure that that is available and everybody knows that's available.

The final session this morning, I

think, is going to be a session that will be of equal interest to all of those we have had thus far. It's entitled, "The Subprime Market Best Practices." Because of the explosion of the subprime market, there is, first of all, clearly, from our perspective, a significant societal value of the development of that marketplace. But the nature of the marketplace brings a risk, both to the market and to individuals. And so I think that -- and also when you add to that the development of the secondary market for the subprime product, it adds, in fact, another complication. So the best practices, I think, will be extremely informative.

We will continue, as we have, to go from right to left, counterclockwise. Eric Eve will go first. Eric, if you would introduce yourself, your group, and as a reminder, Keith, down there, has a sign that will show you when you have one minute left of your five minutes. By limiting the statement we have discovered that gives us opportunity for very full follow-up discussions. So, Eric, you're first.

MR. EVE: Good afternoon. Thank you,

Governor Olson, for the opportunity to discuss best practices as you spoke to earlier. My name is Eric Eve. I am head of the Community Relations for Citigroup's global consumer group businesses, which includes all of our retail businesses, both in the U.S. and around the globe. Among the functions that my office manages is the CRA HMDA fair lending data analysis unit of the company, public policies issue management team and global programs functions, which structures our partnerships with nonprofits, both in the U.S. around the globe.

In this job, I take a pretty expansive view of Citigroup's role to make communities better because we're there. One of the key areas in which we can improve on, is strengthening the financial health of all these communities. In this respect, the more strategic we are, the greater impact we can have.

Being strategic, first and foremost, from my perspective, means engaging, first and foremost, with some of our partners here. Consumer community advocates around the country in order to have more thoughtful solutions and discussions around the subprime market for the reasons that the Governor spoke to, are even more -- the partnerships are even more critical.

These thoughtful discussions have been meaningful and yielded meaningful results and they've translated into a number of best practices, most importantly a partnership with ACORN and NACA, to very prominent community based organizations, and mortgage lending programs were born of often tense discussions which have addressed needs in underserved communities, enabling us to provide mortgages to consumers, through our prime lending channel, to consumers and borrowers who otherwise would enter our subprime segment because of the criteria of the borrower. These programs are very intense pre, during, and post counseling, and the one-on-one nature of the counseling allows us to track, in a very measurable way, the performance of the time.

There are a number of commitments that we've made. I'll touch on a couple, as it relates to protecting against fraud and predatory lending in the subprime mortgage lending space. Sever relationships with thousands of brokers over the years, who would not meet the standards that we set forward in the code of conduct that we put in place; implementing a policy not to originate HOEPA loans as of 2003; our city financial branch network, implementing consumer protection against the negative effects of frequent refinancing.

In addition, to better serve our existing customers, our subprime business, today, offers borrowers significant opportunities to lower their loan rates over time, as their credit improves. Preferred fixed-rate mortgage products allow applicants to qualify for a rate comparable to a rate that we found in the prime channel, but within the Citi financial network, a rate reduction program, a graduation loan, and a number of other initiatives, which we and others in the industry have adopted over the years.

These commitments are not static. They're evolving to be responsive to contemporary issues. So when we hear that rising foreclosure rates are rescue flawed, we need to engage in brainstorming to let vulnerable communities know a lender they can turn to, to provide valuable post-purchase financial information and recognition of the hardship that foreclosure causes. We've lead the way with other institutions in being one of the early adopters of the HOPI initiative, which many of you are familiar with in Chicago. This program, a unique private partnership, has allowed us to fund -- provide affordable mortgage options in homeownership in the Chicago area.

GOVERNOR OLSON: Eric, thank you. We are interested in hearing more, particularly, some of the partnership arrangements that you had, and also, the counseling that has lead to more appropriate allowable pricing.

God bless Loretta. She was with us in Chicago and she's back. Loretta, we don't have to tell you the drill.

MS. ABRAMS: I know the drill. Thank you, Governor, and it's good to be here today and it's good to be back. My name is Loretta Abrams. I'm the vice president of consumer affairs for HSBC North America. HSBC serves more than 60 million customers in the United States, across five lines of business, from consumer finance to banking. I'm pleased to be here today just to share some of our learnings and our input regarding best practices in mortgage lending.

We feel that there are many definitions of best practices, and there's a broad range, a varied range, of consumer protection. But there are three elements that we find to be important to be included. And those are: Value-added products and services, easy to understand customer communications, and clear consumer choices. Then you have to bind all of these practices together with solid investments in the community, investments that will ensure the availability of banking services, provide financial education, encourage homeownership, and support affordable housing developments.

To understand how we, at HSBC, deliver these best lending practices in community investments, we conduct a good deal of consumer research. We research to understand what worries consumers have about their finances. We want to know what they like, what they dislike, what they don't understand, and what they want us to help with. And the people we meet with in the many financial educational workshops and seminars that we conduct, tell us that they want to make sure that the loan issue is the right one for them, that it meets their immediate needs, and it brings them closer to the long-term financial goals.

However, there's a knowledge gap. Only 18 percent of the consumers we talked to, stated that they have a complete understanding of the different types of mortgage products.

Our consumer finance business has required that each mortgage loan must provide a very real benefit to consumers through such features as interest rates or payment reductions. If the loan doesn't pass the benefit test, the loan doesn't get made. It can't be funded.

Our March 2006 survey highlighted the need to provide clarity in the loan closing process. Now, in spite of the fact that the majority, 78 percent of consumers, stated that they are not, at all, very knowledgeable about how to take out a mortgage loan, they actually spend very little time reviewing mortgage options. We talked about that a little bit earlier today. 34 percent of consumers told us that they researched their mortgages options for less than a week, and people spend months looking for just the right home, and then they spend less than a week making sure they've got just the right mortgage to match up to that home.

Another third of the people that we talked to, and half of those who make less than $25,000 a year, said that they didn't have a home inspection before the loan closing process, an opportunity to help consumers understand the often complicated and oftentimes stressful loan closing process. So to ensure a fully informed decision, HSBC's finance corporation uses an independent third party loan closer, who works with each customer to manage the loan closing process and review all the loan documents, whether they're written in English or Spanish.

Also, in this package is a simple one-page plain English document that provides a quick, easy to understand snapshot of the loan fees, the points, the payment amounts, and the key product options that are available to that loan.

Finally, there is a cancellation policy. The customers have a full ten days to cancel the loan if they change their mind. And we also know that it's not enough just to put the practices in place. We have to overlay all of this with systemic controls, underwriting practices, training, compliance, and monitoring policies, that will ensure that the best practices are working and that they keep on working.

And so we automated as many of these processes as possible. We operate everything with strict monitoring, regular compliance testing, and audit reviews throughout the process. And I couldn't conclude my statement today without commenting on the special responsibility we feel to educate our own customers and to advance the financial literacy of all consumers. It's for this reason that we've been involved in educating consumers about credit and finance matters for over 75 years, and we're continuing that today with our Your Money Counts education program and through the programs that I've described, and by conducting the surveys I referred to today. I think this is a wonderful opportunity for us to work together and collaborate and discuss solutions on this very important issue. And I thank you for the opportunity to be here today.

GOVERNOR OLSON: Thank you very much. Eric Stein, just introduce yourself, your group, and five minutes.

MR. STEIN: Thank you very much Governor Olson. My name is Eric Stein and I'm chief operating officer of Self Help that's affiliated with responsible lending. We're a community development financial institution. Our mission is to create wealth and ownership opportunities and financing for small businesses and homes. We have a billion dollars in assets. We've done about four and a half billion dollars in financing for 50,000 families to buy homes and build businesses. Compared to these two groups, we're like a branch developer, but anyhow, that's our contribution.

Our focus is addressing wealth disparities between Latino and African-American families on the one hand, and white families on the other, which is about ten to one. How can one address that? Well, social scientists said that 20 to 80 percent of lifetime wealth is a generational inheritance. It's kind of hard to pick your parents, so we focus on homeownership.

Two-thirds of low income and minority wealth is in home equity. Three-quarters of whites own their homes versus half of Latino and African-American families.

If you look at a low-income renter, they have $1 wealth of the loan, and a homeowner of the same income has $12. And Neighborhoods Social Indicators Group has homeowners' rates increase as well. We would look upon it as a national goal, raising minority homeownership rates to the national average. How we would go about that, on the lending side we have two programs that I'll mention. The first is direct home lending through Self Help Credit Union, which we started back in 1984. Obviously, times have changed significantly, and we've done about two hundred million dollars in direct loans to 3,000 families. We realize that our direct lending was going to have a limited impact, and banks, such as the ones sitting next to me, are the ones who have the distribution networks ability to meet people. If you're going to make a difference, you need to speak to the large players.

In addition, we realized, in our

experience in North Carolina, that they're not going to replicate the experience of the savings and loans. If they're going to do the CRA loans, they need to be sellable. They need an outlet for those loans. That's why we wanted to step in, and we created a secondary market program. The goal is to harness advances and securitization and bring Wall Street money to help subprime purchase borrowers the opportunity to get the conventional findings, and it's what Eric was saying was his goal as well, and therefore to create wealth for other families.

The benefits of getting a loan through our partner lenders, which includes Citigroup and HSBC, to provide loan assistance to us, as well, and both have been significant partners in this, is substantial against the alternatives that we would like to receive in, really, three different ways. The first is product, and the product we offer is, generally, a vanilla, 30-year amortizing fixed-rate mortgage, which is kind of boring, but if you compare it to the dominant subprime product, which is a 228 hybrid ARM, fixed for two years and then becomes adjusting every six months thereafter, it's really a superior product for local families, in my opinion.

Six hundred billion of these hybrid ARMs, 228, face a reset problem in the next few years, they're going to adjust up, with interest rates going from 7 percent to 11 percent; monthly payments going up 50 percent. Families just aren't going to be able to sustain that, the low-income families.

The second way that families will get value through participating in the program is better terms, up front fees between 0 and 1 percent versus subprime, 3 percent plus, and in some cases better than that. Prepayment penalties, we don't allow them, two-thirds of subprime loans have them and probably two-thirds of borrowers pay them if they have them and the rate is the best available.

And the third way I think that it's superior is in foreclosure, in trying to keep that house. If you look at subprime loans originated in the year 2000, almost one-quarter have actually entered foreclosure, and it's much better here. We started small in North Carolina and expanded through the Ford Foundation and with partnership with Fannie Mae, where we get nonperforming loans and turn them into performing conventional.

The two most important results, I think, in addition to the numbers, are the families have been able to pay back their loans. Our total losses in the system is 43 basis points, which is not an annual figure but a total figure. Secondly, the families have, indeed, created wealth. UNC did a study with Fannie Mae and found that the average appreciation, as of the end of last year, was 30 percent, so times 4 billion dollars, that's 1.2 billion dollars of wealth that's been created to date. Thank you very much.

GOVERNOR OLSON: Eric, thank you so much. Mark Pinsky is next.

MR. PINSKY: Good afternoon and thank you inviting a Phillies season ticket holder. I am Mark Pinsky. I'm president and CEO of the Opportunity Finance Network, which is a national network of about 165 financial institutions around the country, working at urban, rural, and reservation based communities. We've done about 9 billion dollars of financing through our history for quality and affordable housing for small business and for community services.

The assumption I come into this discussion with today, is that laws, rules, and regulations can slow but they can't stop predatory lenders from doing bad things to good people. And we believe that the best hope for responding effectively is a both/and approach to predatory lending, which is both through the law and through the marketplace.

We, in our industry, represent CEFI, the best self-help and reinvestment fund that you heard from today. We think of ourselves as working just outside the margin of conventional finance to try and bring the people in those communities to the economic mainstream and through the economic mainstream that's in those communities. And in these markets, we call them opportunity markets, people are seeking nothing more than the chance to join the race for the American people of economic and social mobility. Predatory lending in these markets, as you know, is a constantly mutating viral infection that others have said before me, and I wouldn't go on about that. That's the first point I really wanted to make today.

The second, as I said, is a policy. Policy solutions are critically important. We need them. But they are probably inadequate and still too limited to really be able to stop the damage.

But the third point, the one that I was asked to focus on, is the new generation of responsible mortgage financing strategies in subprime and predatory markets that are intended to use market forces to mitigate predatory lending in the short-term and, hopefully, to undermine it or to stop it in the long run, if that's possible.

We know that in, sort of, taking this approach, we may be pursuing the good and not always necessarily the best solution, but we believe that the pursuit of a changing market behavior is going to be difficult and that at most, we may be a tail wagging a dog. But we can no longer sit by and wait as we see the people, as Eric and others have described, we see people, good people, having their lives ruined by incredibly bad practice.

We are now in the process of putting the finishing touches on a mortgage platform, in conjunction with a whole range of partners, to deliver responsible mortgage products, through CDFI's people who are, or may be, vulnerable to predatory lenders.

Let me try and explain, quickly, how it will work. We are creating a CDFI industry owned mortgage company that will contract with a mainstream mortgage company. That mainstream mortgage company, as a subcontractor, will provide a full range of mortgage services through the CEFIs. This structure is intended to insure that the CDFI industry maintains the government's control over the entire process, and therefore, the ability to maintain the purpose of what we set it up for.

The industry's own mortgage company, the one we're creating, will screen and monitor the mortgage distribution network for compliance with a set of responsible lending criteria. The lenders will operate, either as correspondent lenders or as brokers, whichever they choose, whichever makes more sense for them. We've prepared a series of software decision-making tools to help them, our potential correspondents and brokers, decide whether the market is right for them to be involved, and to assess what the economic impact on them will be of getting involved in this business, many of whom are not in the mortgage business.

We're involving a marketing campaign that will focus heavily on the generation. The entire effort that we're trying to make will make sense only if we can achieve real material scale. We're incorporating financial education as part of a loss mitigation strategy in a way that's quantifiable and translates into savings for borrowers and security for investors. And in the end, what we're trying to do is create a mortgage system, rather than just a product to offer.

On the topic of best practices, let me just try and quickly sum up what we see as the best practices that have come out of what we've learned from Self Help, from ACORN, from our bank partners, and from others.

First, in order for this to work, we need to be prepared to stay with our customers every step of the way: precredit, post credit, through servicing in the event that there are any credit problems down the road.

Second, the long term success of any strategy like this has to ensure that customers have access to the full spectrum of consumer finance products and services going forward, not just mortgage finance services.

Third, it's critical that we provide the expert long term foreclosure mitigation and prevention services.

Fourth, that our product will provide a fixed-rate interest rate option at the lowest possible rate. I'll talk a bit more about that later if that comes up.

Fifth, we're going to provide fair financial incentives to brokers and correspondents that give them reason to pursue customers aggressively but eliminate unfair incentives.

Sixth, we'll use a detailed prescribed settlement fee that will prevent brokers and others from taking advantage of customers.

Seven, we'll have no prepayment penalties.

And eight, we will certify all of our brokers and correspondents in a way that ensures that their full product line is compliant.

GOVERNOR OLSON: Thank you. We want to come back to those because I think those are -- I'm interested to hear how you do some of those because the trade off between following the customer through every step of the process and the disaggregation that allows for efficiencies seem to me to be inherently contradictory so I think we'll want to go back and see how you do that and what that ultimately means in terms of pricing and support. But that certainly is a great approach.

Bruce Dorpalen.

MR. DORPALEN: I'm Bruce Dorpalen. I'm the Director of Housing Counseling for ACORN Housing. We'll see 30,000 people this year in 40 cities providing housing counseling to low and moderate-income people.

So the current problems that we're seeing in the subprime markets that are the most common are: abuse by brokers, where they're only offering an adjustable rate mortgage to people even when they're asking for fixed loans; people being offered teaser rates and not understanding when the rate will jump up, and often, they can't afford it when the loan reposts; selling option ARMs and interest only to buyers when they don't understand the negative amortization, and don't understand the situation. Often these are being sold in markets where there's slow growth markets, Indianapolis, Philadelphia, Detroit and places where there's much less likelihood of recovering what their amount is; the stated income loans, we regularly see stated income loans where brokers have written into the application even though it doesn't exist and the borrower is not aware of it; and giving B and C credit to people who have A credit, so they're getting a loan that's much more expensive than what they need.

So, on to best practices. Strong regulation is key to this. The industry will not be able to do this all themselves, and we need to create a level playing field. One of the interesting things that subprime lenders routinely tell us is that they can't do the elements we talk to them about because brokers will go someplace else. Well, if it's a regulation, they won't have any other place to go. When HOEPA pricing was dropped, percentages were dropped, the market, then, went to meet the lower level. That's what the pricing did. That's the kind of level playing field that's important in this.

We have two signature programs, one with Citibank, one with Bank of America, where we have very flexible underwriting. We do 95 percent, 97 percent, sometimes even lower LTV loans, largely minority loans. We have credit scores between 540 and 640 routinely, and we have very low delinquency rates.

We routinely do what the industry calls stated income, we call undocumented income, and we go ahead and document the income. We make sure it's real and that it can match what people's needs are for meeting the loan terms. We feel like solutions like that are what are needed in stated income markets, so people don't end up getting stuck with something they can't afford.

We do credit based on the credit report rather than the credit scores, so letters of explanations, mistakes can be corrected. We can get an actual picture of what it is, and Citibank has done an excellent job on this. We did something similar to this with HSBC.

With HSBC, we have a subprime program, the Foreclosure Avoidance Program, which is state of the art, and essentially, what it is, is a permanent solution for people who are having affordability difficulties with their mortgage, and if it's a rate reduction, to get it to the point where it's affordable to people. This keeps people in their houses and stops foreclosures. We have done thousands of these now, and to the tune of 85 million dollars in savings people have had on their rates. It's highly successful, and we've been doing it for two and a half years and 10,000 borrowers who have gone through the program, who owe 60 days or later, could qualify for it.

ACORN Housing has created a mortgage servicing network with 21 of the largest servicers of the United States, both prime and subprime. The whole goal here was to take housing counselors working on cases where there are easy solutions, and instead of working through the front lines of servicers and finding somebody with a very limited authority, get them to a point where they're talking to senior people who have the ability to do loan modifications and payment agreements quickly. This became crucial in the Hurricane Katrina disaster, where we helped over 2,000 homeowners, but also to define in the industry what the best and worst practices were and be able to change what was going on.

Critically, I think the issues that we would like the Fed to address, one would be suitability and benefit to make sure the loan matches what people need. We think it's also important that there's an adequate funding stream for housing counseling in the United States. HUD does its share at 41 million, though it's not enough. State and local governments, many of the lenders in this room, contribute to it, but the Federal Reserve should aggressively contribute to funding so we need a large infrastructure to move demand.

Lastly, we think that there ought to be support for the state legislation on predatory lending in states and we should put aside this conversation about preemption, and to protect the private right of action and preserve the strengths that have been worked out in the local states.

GOVERNOR OLSON: Very well done. For those of you who didn't have a chance to see, he ended just as the card went up. It also was a very well done presentation.

Eric, let me come back to you. You were the first, at least today, to talk about a very important subject that we haven't focused on, but it is fundamental to what we're doing here, which is building and rebuilding the communities. Could you talk about how you -- I would be interested in how that goal, which is a very important goal, but it's a huge goal, how that gets incorporated or how you measure your progress against that goal.

MR. EVE: You're correct. The goal is huge and Eric Stein went through some pretty daunting data that reminds me about the 10 to 1 wealth disparity. If you spend enough time thinking about it, you wouldn't want to touch the problem because it is so overwhelming.

I think the first place that we start, I spoke to it briefly with the partners here, we partner with everyone sitting at this table and we'll continue to in the months and years ahead. And I think we're, Citigroup, has been able to -- we've been able to distinguish ourselves as HSBC, as trying to anticipate some of these risks. We were talking months, if not years ago, about the ARM recess, the potential that it would have in the foreclosing space. And now, we're seeing those rising foreclosure rates come to fruition in the communities. I think that through these partnerships, and it's just one example, we're well positioned to address those issues, but it is an evolutionary process. We created programs and adopted solutions that we think will work and that we've had to adjust along the way.

Your final part of your question, metrics, that is, in fact, the most difficult thing to do, to actually measure our performance.

GOVERNOR OLSON: It's difficult in the short run; it's not particularly difficult in the long run. And having moved to Washington, D.C., for example in 1971 and still live there now -- Theresa Stark who's here someplace, and Sandy, and I were involved, recently, in celebrating the extraordinary rejuvenation of one community in

Washington, D.C. There are other communities in Washington, D.C., there's one I can think of, overwhelmingly Latino, that has created a very vibrant economic community in an area where it was not sometime ago. So we can see that it can happen, and it seems to me, that one of the keys too, is recognition that the real support comes, not through elaborate government programs, but it comes one at a time through providing the opportunity for individual initiative and individual ownership and wealth building, broadly stated, and I think that it would be interesting in hearing more from some of the borrowers on that subject.

Loretta, you mentioned something that I would be interested in hearing more about, which is, the process by which you assure, if you used it that strongly, that a person is not put into an inappropriate loan. The blizzard of applications, the blizzard of opportunities that all of us get, that's a daunting task that you said that you can build into your product. How do you do that?

MS. ABRAMS: We have and we did. I've managed to observe the people processes and paper processes for more than 30 years, so I know that you have to inspect what you accept because people are going to make mistakes, and when you have a lot of volume and a lot of people, there's a greater likelihood. So we automated and spent the time, hired the people, and spent the time in developing the system to automate processes. So when you say, we haven't that tangible benefit test, we do, and nobody can override it. The system calculates whether the loan proposed is going to benefit the consumer and how those benefits are going to be realized, whether there are going to be payment reductions and how much of a reduction, and etcetera.

So we make sure, electronically, that the loan is appropriate and that it's a helpful loan and it's an affordable loan, and then we follow that up with a lot of compliance people, going after the process and regular routine audits, to just keep on checking and keep on making sure. But the automation is a key.

And the second thing we did is centralize as much as possible, and we automated and centralized it to make sure that it's easier for to us control and easier for to us audit. It's important to us that we get it right.

GOVERNOR OLSON: Eric, one of the subjects you touched on, I'm intrigued by hearing how you did it and what you learned in the evolution. You started as -- one part of your presentation, as a credit union portfolio lender, recognized that it was inadequate. The loans were good but it was inadequate to address the problem. So then you moved from there to developing a secondary market capability. And of course, as we've all seen, the growth of that marketplace was contingent on the secondary market appetite for the product. So, now, you're subject, if you will, to the grim reality of secondary market evaluation.

So, if your market is a low line market, and you're competing in the market for rate and terms in that market, what are you learning in the process?

MR. STEIN: There's been a lot of change in it, but when we first started the partnership with Fannie Mae in '98, '99, there'd be a package of loans that we wanted to buy that we trusted, based on our experience as a direct lender for, at that time, 14 years with virtually no losses. It would be a portfolio that was high on TB because people didn't have a lot of wealth to put down, and then high ratios, because people's incomes were low. So they had credit loans just because there's really two aspects to credit. There's the willingness to pay, which you can't do much about. There's the ability to pay, except they don't have a bank account. People extend their payables if they have a divorce or something. But these were first-time homebuyers buying modest houses, where their mortgage payments weren't much more than their rental options. These are the type of people who we're making loans to from the credit unions, so we had trust in these loans. We didn't allow brokers and we wanted to sell those loans to Fannie Mae and it was a knock down, drag out, every single time. Even though we were taking full recourse, the answer was, no, we won't buy those even though we're in a partnership. The market has changed now, so we don't have those fights with Fannie Mae for the most part.

GOVERNOR OLSON: Let me ask you this: Fannie and Freddie, historically, their product is a conforming product. Were you trying to sell a nonconforming product, so it wasn't the unwillingness so much, as you were outside of their --

MR. STEIN: That's right. But the larger point I was making is that the market has changed, in partly the congressional goals, partly their experience with these loans, where we don't have to have those fights because they're eager to --

GOVERNOR OLSON: I see. So what are you finding now in terms of the access and the appetite?

MR. STEIN: I think the access to credit is wider than it's been and the appetite is there. I think the challenge for these markets, as I was pointing to, is really the type of products. With the explosion of the subprime now being 20 percent of the market, I think, to the extent that people are shoehorned into the conventional shops at banks, either through our program, which is very small, or the other banks, they're going to get a product that they're much more likely to be able to stay in, because there's plenty of liquidity now for conventional loans as well as the subprime.

GOVERNOR OLSON: Mark, I'm interested in the CDFI that you talked about -- well, anything that would bring a suitable, if you will, product into that market would have to be welcomed and positive, but to the extent to which the secondary market -- I'm interested in hearing more about your experience in that regard.

MR. PINSKY: Well, as we go forward, what we've found -- the goal is to build a platform where we can offer multiple products. Some of them we think will be suitable for the secondary market and suitable for the consumer. Some of them may not be; we may have to find and create a liquidity, but what we've been able to do, through a series of, sort of, structuring issues, is created this product which is a high level value product with a, sort of, a national risk indication strategy CDFI delivery system, is actually postured in a way that we actually think that the 80 percent will, in fact, be of interest to the secondary markets in our discussions so far. The deal's not done, so we don't know that. And the next tranche, the next risk tranche, is something that we found of great interest among socially motivated investors who are going to have some appetite for looking to do something to combat predatory lending.

GOVERNOR OLSON: Is there any tranche of a mortgage bank that isn't appealing to somebody the some price?

MR. PINSKY: Well, the pricing issue, the structure that we have -- you asked about pricing earlier -- the pricing on this lead product, actually, over the blended price of this is going to be, at most, about 80 basis points over prime rates. So it's a very competitively priced product.

GOVERNOR OLSON: Bruce, the partnering you do, and which has obviously made -- I'm interested in the extent to which, in that partnering, does that partnering lend itself to scale, or is it by definition, sort of, a one at a time kind of approach that you need to take? Another way of asking the question, is it -- you have a solution that will be available broadly or is it going to be available narrowly?

MR. DORPALEN: If scale is the number of people that come for a program -- with Bank of America we did 8900 mortgages last year. We'll do 800 with the Citibank program so far. We'll at least break a thousand this year, and that's a relatively new program. And I think one of the challenges that a counseling industry has, is to be efficient in its own way and not hold up the process and be there at the right time not just as an add-on. And we've really worked very hard at getting people through our system, so that you come into a group intake session, run the basics, we collect the paperwork. We call in and within three days you have your first interview. And with some people that may be the only time you see us, those three sessions, and then we have some follow-up classes you can attend or not attend.

Some people need more work. Our view is that we need to automate the housing counseling side, the correction, the evaluation of people, but there's a manual component to our work, and the underwriting at the banks has a manual component as well. It is a more time consuming process but also a higher value process.

GOVERNOR OLSON: Other people I know have questions.

MS. BRAUNSTEIN: One of the things we talked about this morning, in fact, Irv talked about quite a bit, were some of the differences between people looking for a loan to purchase a home versus re-fis. One of the things that I think was especially interesting, and we all know this, when people are purchasing, and they're going out and looking for a loan, they're more likely to shop, whereas a lot of clients on re-fis, they're not shopping because they're being approached by others and told, you need to get your roof fixed, you've got all these bills, and we'll consolidate. And I was just wondering, keeping those kinds of things in mind, I guess, Mark, I would address this to you first, with this platform you're setting up, how are the CDFIs going to compete with the lenders, the subprime lenders, who are out there ringing doorbells and making phone calls, and aggressively push marketing people. Is that part of what you're planning to try to have people do? I'm just trying to picture CDFIs going around to people's homes and trying to push products on them and it seems counter to what CDFIs do. So I was wondering how you're going to...

MR. PINSKY: I can answer that in part. One of the -- we started thinking about this years ago, actually Mark Peets (phonetic) from Self Help was one of the first people to say to us, it's very hard to compete in those marketplaces for exactly the reason you're describing. And we think we're going to have to, sort of, transition it to be able to compete on the re-fi side in particular. It's going to be tough on the re-fi side.

What we have going for us is CDFIs who have presence in the a marketplace and are known in some ways. We have a set of relationships, often through churches or mosques or synagogues or other communities of faith that allow us to get into the marketplace where we want to get, and we need to create a marketing presence. As I said, if we can get the tail wagging the dog in this market for a while, it will be a good thing. But to the extent, yes, we need -- that's what we do now. That's what a lot of CDFIs do now. If you're in business lending, for example, you're knocking on doors to businesses, trying to get to know them, and find out what's going on.

That's why I said I can answer it in part way. I don't have the full answer. I don't know how far can you really go and do that in a responsible way, and how you can, sort of, get people who are in the clutches of a predatory lender and bail them out before you get there. We don't have that solution yet.

MR. DORPALEN: Can I jump in?

MS. BRAUNSTEIN: Sure.

MR. DORPALEN: I think we understand a lot more how to do purchase marketing because there's an infrastructure, there's real estate agents, there's lenders. People have an idea where to go, but for refinances, people don't have an idea where to go. There's not a good marketing approach to all this.

And ACORN goes door to door around organizing issues, and sometimes people look at people's loan papers and advise them to come in and see a housing counselor. We do have large community meetings. We do a range of pieces that get us some volume to this. We are not scratching the surface, and it's a big need.

I think one of the interesting things of what Mark's talking about is, trying to create a grant that says it's safe to come here, and we're very interested in that. I think that that helps. The real challenge though is, there needs to be large visibility about what their options are.

The other problem is, is that the industry, the subprime industry, has designed a product that doesn't match the need for many people. What they are really selling is adjustable rate mortgage loans, and what they should be selling is a home equity loan. So, if you want to get your bathroom fixed up, it's a $6,000 job, and you end up with a subprime lender, the product that they're offering you is to refinance your entire mortgage, add the $6,000, plus whatever fees they can, to your equity. That's not what people needed. They just needed to borrow $6,000. In some of the deals we see, people spend more for fees than they are getting for the bathroom. That's the lack of match between customer and product.

MS. BRAUNSTEIN: I know, Loretta, you wanted to comment.

MS. ABRAMS: I have to make a comment about education and awareness and the importance of that and finding those teachable moments and making sure that when people think about the need, that they think about those moments, and they know where to go, and they know where the resources are, much in the same way as when people are thinking about, it's time for a car, they know, just from awareness and that information being out there, to be sure to check on the mileage, be sure to take a look at the tires, be sure to check that that car hasn't been in an accident. I think as an industry, continuing to educate people, raising general awareness about the whole mortgage and loan process will help them to feel more empowered and more informed, and they're better able to even ask the right questions. I said this before, but too often, you don't know what you don't know. And if you haven't had any exposure, it's even hard to ask the questions. So education, I think, is really very, very important in everything that we do.

MR. EVE: I was just going to add that the solution, in part, is right here. When you look at Bruce's ability to be on the ground, door to door, in communities, if you ever come into contact with any core organizer, they're it. When you look at Mark's CDFI relationship --

MS. BRAUNSTEIN: Our contact with them is usually they're marching outside our door.

MR. EVE: It's just an unparalleled relationship -- they come back too. Mark has talked about a product or an offering is going to be purchase focused, but his products, and his scale, as Governor Olson mentioned earlier, and Eric, the knowledge and experience with secondary markets and the sophistication of the work that they've done in the past, and none of us expected to leave with more work, but if we could pick one or two markets and partner together, and HSBC and Citi have both the products and the experience and other financial institutions as well, I think if we pick one or two markets, we could, actually, aggressively target the problem, given the skill sets available.

MR. DORPALEN: One of the things that we've experienced is that education is a valuable piece of that, but that the process is too complex, the documents are too complex, and you need somebody looking at the paperwork and have to be able to sort out if this is a right match for them. That's why we've become pretty heavily invested in the housing counseling piece. And I think that the challenge, especially in a refinance market, where there's not as much infrastructure for it, is to figure out how to have that conversation at the right time, at the right moment.

MR. STEIN: I think your point, points to the limits of disclosure identification solving predatory lending problems, because you can, kind of, focus, even if it's only for a week, focus on buying a house and figure out how to do a mortgage and get counseling, but nobody remembers -- I mean, I forget what happened yesterday, but for a refinance, you need to have that state of awareness for your entire life for the moment you're going to do the refinance. I think that's why regulations are important, because it's simply not going to be solved. 20 percent of American adults are functionally illiterate and that's another point altogether.

MR. PINSKY: Can I come back to your question?

GOVERNOR OLSON: Sure.

MR. PINSKY: I think all of these things you're hearing and probably some of the other things you heard earlier today and hearing other places, we simply have to be -- we need as many solutions out there trying to make things better in this marketplace as we can right now, to the extent we can coordinate them and create efficiencies, so we can offer better product at better prices, but as I prepared for this, I thought about a flight home from California that I was on recently. I sat next to some guy who never asked me what I did, who happened to be a very senior person at a subprime mortgage company. I said, what are you going to do, interest rates are going up, no comment on that, interest rates are going up and it's going to change your market, and he said, man, subprime is rich. I mean, I had a five hour lecture on this, on how you please people in a subprime mortgage market. Frankly, it scared the heck out of me. I mean, I know it's going on, but to listen to someone, and this is a big company, and how methodical they are about understanding how to strip wealth out of those communities in some ways. It's scary.

And so I think all of those things, and the fact that -- work here, and there are so many people now who are working on responsible mortgage financing, and view that as an important strategy, not just because it's a good thing for a grant or not just because ACORN's knocking on your door or anything like that, but because they understand it's important for the economics of their business and the economics of the country. We've begun to make a little scratch -- to go back to your question about impact -- the impact on the system, the mortgage financing system, and I think we can start to see some indications that, maybe, we have some traction.

MR. DORPALEN: Well, and it's also what's the subprime industry and what's it going to look like years from now. We sort of have a choice here, either we will let it continue on its way on an aggressive sales force that sells a limited range of products and doesn't care so much about the customer, or it becomes more like what the prime market has done, which is much more customer focused and they want to retain the customer. That means, then, your idea is not that the loan -- you only have a loan for two years, which is exactly what these people all talk about when talking with the senior managers. Nobody believes that their loans are going to be around for more than two years. They think they'll all be refinanced. But if they would use long term loans, and the relationship with the customer was long term, and you make your money on the length of the loan servicing rights, as it is in the prime market, you then have a much different relationship with the customer and you're moving forward in a more rational market.

GOVERNOR OLSON: But in fairness, it isn't the loan that's long term for the prime market, it's the customer that's long term. Isn't that correct? I had one CEO of a major bank say to me, many years ago, they were buying a mortgage company, said, we don't care about the mortgage product. There's a million mortgages out there. We want a million customers. But in the prime market -- but your point is still the same, that it is the relationship that is critical as opposed to the mortgage product, and to the extent that a product is a one off, you never get repeated opportunity, that's an entirely different paradigm. Is that consistent with your view also?

MR. DORPALEN: When you say, "one off", you mean exception, that they don't routinely do?

GOVERNOR OLSON: It is not focused on the customer, it's focused on the transaction.

MR. DORPALEN: That changes everything, absolutely.

MR. CHANIN: Let me follow-up. One thing a number of you mentioned, and that is, kind of, comparing the options out there today with some more suitable product, the 30-year ARM, or 30-year fixed-rate, and how you dealt with consumers who have been approached with -- whether it's for purchase money or refinancing transaction, the fact that, oftentimes, they can get more house, that is, if they qualify for an ARM versus a 30-year, they're able to buy more house, or two, they can have a lower payment with an ARM, or three, maybe the time it takes to process -- anecdotally we've heard, I can put you in a loan by the end of the day, and if you have counseling and so forth, it takes much more time. So have you encountered consumer resistance because of the time, or the payment amount, or the amount of the loan they can get? How have you dealt with those issues?

MR. DORPALEN: We do this routinely. Our product's overwhelmingly a 30-year fixed rate product. And we certainly have some people coming in thinking they'd like to get an adjustable rate, because they're thinking, I've got this payment. They're not quite sure how it all works. We work on a particular market. We are not an upper middle-income program. We are a low to moderate-income program. But we put product and expenses and long-term expenses on parallel columns and let people take a look at what choices they're making. A few people have gone adjustable rate, but it's very unusual for us.

Where we're feeling a lot of pressure is in the California and the Boston markets, where housing products have really skyrocketed, and, frankly, we've had to raise our income ceiling of who we can work with in order to use our program. We've worked wonders about reducing rates. We also have some, what we would say, not so bad choices that we've worked out with people so that they are not going to be hit with rate shock. We have never -- pretty much it's our view that adjustable rates in an up marketplace, if your income's not going to be going up rapidly, it's just too much of a gamble for the value of the property.

MR. STEIN: Particularly with the flatter yield curve, the argument about the lower rates with ARM, really, is only because of the teaser rate, and it's only a short term teaser rate. So, if someone's entered into a long term interest, then they can point out what's going to happen in two years. Problem is, oftentimes, there isn't an ACORN there to advise people. And one other thing that subprime lenders, oftentimes, do, is that they don't escrow back to the insurance, so the payments are initially low, but then every year there's two flipping opportunities. People need a large lump sum to pay their taxes or their insurances, where that's a known cost that everyone knows you're going to have to pay, but the technology's there in escrow, it's just not done as a marketing ploy.

MR. COLLINS: Eric Eve and Loretta, I'll address this question to you. This morning we had a discussion about the role of mortgage brokers in the subprime market, and I'm curious about what you consider best practice is in your institution in terms of the relationship with brokers. How do you monitor them? How do you measure the value that they bring? I think, Eric, I heard you mention, you severed some relationships over time with mortgage brokers. Could you address the best practices in your perspective?

MR. EVE: Sure. Within the Citi Financial branch network and the Citi Financial Mortgage Company we post our associates acquisition. We went through a thorough review of many of the mortgage broker relationships and set up a series of criteria or standards that we felt critical in order to sustain the integrity of the brokerage process moving forward. Some brokers Governor Olson mentioned earlier, some just walked away. It's not a standard to which we wish to be held, and some would urge -- but at the end of the day, it's -- you walk with your -- in grave detail, it's a combination of ongoing review, regular quarterly review, of the performance of those brokers' active loans, their rates, how they're marketing, and the process by which they're bringing loans to us.

And we feel, actually, very good. I mean, I shouldn't only focus on the negative. There are, again, many thousands of great brokers with access to communities that we don't have. I think, at the same time, it's critical on the one hand, it's important to highlight and recognize those that are providing access, providing service, and doing it the right way. And so we want to acknowledge those who are doing it well at the same time.

MS. ABRAMS: I would say we do very similar things, very aggressive compliance reviews, audit reviews. We have a tangible benefit requirement that the broker signs that he says, he's not going to submit an application to us, he's not going to take an application that is not of benefit to the consumer. The consumer also signs the statement that says, I understand that this loan is going to be a benefit to me.

We track the licensing and follow through and make sure that their licenses are appropriately maintained. We have an ineligible list that is public and posted on our Web site. So we take the same approach and we're very, very careful with making sure that we're doing business with the very best of the brokers that are out there.

MS. BRAUNSTEIN: Loretta, are you also making sure that if you have brokers bringing in customers to subprime products that if those people are actually eligible for prime, that you're upstreaming them for prime?

MS. ABRAMS: What we do, we don't have a refer up or down process within our businesses. Our mortgage business is all separate, but we do have a full spectrum of products within each of those distribution channels. So within the consumer lending branch, for example, it's automatically priced, and the pricing is automatic and the consumer gets the best rate for which he's qualified, based on the product type, credit score etcetera, and that happens automatically. So that is not a manual process.

It's a similar process; it's not as automated in the other distribution channels, but there is a full range of products available. So we don't send a person from one office to a bank office, but we have a host of products there, available to them.

MS. BRAUNSTEIN: Everyone? You're saying everyone?

MS. ABRAMS: I'm pretty sure. I'll double check that.

MR. EVE: We have a similar process at Citi. We tried a referral up initiative a number of years ago and customers leaving to -- coming to a Citi Financial branch, and we give you an 800 number, or a Web site, or put you on the phone with someone, or sent you down to the corner to the prime channel, and the fall off, in terms of customers, some people don't want to dial a number, or they don't trust the Internet. They, in fact, want to be able to go see someone who can walk them through the process. So with our referral up program, which was before I started, four or five years ago, we just lost customers. They either went to other institutions or just went on.

MS. BRAUNSTEIN: Just one more follow-up on that. Based on what we heard this morning in terms of talking with brokers, if a broker sends a customer to you for a particular product, and the broker has underwritten that person for that product and it is a subprime product, do you second guess the broker's underwriting? Even though you say you have all those products available, but maybe the broker did not underwrite this person for the prime product. Do you second guess the broker's underwriting or overwrite it and say, actually, they could get a better deal in this other product?

MS. ABRAMS: I do not believe that they're doing that in any of our distributions from the brokers.

MS. BRAUNSTEIN: So you're still depending on the broker to make that call?

MS. ABRAMS: Yes.

MR. EVE: It's dependent upon the loan that we're involved with. If the loan's closed before it's gotten to us, no, we're not involved in the process. If we are involved in the origination of the loan from the broker, then, yes, we would overwrite it before the closing of that loan so it can perform to our underwriting criteria.

MR. DORPALEN: This broker question, one of the things that we find is that people who -- they end up one lender -- if the lender's paying a lot of attention, then just simply go to others. There still in business. And it would probably be great if there was some way to have an industry repository, but I don't know how all that works. And I think the other is that I think that the suitability issue is important and that applies not just to the institution.

MR. COLLINS: Just to follow-up on the broker question. There appears to be some confusion over the roles that the numerous parties play in the mortgage action. And if you have a customer sign off, let's say, HSBC, if that loan was a benefit to them, is there a sense about the magnitude of benefit? Certainly, they get the loan, but are they aware they could have gotten the loan at a better price or a different price?

MS. ABRAMS: I can look into that. I don't have all of those details. I can tell you that the channel that I'm most familiar with, is very specific about how much the benefit must be in order to count. So can't be $5 on your monthly payment. That wouldn't be enough. So there are minimum standards, and I will check to see if those are the same standards as the broker channels.

MR. CHANIN: Eric, let me follow-up on one of the comments you made. So if I understand the way the process works, if the broker brings you a loan, it's preconsumation, and they say we've underwritten this. Let's say the person has a relatively high credit score, 700 or something, they've underwritten it for X, but under your standards, the rates would be lower. So do I understand that you will then push back to the broker and say, we originate this at X rate, a lower rate, which may or may not affect the broker's revenue on that?

MR. EVE: Actually, in terms of the process, I don't know if it is something we do for each loan or during the course of the ongoing review from our broker who found that he or she had the number of prior loans originated outside of our criteria, but it's something I can follow-up on with, exactly, the process, the timing which we intervene in the closing.

GOVERNOR OLSON: So you may or may not be intervening with the flow, but your evaluation of the broker is on going; is that right?

MR. EVE: Right.

MR. COLLINS: Just for all the panelists, are there any best practices that haven't worked?

MR. STEIN: I think that we helped write and negotiate the North Carolina law and it was associate brokers that led us into that. They were quite egregious, and I do have to say that the city really has cleaned up their broker act. And the associates were notorious for flipping, for continually doing refinancing that don't benefit the borrower. And the formulation we came up with is not great, although we couldn't think it better than that tangible benefits considering all the circumstances. The motivation for that is exactly the same as in the investment suitability, which are vague standards, unfair and deceptive, it's a vague standard. A lot of people don't like it because it's vague, but I'm not sure it's really addressed to flipping.

I think a lot of it is broker driven, but the average lives are just too short, of loans, in people's interest, and I'm not really positive how to go about doing it. I think it helps that somebody has to think about it, and I think HSBC, particularly -- and probably Citi, I'm just not aware of Citi, of what, specifically, you mean by they've done the best job that I know of in terms of making sure the loan is right for the person, but in terms of the market as a whole, I'm not sure that that really explains --

MS. BRAUNSTEIN: Because I wondered about that, because if part of the tangible is whether or not it's a lower payment, and even if it's significantly lower, some of the products that we hear the worst stories about -- it could be an IO, that you moved somebody from a fixed rate into an IO and their payment fell significantly, but is that really a net tangible benefit to the consumer. So how do you --

MS. ABRAMS: For us, that's part of the option too. We look at the product's life, and we look at, for example, taking someone from a fixed rate product into an adjustable rate product -- there has to be more than one benefit of the possibilities, and that would be one of them, so it would have to be something else on top of that. So we've sort of allowed for that, as well, in the past.

MR. CHANIN: Please don't ask the Fed to define that tangible benefit.

MR. DORPALEN: We were hoping to improve -- that these hearings are, sort of, a process to improve the strength on regulations in the market and the problems you're addressing. Is that the expectation?

MS. BRAUNSTEIN: We want to look at what the issues are out there and how the issues have changed and evolved over the last six years and then make some determinations as to what we do about them. I don't think any decisions have been made, at all, as to exactly what we will do at this point. That's why we're out gathering information about the markets.

MR. PINSKY: My response to the question about best practices, is that I think the best practice we have was that if we couldn't do this right, we didn't want to do it. And in some ways, I think that was a mistake. This was years ago, and it kept us from doing anything. And I think that because of what Self Help has done and or because of other partners and some of the banks, in fact, things have moved forward. I think the lesson in that is, don't let the broker be the enemy in this, and I would say that, in response to what you're saying, we need to keep moving forward, as aggressively and responsibly with regulation. Broker licensing laws in the states are not a perfect tool. It doesn't mean we shouldn't try to move forward. I know you will.

GOVERNOR OLSON: It seems to me, the greater comfort level the secondary market ultimately gets for the subprime product so that the pricing disparities can go a long way and the opportunities for pricing mischief can be identified and dealt with and isolated. It seems to me that will go a long way. There really is discipline in the marketplace and it isn't perfect. It's imperfect and that's why, sitting at this table, we all have jobs. And that's part of our role. It's that interaction to know when to interfere with the market as it works, and when to supplement what is happening in the market. It's a very subtle but a critically important distinction.

MR. PINSKY: We're glad you're doing it. I think what I said earlier, that it's a both/and solution, both policy and market, I think that's right. I mean, part of our job is to figure out how to feed that secondary market with responsible, fairly priced mortgage financing in a sense, so that there is a market, and the market will come to that.

MR. DORPALEN: Some of the solution, I think, is to figure out how to properly fund the tools to the business, housing counseling, and there are some interesting other pieces out there that are really marketing pieces. A number of lenders were participating and Neighbor Works are participating in a program to get ad counsel to advertising around foreclosure prevention and alerting people that, when they have delinquencies, that they should contact a housing counseling agency or their lender. And I'm not sure we figured out -- the problem with delinquency counseling, which we do a lot of, is, you get people in crisis, and you'd really like to get it when people are at 60 days. If there's a way to make that happen efficiently, that's really valuable.

I think there's other things that we mentioned earlier about getting people when they're thinking about remodeling their bathroom and not making a refinancing decision, and helping people understand that moment. And I think it's marketing not education. There has to be some presence to that.

And the third piece, what I mentioned earlier, that we really do need a much better funding stream for paying for housing counseling.

Because what it does now, it's just inadequate because there's not enough of it.

GOVERNOR OLSON: I wasn't part of the efforts six years ago, but it would be interesting to go back and look at the transcripts and look at the summaries, but I think the issues that are being discussed were not predictable six years ago, because of the evolution of the marketplace and how much it's changed. And my real concern, why we're here, it is possible for to us look at revisions in law and find that we've missed a point. We're fighting the last war. I think that the real challenge is the extraordinary knowledge asymmetry in the marketplace today, given the range of new products in the market, the opportunities for new products, but also the opportunities for all those new products to be misused, or people who are not fully informed and taken advantage of. It seems to me that I would not have articulated it that way even six months ago.

MS. BRAUNSTEIN: I think that's absolutely right. Six years ago, we were hearing about different issues, very different issues.

GOVERNOR OLSON: Eric, do you have something you want to add?

MR. STEIN: I was just going to address your points about pricing, because I think we have objective underwriting and pricing in the subprime market because of the secondary market. However, the discretionary pricing of brokers was 60 to 65 percent of the subprime market, and they have those subjective boxes, but then they have the ability to do yield spread premiums, which can be limited or unlimited depending on the lender.

I don't know if you saw our HMDA report, which came out last week, which builds on the work that the Fed did, where it looked at the disparities in the pricing among African-Americans and Latinos versus whites on HMDA pricing overlaying that the credit risks, LTB and FICO, and there's documentation to that, but it still exists. There's 30 percent greater likelihood than many products. I think that's due to discretionary pricing by brokers. If you look at the car lending lawsuits, and they say -- they're essentially yield spread premiums for cars when dealer originates the loan and sells it, and they get more money the higher the interest rate. If you look at the impact of that group, it's discriminatory by race, by affect, and I think that's the pricing mischief that occurs just in the market, because there aren't limits on the discretionary pricing by brokers. Who can they get more money from, and it tends to be people in less financial sophistication, not all women, not all minorities, but people they can get more money from.

GOVERNOR OLSON: Thank you very much. We thank each of you and thank everybody who is here. We are 15 minutes ahead of time. We said at 3 o'clock, but for people who wish -- let's find out now if there's people who would care to -- we thank everyone of you for being here. That then concludes our program. Have a wonderful time in Philadelphia. If I could hum the theme song from Rocky, I would. You are spared. Thanks to the panel, and Mike, thanks again for being a host.

(Whereupon, the proceedings concluded at 3:00 p.m.)

C E R T I F I C A T I O N

I, EMILIE S. PAKMAN, a Professional Reporter and Notary Public, do hereby certify that I reported the deposition in the above-captioned matter; that the witness was duly sworn by me; that the foregoing is a true and correct transcript of the stenographic notes of testimony taken by me in the above-captioned matter.

I FURTHER CERTIFY that I am not an attorney or counsel of any of the parties, nor a relative or employee of any attorney or counsel in connection with the action, nor financially interested in the action.

EMILIE S. PAKMAN

DATED: