THE FEDERAL RESERVE BOARD

BUILDING SUSTAINABLE HOMEOWNERSHIP:

RESPONSIBLE LENDING AND INFORMED CONSUMER CHOICE

PUBLIC MEETING

Federal Reserve Bank of Chicago

230 South LaSalle Street

Chicago, Illinois 60604

Wednesday, June 7, 2006

8:30 a.m.

ATTENDEES:

GOVERNOR MARK W. OLSON
Board of Governors of the Federal Reserve System

MR. LEONARD CHANIN
Associate Director
Division of Consumer and Community Affairs

MS. SANDRA BRAUNSTEIN
Director
Division of Consumer and Community Affairs

MS. PAULETTE MYRIE-HODGE (Panel 1)
Assistant Vice President
Supervision and Regulation
Federal Reserve Bank of Chicago

MS. ALICIA WILLIAMS (Panels 2 & 3)
Vice President, Economic Research Department
Federal Reserve Bank of Chicago

PANELISTS:

PANEL 1:

MS. DIANE THOMPSON

Attorney, Land of Lincoln Legal Assistance Foundation

MR. THOMAS JAMES

Deputy Attorney General, State of Illinois

MR. DANIEL LINDSEY

Supervisory Attorney, Home Ownership Preservation Project, Legal Assistance Foundation of Metropolitan Chicago

MR. GEOFF SMITH

Project Director, Woodstock Institute

MR. JAMES NABORS, II

National Association of Mortgage Brokers

MR. MICHAEL WILLIAMS

Vice President for Legislative Affairs, The Bond Market Association

MR. WRIGHT ANDREWS
National Home Equity Mortgage Association

PANEL 2:

MR. SCOTT MASON
Director, Structured Finance Ratings, Residential Mortgage Backed Securities, Standard & Poor's

MR. KENNETH POSNER
Managing Director, Specialty and Mortgage Finance, Morgan Stanley

MR. ANTHONY PENNINGTON-CROSS
Senior Economist, Federal Reserve Bank of St. Louis

MR. KEITH ERNST
Senior Policy Counsel
Center for Responsible Lending

MR. ROBERTO QUERCIA
Associate Professor, Department of City and Regional Planning, University of North Carolina at Chapel Hill

MR. MICHAEL STATEN
Distinguished Professor and Director, Credit Research Center, Georgetown University

PANEL 3:

MR. DAVID ROSE
Director of Research and Technology, National Training and Information Center

MR. MICHAEL SHEA
Executive Director, ACORN Housing Corporation

MR. BRUCE GOTTSCHALL
Executive Director, Neighborhood Housing Services of Chicago

MS. HEIDI COPPOLA
Vice President and Director, Public Policy and Issue Management, Citigroup

MS. LORETTA ABRAMS
Vice President for Consumer Affairs, HSBC

GOVERNOR OLSON: It's 8:30, we can get started. I suspect that people will be drifting in and out over the course of the day, but we are looking forward to a very full and free discussion as these issues always tend to generate. Time is precious, so we will want to get started.

I'm Mark Olson from the Federal Reserve Board in Washington DC. We have a couple Fed colleagues with me this morning. Leonard Chanin, who is Associate Director of the Consumer and Community Affairs. Sandra Braunstein, the Director of Community Affairs. We have Paulette Myrie-Hodge, from Supervision and Regulation here in Chicago. And it may appear that we are playing tricks on you, but Alicia Williams -- Alicia, will you identify yourself -- also with the Consumer Affairs here in Chicago, will be part of our panel.

Welcome, Diane. I was just commenting that we will be introducing the panelists in a moment.

There are a couple of rules that we have instituted. As you know, in Washington DC, the House of Representatives is a large, very diverse group. Let me back up.

The Senate. The Senate thinks of itself as a group that does not need to have a great deal of rules. They think of themselves as exclusively gentlemen and gentlewomen and not in need of a great deal of rules. So chaos tends to prevail in the Senate.

The House is under no illusion. So they have a lot of rules, and it seems to run a lot better.

We are sort of half way between here. We've decided the rules make a certain amount of sense. In part because we want to make sure that the time is well used, and in significant part because at the end of the program today is when we have our open mike to allow people who are not on the panels to have a chance to speak.

So for our panel members this morning, we are going to ask each of them to have an opening statement. And the opening statement will be five minutes, which will be timed by the two timekeepers sitting right out in front, so you can watch carefully how that time goes.

When you are speaking on issues that

you're familiar with and that you feel strongly about, five minutes goes very quickly. And I know that from personal experience and I know that from watching. So it is not that we think that you're abusive of time privileges, it's just that we think we are being respectful.

This first panel will go from 9:00 to 10:30. We may get started earlier, and if we get started earlier, that's just fine. But then we will take a break. We will have a second panel. We will then break for lunch and have a third.

Then at 3:00 o'clock without fail we will leave that hour for comments from people from the audience. Those of you who would care to speak, that will be a three minute time opportunity. It will also be timed. And we ask that you sign in. Now, where are they -- who is accommodating --

MS. BRAUNSTEIN: It's outside of the room.

GOVERNOR OLSON: It's outside the room. If you care to speak during that time, we'll do some other reminders, but if you care to speak during that time please sign in and we will then recognize you for that purpose.

Are there any other house rules that we need to talk about before we move on?

MS. BRAUNSTEIN: Maybe just how this little timer works here.

GOVERNOR OLSON: A yellow light comes on when it's two, and then the red light comes on at five and you're done, okay.

The HOEPA hearings are a continuation. Actually, four years ago was the last time that the HOEPA hearings were held. And in that four years it's hard to imagine that as much change could have taken place in the industry as has taken place. And so we are going to be doing a series of four HOEPA hearings now around the country.

The purpose of the hearings are threefold. The first purpose of the hearing is to have a determination of the extent to which the HOEPA regs that were passed in '02, were put in place in '02, are effective. And we will be hearing from a number of groups about that.

The second purpose of it is to look at the growth of the nontraditional loan product. The nontraditional loan product is certainly the most significant change that has taken place in the marketplace during that interim period, and it has raised some real issues with respect to the mortgage industry. It has certainly allowed for a great deal of flexibility and has brought a lot more dollars into the home loan market. But it has also raised some fundamental issues. So that is an issue that we will want to look at carefully.

The third thing that we want to talk about is the channels the mortgage product is delivering, because that is a very significant issue. And as the mortgage product continues to grow and as there are more players in the marketplace, that is a significant change that we will want to take into consideration.

The four goals for the program, two very hard goals and probably one that I would describe as more of a soft -- two that are probably softer but equally important. The first goal is to look at whether or not there needs to be an update. Whether or not we need to make changes in the HOEPA regs and the threshold amounts that were in place in '02.

The second thing, the second

objective is to review Reg Z. That will be also one of the goals of this and one of the objectives of this session.

The two softer ones, one is to determine whether or not there are going to be some areas of further education that we would like to -- any additional education that we can do from the standpoint of the Fed.

And the fourth would be to identify areas that might be important targets for further research.

So I think that is an ambitious agenda. But in a time of significant change, I think that is very important.

There are four key constituencies, if you will, or four key variables in the home loan phenomenon. And those participants have differing but important areas of responsibility.

The first, of course, is the consumer. In a world of free markets and in a world of free choice, you begin with a presumption that the consumer is responsible for his or her own actions. That has to be a fundamental statement that is made as we consider the fact that there is a wide range of products that are available and a wide number of choices. You can't provide an environment where those kinds of choices and those kinds of options exist without a fundamental presumption that the consumer is responsible for their own choices.

Number two is the lender. And I'm going to spend a few minutes -- maybe not minutes, but a little while talking about that, because I think that that is so critical.

Some of you know and some of you have heard me say that I was in the banking industry for about 16 years. During that period of time I was never in the mortgage lending business, but over those 16 years I was probably involved in closing maybe 100 mortgage loans. So I thought in a relative sense I knew a lot about the mortgage business and closing mortgage loans.

Yet every time I have sat down to close my own mortgage loan, I have felt at a disadvantage in terms of my understanding. So I can imagine what a first time home buyer and a first time recipient of a mortgage loan would feel when they are confronted by all of the issues and all of the choices and all of the paperwork.

There is a fundamental asymmetry in knowledge that is built into that process between the mortgage originator and the provider of the mortgage and the recipient of the mortgage, and that can't change. That will always be the case.

So there is a real responsibility with the mortgage lenders, I think, not to be abusive of that process. To make sure that they are recognizing that asymmetry and they are providing to a great deal the extent of appropriate education, the appropriate explanation, the appropriate assistance in choices that takes place with that product.

Now, I would also say that in most cases with most mortgage products over the years there has been a check and balance that has been built into the system in this respect. The mortgages for the most part have been carefully underwritten. And the significant development that has taken place in the mortgage market over the years, and I'm talking now over a 20-year time horizon, was the development of the secondary market. It was that secondary market that provided access to a wider range of funding for the mortgage product. And that wider range of funding has brought more people into the marketplace, has allowed for homeownership for a wider number of people than could have taken place without it.

And historically, that secondary market was a conforming product. Was a Fannie-Freddie conforming product typically, and that Fannie-Freddie conforming product was very carefully underwritten.

Today with the new nontraditional products and the voracious appetite of the secondary market for that product, it is not as clear that we have that same check and balance, that the underwriting is done as carefully. That the market is taking into consideration the same ability to pay and the same risk aversion that had been the case before.

I don't know that for sure, I'll have to be honest with you. We've looked at that very carefully, and we wonder. We ask the question is risk appropriately measured in the secondary market?

That's why we have here on some of

our panels some of the secondary market participants that can help us understand that. Because that has, on the one hand, significantly widened the opportunities for mortgages, but it brings in certain questions with respect to risk. So that I think will be a fundamental focus of our discussion here.

Group number three that is of interest are the community groups and the consumer advocacy groups. It's so clear from our perspective, and I speak I think on behalf of my Fed colleagues, and it is also clear from my background in the banking industry, that the consumer groups, and particularly the community groups, are very close to that market in a way. Especially in the emerging markets and the low-mod marketplace where the education needs to take place and where the opportunities to use financial products provide such a positive opportunity, but at the same time if those products are not used well, you could so easily get into a deep hole that is very difficult to get out of.

And working in partnership with the consumer and the community groups, this makes tremendous sense for everybody, so the ability of that group to provide education, to provide a feedback actually. And I think we are going to hear from a lot of community groups today who will help do that.

The fourth group who has an ownership interest in this whole area is, of course, the regulators, and that's why we are here. We are the rule writers. In almost all cases it's Congress that gives us a directive. We rarely, if ever, initiate rules. Congress tells us, gives us the outline, the framework, just as they have done with HMDA and they have done with HOEPA and Reg Z and a lot of others, and it is our responsibility to write the rules. And that's why we are here.

A number of my other Fed colleagues are here, Jane, Jim. Would those of you -- would my Fed colleagues please raise their hands and identify themselves. Okay. So we don't have you outnumbered yet, but you have us outnumbered only by about three to one so far. So I'm sure that more people will be coming in.

Again, for those of you who are still coming in, welcome to these sessions. We're proceeding on schedule, and we hope if we can even get a jump on the start time, we would like to do that.

We will be hearing from three panels. And then at 3:00 o'clock today those of you who would like to speak that were not on one of the panels, we would ask you to sign in and we are going to do that in three minute increments beginning at 3:00 o'clock.

Sandy, anybody else, is there anything else we need to say at the front end of the process?

We will then begin with the panelists. And we will go clockwise starting with Jane. And if you would please just introduce yourself briefly.

Starting with Diane. It was a senior moment there, Diane. I apologize for that. And identify yourself. And if you would, then, the group you're with and your five minute statement. And then after the five minute statement, then we will get questions from our panel here and an opportunity for interaction.

MS. THOMPSON: Good morning. Thank you,

Governor Olson and Fed staff. I'm very glad to have the opportunity to be here. My name is Diane Thomas. I'm a legal services lawyer and I work in East St. Louis where I primarily represent low income homeowners who are threatened with the loss of their home.

We have seen in the last ten years an unbelievable rise in the amount of destructive home mortgage lending. The communities have literally been devastated. I think it's fair to say that there is probably not a block in the city of East St. Louis in which one or more homes have not been foreclosed. Many of those homes sit vacant for years. It's a terrible, terrible blight on the community.

The typical client we now see in our office is a young working couple or a single mother. Some elderly people on fixed income, but many first time home buyers. By and large, we are seeing first time home buyers who are being put into adjustable rate mortgages, typically at interest rates higher than what they're eligible for. So they are being up-sold on the interest rate, often by a couple of points.

We're seeing adjustable rate mortgages that start in this climate with the teaser rate of anywhere between 10 to 12 percent interest rate. That's a teaser rate. They typically, once they are fully indexed, will go up to something like 14 percent.

There is very paltry and inadequate disclosure. Most of the people I see that are buying these don't understand they have an adjustable rate mortgage. They don't understand how much it's going to go up, they don't understand what the index is, and they have no idea what the maximum payment is going to be.

We have cases in our office where the maximum payment could easily be more than the current income of the family. And in many cases, the fully indexed rate would be 60 or 70 percent of the family's current income.

There is one case recently of a client in our office who ended up in one of these homes. She had been in public housing. She was working and she wanted to buy a home because she wanted to put her family on a better footing.

The center gets the call. They get

them out of the neighborhood that public housing was in, to build pride in homeownership. She ended up in a house that had many problems, one of her children ended up with lead poisoning. And the mortgage itself was very, very destructive. In a recent deposition she testified that she wished she'd never moved out of public housing. That her life had been better when she was in public housing than it was as a homeowner.

I have clients that sit in my office every day and tell me that they now tell all of their friends that they should never become homeowners. That being a homeowner is a trap, it is a downward spiral.

There is something seriously wrong with our system when I see every year close to 100 families come through my door who determine that homeownership is a trap. And that homeownership for them, instead of decreasing the wealth gap between whites and blacks, has only served to increase it.

I think there are two reasons we have seen this explosion of devastation. The first Governor Olson has already alluded to, which is we have lost meaningful underwriting in many circumstances. Many of the loans I see would never have been made if there were thorough and responsible underwriting. The ARMS that I see, if you read in the pooling service agreement, it says in the pooling servicing agreement that they weren't underwritten for even the fully indexed rate, let alone the maximum rate. There is no attempt to determine whether or not these loans when they index upwards in two years are going to be able to be paid.

There is no residual income test. And if you're making loans to people who are low income, a family of four who is earning $1200 a month, you can't assume that 50 percent of that income is going to be available for principal and interest without seeing how much more they are going to have to pay for utility costs, for taxes, for insurance, and then allowing something so that they can eat and put clothes on their children's backs.

I think that one of the reasons that we have see this dearth of underwriting is the lack of assigning liability, and the difficulty of assigning liability in those situations where it is. The only place where we see meaningful assignment of liability is in HOEPA loans. Even that in Illinois has had to be hard fought over and over again.

What that means is that Wall Street has been, I think, very good at pooling these loans and pricing the risks so that investors in the aggregate are not losing money on these loans. But homeowners are not given the same kind of disclosures that Wall Street investors are.

One very obvious example is the pooling servicing agreement that I mentioned. They talk about how they haven't done the underwriting for the fully indexed rate. The homeowners all believe that that has been done, and it's not.

GOVERNOR OLSON: Thank you very much, Diane.

Thomas James.

MR. JAMES: Good morning, and thanks --

GOVERNOR OLSON: Could you pull the microphone over.

MR. JAMES: Sure. Good morning and thanks for inviting me. Diane is always a very hard act to follow, and I will keep my comments short as she said everything I wanted to say.

I think one of the things that --

GOVERNOR OLSON: Could you identify the group that you represent?

MR. JAMES: Sure. I'm with the Illinois Attorney General's Office. So we are the police and regulatory of the state apparatus.

I was one of the chief authors of our High Risk Home Loan Act, a mini-HOEPA that we have in effect here in Illinois that really shadows HOEPA in a lot of ways. Except that we tweaked it to lower the triggers to 5 percent on these points. And where we saw most of the -- where we see or we did see historically most of these used.

And I want to say that HOEPA and I think our Act have been entirely effective in shutting down that abuse. So that I think less than 1 percent of loans that are written today are HOEPA or high home -- High Home Loan Risk Act susceptible.

So I encourage you to look at HOEPA and to tweak it more. I think the triggers can come down to the levels that we have in Illinois easily to shut down the front end abuse that we see in fees and points.

And I want to say that one of the side effects has been that the abuses have been pushed into other areas. Particularly structural areas, in the way loans are structured. Foremost among those are prepayment penalties, teaser rates that end before the prepayment penalties end. Margins that are never disclosed to consumers, margins over the index rate. And then, of course, the ARM.

And the ARM is really the source of a tremendous amount of abuse in the marketplace. People simply don't understand how the mechanism works. And they don't understand how the indexes fluctuate, they don't understand that they are written into loans with an initial rate below which their loan will never descend.

So I encourage the Board, the Fed, to look at the structural abuses that are -- that consumers have no chance.

Yesterday I was in a training session with 11 experienced lawyers and I handed out the current disclosures that are given with ARMS. And I gave everybody three minutes to read those disclosures. Then I gave them five minutes to read those disclosures. And then at ten minutes, I called time. And there wasn't an individual in that room who could explain to me the nature of a transaction that they would engage in as lawyers were they to go through with that loan.

So in the disclosure areas we work in an atmosphere of basically total failure. We don't know how to communicate the nature of the products to the consumers.

And if you go, if you flip in the commentary to the disclosures, the ARM disclosures, they're completely laughable. First of all, we are in an age of technology where we can and we have forced Ameriquest to give the real deal when the deal goes down. They have to give the real figures at the point where the consumer is making the choice to buy. And that comes before the closing, it comes at the sale of the loan. And the sale comes with the push marketing, and that comes with the first contact. Particularly in under-served communities where banks don't exist historically.

So at that initial contact when the offer is made, the real figures have to be given.

And the technology for that is there.

GOVERNOR OLSON: We will get back to you.

Daniel Lindsey, again if you just identify yourself and then five minutes.

MR. LINDSEY: Thank you. Thank you for allowing me to testify this morning. My name is Dan Lindsey, I work for the Legal Assistance Foundation of Metropolitan Chicago. I'm the supervisor attorney of the Homeownership Preservation Project, which was formed about ten years ago when we started to see an epidemic rise in foreclosure rates in Chicago. In an effort to try to deal with that, rates going from two thousand by 2000 to tens of thousands per year.

Over the past ten years we have provided legal counsel and advice to thousands of homeowners and represented hundreds of those homeowners in court, mostly defending them in foreclosures.

Most of our clients have been victims of predatory lending. My quick definition of what that means is simply fraudulence, or at least irresponsible peddling of subprime high cost mortgage loans, or push marketing, as Thomas said, of those products. And despite the fact that we have been able to help many homeowners stay in their homes over the past ten years, I would offer the perhaps controversial statement, and in some cases it sounds different from one thing Thomas said, but my heartfelt condition is that there has never been and still to this day is not meaningful and effective protections for consumers for homeowners from high cost home loan abuse.

Now, how can I say that? After all, this is the HOEPA, HOEPA was passed in 1994, ten years ago. Well, HOEPA was important in the sense that it introduced some very important concepts to the subprime mortgage market. Adding disclosures for high cost loans, substantial restrictions on some of the more onerous loan terms in the context of those loans, and asking for liability.

However, HOEPA never covered more than a small fraction of loans. And after the year 2000, and especially in 2001, in states like Illinois where our own first regulations and then statutes were put into place, it's almost not an overstatement to say nobody makes HOEPA loans anymore.

In 2001, our state regs came into place, later codified. As Tom mentioned, borrowing from the HOEPA model, there are fees and interest rate triggers above which many restrictions are put in place. The singular effect of that law has been to bring fees and interest rates down so that lenders don't have to make loans that have to comply with the regulations, with the laws.

Now, in a sense that's good. Fees and interest rates have come down. But the dark underbelly of that is that many of the same predatory practices that existed 15 years ago, 10 years ago, and 5 years ago, still exist in abundance today.

Case in point, I now talk about my pet peeve, my bet noire, stated income loans and the abuse thereof in the subprime market.

We had a client, Ms. A, 73 years old, African-American, widow. She was pushed marketed a loan that she obviously could not afford from the get-go. Her true income, a thousand dollars from Social Security, $700 from part-time housekeeping work for a couple down the street.

What did her loan application say?

It said that she made $7,000 a month as a housekeeping supervisor for a large institutional employer. Ridiculous, right? Of course it's ridiculous. But the loan went through, because it was a stated income loan, a no-doc loan.

There is no true underwriting on such loans. They are an invitation for broker fraud. In the industry itself there is the wink-wink, nudge-nudge, and the term that has developed, which is probably going to be mentioned in the deposition, of a liar loan. This product invites fraud.

Certain lenders I'm told up to a quarter of their subprime loan products involve the use of stated income loans. Obviously this leads to default and foreclosures. Our client was never able to make a single payment. She came to us. Fortunately we were able to help her. But there are thousands of borrowers out there who do not receive such help.

And one reason I focus on this particular pernicious loan product and its use in the subprime market is, first of all, how devastating it is. Second of all, it just shows that there is no real underwriting for this and many other types of loans. Third, it shows the problem that without accountability and liability up the chain, there can be no effective regulation and protection for consumers.

With these products, really the only legal hope we have now is directly against the broker who orchestrates the deal. In this particular case I mentioned, we were able to bring the broker in and that helped us get satisfaction. But many times the homeowner is not able to do that, even with lawyers. And many times lenders are able to evade responsibility because they simply point at the broker, or worse, point to borrowers. For those kinds of issues, we need protection, underwriting, and asking liability.

GOVERNOR OLSON: Geoff Smith, you're next.

MR. SMITH: Thanks for the invitation to testify at today's hearing. My name is Geoff Smith and I'm the project director of the Woodstock Institute. Woodstock Institute is a nonprofit Chicago-based research and policy organization that for over 31 years has worked locally and nationally to promote reinvestment and economic development in lower-income and minority communities. Woodstock has been extremely active conducting research that illustrates the scope of and harm caused by abusive mortgage lending practices and the impact that concentrated foreclosures have on individuals, neighborhoods, and cities. We have also worked to develop and promote local, state and federal policy that addresses the problem of predatory mortgage lending.

There is substantial evidence showing continued abusive lending practices and significant disparities in access to prime mortgage credit for minority borrowers. Concentrated subprime lending to minority communities remains a major concern. High cost mortgages have been shown to frequently contain predatory features such as unnecessarily high fees and interest rates, restrictive prepayment penalties, and other onerous terms. These loans often contain terms confusing to borrowers, are poorly underwritten, with minimal and even fraudulent documentation of borrower income.

The release of the 2004 Home Mortgage Disclosure Act, HMDA, data for the first time made available information on the pricing of high cost loans. Analysis of these data has confirmed that there are substantial disparities in mortgage pricing by borrower race.

For example, in 2004 in the Chicago area, over 40 percent of conventional single-family mortgages to African-American borrowers were high cost. Over 25 percent of similar mortgages to Hispanic borrowers were high cost. Only 10 percent of such loans to whites were high cost. These disparities widen as income level increases.

In the Chicago area, low-income African-American borrowers were just over three times more likely to receive a high cost loan than a low-income white borrower. However, an African-American borrower earning at least twice the area median income was over five times more likely to receive a high cost loan compared to a comparable white borrower. In fact, a high income African-American borrower earning twice AMI was over twice as likely to receive a high cost loan as a low-income white borrower earning half AMI.

Patterns of concentrated subprime lending to minority borrowers and neighborhoods can be seen across the Chicago region, the state of Illinois, and the rest of the country. Recent research to be discussed at a later panel will show that these pricing disparities cannot be explained by differences in borrower credit risk alone.

Concerns about concentrated subprime lending remain tied directly to the wave of foreclosures that have continued to plague cities, and in particular minority neighborhoods, since the 1990s. In the Chicago region foreclosures have been a staggering problem and have long been a leading housing issue for local government and area community development organizations.

In the Chicago region foreclosures increased by over 160 percent between 1995 and 2004. This rapid increase has been driven by increases in foreclosures of conventional mortgages in minority communities. In 2004 census tracks, greater than 80 percent minorities accounted for 37 percent of all regional foreclosures. These same tracks accounted for less than 15 percent of all single family properties in the region.

Woodstock Institute research has shown the primary driver of rising foreclosure rates has been increased levels of subprime lending. Woodstock Institute research has also shown that foreclosures have a significant impact on local economic development. Our research estimates that in Chicago, the cumulative impact of lost or suppressed property values due to foreclosure to homeowners not part of the actual foreclosure is greater than $600 million annually.

It is clear to us that there is a foreclosure epidemic in the Chicago region. The epidemic has been largely concentrated in highly minority communities and fueled by high levels of subprime lending in these neighborhoods. These foreclosures continue to have a devastating impact on neighborhoods and cities and individuals.

The Federal Reserve Board has the authority to implement a number of changes that would help curb many abuses in the subprime market. The Board can use its regulatory authority to limit some of the most abusive practices currently seen, such as no income documentation loans or onerous prepayment penalties. The Board can place increased emphasis on enforcing fair lending laws, particularly as they relate to mortgage pricing.

In this regard it is critical to increase transparency and make more public information available on fair lending examination processes.

Additionally, encourage coordination among regulatory agencies. The complex nature of bank holding companies makes it essential that regulatory agencies coordinate fair lending enforcement efforts in order to better monitor steering among prime and subprime affiliates of large bank holding companies.

Finally, further enhance data collected under HMDA. Include information on applicant credit risk and origination channel. This will add transparency to the mortgage pricing. Better ensure that all borrowers are receiving fairly priced loans.

GOVERNOR OLSON: Okay. I suspect we will have something of a different slant now as we move to the other side of the panel.

Jim Nabors is our next presenter. And, Jim, would you also introduce yourself.

MR. NABORS: Thank you. My name is Jim Nabors, I'm president of the National Association of Mortgage Brokers who represent over 25,000 mortgage brokers in all 50 states. Thank you for inviting us to speak on Federal and State predatory lending laws and developments of subprime lending.

I want to say right up front I'm a practicing mortgage broker. I'm not a staffer and I'm not an attorney. I make loans and deal with customers every day.

NAM is committed to assuring that abusive lending does not destroy the dream of homeownership. We believe that five critical steps are needed to curb this practice.

One, financial literacy needs to play an important part to help consumers make the right decisions.

We also believe that every single mortgage originator, just not mortgage brokers but anyone who will be dealing with the consumer, should have a thorough background check and continuing education and testing requirements, and that they need to understand the products that they are offering.

Three, we think that every single mortgage broker's criminal background check will help remove the bad actors that are committing the fraud that we're hearing about.

Four, we think it's important to create and implement well-designed and well-tested consumer disclosures that are uniform, consistent and meaningful to the consumers that read them.

When I started in the business a consumer 30 years ago signed their name eight times on six pages to borrow a mortgage, back in 1976. They now, as you pointed out, sign 70 to 80 times in the effort to increase their knowledge and make sure that they get a better deal.

And the problem is the disclosures aren't written for consumers, they are written for attorneys. They don't help the consumer. There should be fewer disclosures, simpler disclosures, that lay out exactly what the deal they are getting is. But the consumer ultimately has the right to make that decision.

We also believe that the good faith estimate needs to mirror the HUD 1, so that a consumer at closing can take their document and put it down next to the actual closing document and compare costs. And it will be the easier thing for a consumer to compare what they were promised as compared to what they got.

The number one consumer complaint that I hear is, "I didn't get the deal I was promised." And yet the disclosures -- they didn't have the ability to question the disclosures because they are too confusing.

We must be careful not to rob an innovative and dynamic industry of their ability to grow and offer these new products. Homeownership is at a record high. Mortgage brokers go into communities that banks won't service.

Some would say not everybody should have the right to own a home. Some would say there are record foreclosures. But I don't think those record foreclosures come because of the interest rate, points and fees. While at the same time the government takes an easy out, not taking into effect how the economy is performing. When people lose their jobs and are blue collar workers -- I'm from Cleveland, Ohio. When a company goes out of business it doesn't matter what their income was, they don't have the ability to make a payment.

And I think studies that ignore exactly those factors: marriage problems, credit problems, employment problems; and just focus on points, fees and interest rate, aren't doing the customer the benefit.

I think that our biggest concern is, as we say, this is an underused market. Nontraditional products are coming in, more education needs to be done at every level. Not only every originator needs to be educated, consumers need to be educated to make the right decision.

But ultimately we should not decide for people you can't have the option to succeed. If you get a hundred people in your office a year that fail, what about the two thousand under the same situation that succeeded? Don't rob them of the ability to have the American dream of homeownership.

GOVERNOR OLSON: That was well timed. That was a good summary of your presentation.

Michael Williams, you're next.

MR. WILLIAMS: Thank you, Governor Olson, Fed staff. Thank you for giving us the opportunity to present here. It's a very important topic.

My name is Mike Williams, I represent

the Bond Market Association. The Association is a collection of broker/dealers who make markets in fixed income products, and for purposes of this particular hearing we make markets in mortgage backed securities.

Now, we have been involved in this issue of high cost lending, predatory lending, alternative mortgage products. The name changes, but the issues seem to stay the same. We have been involved here for a good part of 70 years on a state-by-state basis where we have gone into various states where we have testified and we worked with the legislatures and governors and staffs on particular pieces of legislation that they were trying to implement to address the issue of high cost lending and abusive lending.

Now, what I've found in all of those instances were stories that we have heard from the first four panelists. Now, when you listen to those things, they are true. Obviously they are true, and obviously those people were negatively impacted. The question always comes back to what do you do to address it. Is there an identifiable problem, right? Is there a definition of predatory lending? Is there a way that you can essentially cut that cancerous growth out of the system without destroying the system.

And we have gone back and forth on this issue, and I have to be honest with everyone here, our position has evolved over the past seven years. It's not always been well, assigning liability is not such a bad thing. It evolved from why us? This is not our problem. We are so far removed from this process that, you know, we don't have -- it's a hands-off approach.

That's not where we are right now. Where we are is essentially there needs to be responsibility and culpability in every step of the process. Starting obviously with the consumer, because that's where you go. The consumer decides they need a loan, there needs to be adequate disclosures, there needs to be adequate education to understand the products.

Then you go to the brokers. And I think Jim just laid out perfectly that there needs to be background checks. You need to make sure you have responsible people who are pushing those products, that they understand the product and that they are actually operating aboveboard.

Then you get to the lender who is going to fund the loan. The same needs to apply. You need to ensure that you are taking responsibility for the money that you are doling out and that you're getting a good product. And that the person who is selling you this product, the broker who is now representing you, is actually pushing a good product.

Then it comes to the secondary market participation. The secondary market participant needs to be responsible and look at the information that they are given. One the first panelists, and I can't remember who it was at this point, mentioned the notion of the extraordinary amount of information that Wall Street gets versus the consumer. And I don't think that is fair at all. Fraud is fraud, and if there is bad information that is given to the consumer and given to the broker and given to the lender, then that bad information is going to pass through the system and go to the secondary market as well.

And what we try to do is eliminate risk. We try to assess it as much as possible so we are giving the end investor a product that they can rely on that is actually going to perform.

There is no incentive from our perspective to give investors a bad product. Because if we do that, they are not going to want to come back and invest with us. So we are trying to eliminate as much as risk as possible as well. But we need to have that information and we will take responsibility for the things we do wrong. What we won't do and what you shouldn't do as regulators is impose responsibility on areas where the expertise does not exist.

GOVERNOR OLSON: Wright Andrews, you're next.

MR. ANDREWS: I'm Wright Andrews, Washington counsel to the National Home Equity Mortgage Association, and actually I enjoy being here at the Chicago Fed. During law school I worked at the Atlanta Fed. That was a long time ago, but I tell you if your food here is half as good as it was then and is as well priced, I almost wanted to become a Fed lifetime employee for that.

GOVERNOR OLSON: You just divulged one of other important secrets.

MR. ANDREWS: I think that is probably true.

I have written comments for the record, but today I'm just going to highlight a few points here.

First, so you know who HEMA is, the HEMA, National Home Equity Mortgage Association, represents about 250 mortgage companies that generate about 80 percent of the nonprime mortgage loans. In 2005, there was about a trillion dollars in nonprime mortgages outstanding, over 600 billion originated in that year alone. And this was roughly 25 percent of the overall housing market.

Now, about 40 percent of those nonprime loans were for home purchases. Showing that this is a very important issue that you have to take into account as far as this industry goes. This is putting a lot of people in homes.

Now, HEMA has long recognized that there have been problems in the industry. HEMA has supported toughening legislation over the years. HEMA has supported additional education for borrowers, best practices, et cetera. I can say that in my comments today, I agree on a couple of points that Tom and Dan made, and I'm going to focus my remarks on -- I disagree with some, too, but focus my remarks on the state laws.

I'm going to say that the state laws' main positive benefit probably has been to increase the awareness of many of the major nonprime lenders. I think you will find that many of the lenders today have shifted and employed practices that reflect a lot of what is in state laws and apply them to all home loans.

I think there have also been negativity aspects of the state laws. I don't think many people recognize perhaps how weak they might be. Just say many states still don't have them. Many of those that do have a law that is little more than a mirror of the current HOEPA, which I think most parties would say is weak. Others we think go too far the other way and are over-restrictive. And even in those states that have the so-called tough laws, you have many borrowers who borrow from federal depositories who are exempt from whatever protections they may provide.

Now, with respect to the state laws, we feel that the big thing, I suppose, that has happened is that the points and fees trigger has been the primary focus of state laws in terms of impact it seems to us. By lowering the trigger in most cases to 5 percent, and then in many cases adding either YSP or adding prepayment penalties in or both, that changes the dynamics greatly.

Many have said in the past this makes it apply to a lot more loans. I guess where I agree with Tom and Dan, I think they were both in there referencing this, is that in many ways it really doesn't. What happens I think in the marketplace, as was mentioned earlier, almost no lenders are intentionally making high cost loans today. Some will make them under the current HOEPA, but certainly not under most of the state laws.

What happens is that lenders shift their pricing on the loans. They do more pricing in putting things more in the rate. They are, because of the way the triggers are structured, unable or often to offer a prepayment penalty, which many of the advocates here feel is, I suppose, not a good thing. I think the issue on prepay is it can be abusive, it can be very beneficial. It's how you regulate it. And we would submit that that needs to be regulated properly.

In any case, what you get I think is the bottom line with many of the state laws is that a borrower ends up with a loan that is not subject to most of the protections, and it also does not allow them to provide -- to opt for flexible financing. So there are problems in those laws.

GOVERNOR OLSON: Thank you very much, Wright. Thank you to each of the panelists.

We will now get some questions from our panel. I would like to start out by asking a couple of questions.

One of the questions that I have not yet had a good answer to, is the extent to which the foreclosure process has a check on abusive lending.

Let me go beyond that. As a lender we would do almost anything to avoid foreclosure. We would rewrite the loan, we would make accommodations, because the foreclosure process assures that at the end of the day we would lose money on that transaction.

The fact that you have a plethora of

new products, the fact that you have a more aggressive secondary market doesn't change, I don't think, the state laws with respect to foreclosure.

And so I would be interested to hear why that hasn't been more of a deterrent in the underwriting.

MS. THOMPSON: If I may, I have some thoughts about it, although I think it is a complicated question.

The first thing I think about that process is that the state processes vary dramatically. Illinois has one of the most protective ones. We still don't, even in areas like Chicago or where we are, where we have aggressive homeownership preservation projects, we are representing less than a tenth of the borrowers in foreclosure. The process is extremely cumbersome. It's very difficult to explain to the judge what is wrong with these loans. Judges tend to not understand the defenses, homeowners tend to not understand the defenses. So it's not something that without representation is going to get explored in the foreclosure process, even in a state like Illinois, which is more time consuming and more cumbersome.

So that is the first piece. That in terms from the perspective of the community or the homeowner, you're not necessarily able to use the foreclosure process to address the abusive lending. There aren't enough lawyers like me and Dan to go around.

But the other question I think is your broader question about it costs something to foreclose, so why are lenders still foreclosing.

GOVERNOR OLSON: That is not the question. The question was because it is expensive to foreclose, why shouldn't that provide a check on the underwriter to try to avoid that step of the process, the foreclosure.

MS. THOMPSON: I do think that the secondary market in the splitting of the itemization of the loan makes a big difference in this. So that the incentives about how the loan performs gets split up and are not necessarily rationally -- for example, many servicers, depending on how they get their fees, may actually generate more fee income to themselves if the loan goes into foreclosure than if the loan stays performing.

Pooling and servicing agreements may also tie the hands and requirements by investors may tie the hands of servicers in terms of doing work-out agreements.

It's not uncommon when you're trying to work out a foreclosure to be told by the servicer we would love to do that, but the investor will not sign off on it, it's too complicated. It's easier for us to let it go into foreclosure than to try to get this loan removed from the pool and substitute another loan.

I do think that the securitization process and the atomization of the interest in the loan has made that foreclosure process -- has not aligned the interest in the way you would expect.

GOVERNOR OLSON: Tom, from your perspective do you have anything to add to that?

MR. JAMES: I think she's right on. It's the stratification of the risks, the warranty agreements, the prepurchase agreements. And also the way regulators view --

GOVERNOR OLSON: But come back to my fundamental question. If a loan is foreclosed upon, somebody experiences a loss in that transaction, do they not?

MR. JAMES: Yeah, but the losses are insured over. So they are distributed through the investment network and they are not felt.

GOVERNOR OLSON: I see, okay. I'd love to pursue this a little bit also.

Does your figure, Geoff, regarding foreclosure, does that -- it's a fact of life that appreciating values is the best antidote to foreclosure. Because if you have an appreciating value, that is a product that can be rewritten or adjusted.

Do your figures account for that in terms of where you find the foreclosures?

MR. SMITH: In terms of the impact of the foreclosure on property values, we only looked at one year. But it was clear to us from our data that low and moderate income neighborhoods are more significantly effected in terms of the effect of foreclosure have on property value. I think that is directly tied to the nature of the real estate market.

GOVERNOR OLSON: Let me move to this side of the table, and let me begin by making a statement.

The one of the real advances that -- I'm now speaking in macro terms as a Fed Governor, one of the important advances we have seen in the marketplace is the growth of the secondary market. And one the good parts about the secondary market is that it has in fact significantly dispersed risk exposures. So we don't have the same concentrations of risk exposure that we had in the financial markets years ago.

So single events in the economy, like, for example, the problems of the oil patch in the southwest that brought down several banks, don't in much the same way because of the fact that the risk is dispersed.

That does raise a question -- and, Mike, you were anxious to get to that question -- is how that dispersement of that access to the market and the dispersements of risk, what does that do to the foreclosure process?

MR. WILLIAMS: Thank you, Governor Olson. Well, I would like to start out by saying there is a misperception about what happens when these loans are made. And if you didn't look at the financials, you would believe that every loan that was ever made in the subprime market is actually sold, right? And that's not the case. So you don't have 100 percent turnover of these loans going in. Some loans are actually held in portfolio. HOEPA loans are still made. People make them, but they hold them in portfolio. And even the ones that are non-HOEPA loans that are under the trigger, they may be eventually sold, but it's not an immediate turnover. So that is the first part of it.

So you're talking somewhere in the 50 to 55 percent now, and that number has been increasing now of loans that are actually sold to the subprime market in a short time frame.

GOVERNOR OLSON: Jim, from the initiator's point of view, is there a distinction that you find between mortgages that you think will end up as a portfolio product as opposed to a mortgage that you think will be sold in the secondary market?

MR. NABORS: I don't think so.

And just to go back a quick second, in the 30 years I have been in the business I've never seen a foreclosure where the lender made a dime. There was a study in the '90s that on average lenders were losing 28 percent of their balance to go to foreclosure. So we would do anything to not have to be in foreclosure.

I know when people say, well, why do you have to foreclose, part of it is Federal regulations require you to take certain actions at certain times. Writing down the balance, and if the loan goes a certain delinquency you have to go into foreclosure. That is not, you know, an option. Loan modifications, anything we can do to stop a foreclosure.

The other things as a broker, the lenders we do business with, they keep track what our delinquency is. What percentage of loans we have go bad. And if too many of them go bad --

GOVERNOR OLSON: You mean originated by a specific broker?

MR. NABORS: Originated by a specific broker. If they see a high rate of delinquency, they cut those people off, because they are at risk.

GOVERNOR OLSON: Let me move on. Wright, the question that comes up in a -- did you say a $2 trillion market, $1 trillion market with a 600 billion of originations, and that is all subprime, what sort of -- is there a market expectation for what a loss ratio would be or delinquency ratio would be for that portfolio?

MR. ANDREWS: Governor, again, first I would just say the lenders absolutely do not want foreclosure. They try their best to make only loans that are going to perform. It does cost money. Jim referenced a 28 percent figure, I've heard many people say 30 to 35 percent loss easily when they have to foreclose.

Lenders are putting a great deal of emphasis in recent years on work-out agreements. There is much more effort being done to have that. Lenders do not want their loans to perform badly in the secondary market because it shows up.

And the pools attract, in terms of the overall expectations, I don't know that there is a precise, but you're going to have some higher level of foreclosure on nonprime loans. That is a given. I think they try to manage it, maybe 2 percent, 3 percent, just ballpark in terms of loans.

GOVERNOR OLSON: I will say that if you look at the mortgage market overall, as we look at those numbers and we look at those numbers carefully, the overall portfolio is very strong if you look at the US mortgage market.

However, and this comes back I think to Geoff's point, we clearly see that there are some pockets, there are some markets, and they tend to be the low-mod neighborhood, where there are pockets where clearly we are seeing rises in delinquency. And we have spoken to that issue before and that continues to be a concern for us.

I'm sure that some of my colleagues have some other questions. Sandy, of course, is just bubbling with questions.

MS. BRAUNSTEIN: No, I just actually at this point wanted to ask a little bit of follow-up on the foreclosure issue. We have heard from the industry for years that the industry really, you know, does not want to go to foreclosure.

Can you explain, then, why we are seeing an increase? If that's true, and I would be giving -- you know, I would give that that is probably true, people don't want to go to foreclosure. Then why are we seeing an increase in loans with stated incomes and low doc?

Because it seems like there is a loosening in a lot of cases of underwriting. And if the industry is really adamant about the fact that we don't want to have to foreclose on people, why do we see these loosening underwriting criteria or loosening document criteria?

MR. ANDREWS: I would just say that I think that industry recognizes that those loans are going to have somewhat higher loss ratios. That is a given. The industry tries to manage that, though. And the stated income loans have been shown I think over time to perform relatively well.

But in some cases there is no question that there are bad loans that are put out there, such as when you have a senior citizen with some ridiculous figure given for the income. There can be problems there. But we think that they are managing the risk relatively well.

One thing I want to add in here, how much of this is truly caused by fraud? When you look at so many of the pockets, when I hear from Linda Clines (phonetic), I continue to hear what a serious problem we have in terms of fraud. There is fraud over the lenders to improperly flipping, et cetera, and everybody comes out of it hurt. I think some percentage, I don't know what, but a significant amount of all of this could be from fraud.

MS. BRAUNSTEIN: We laid the question on its side.

MR. NABORS: Can I add to that?

MS. BRAUNSTEIN: Sure.

MR. NABORS: We're hearing about stated income, and that program has been around forever and it's been expanded. Well, what NAM would like to see is a legitimate -- stated income loans have been around forever. They're not a new product on the market. What we would like to see is a legitimate third-party government -- to us legitimate third-party is the government, okay -- the Federal government do a study on that foreclosure and what truly is -- what products are causing foreclosure. What is it.

I mean, whenever we see a consumer group or an industry group do a study, those have to be questioned. Because going into it you kind of know what you want the results to look like, so you tend to lead the study in that direction. I think if we always now as mortgage brokers use the FTC study of 2004, that yield spread premium was confusing to the consumer, as an example of a legitimate third party that came out and studied the issue and didn't care what the results were.

I think before we -- there is a need for -- there are legitimate uses of stated income loans. But to characterize that is causing the majority of foreclosures, for example, I don't know that.

You know, I hear the terrible stories about the people that have lost their homes because they had a stated income loan. But people for the most part who have gotten stated income loans who have succeeded don't really -- they don't get into the paper. They don't, you know, they don't go out and say, hey, what a great deal I got. I mean, you know, and when they are in lower income levels, those are the cases where there is an economy that exists where you can look at someone's -- how they live.

If I have someone who is claiming they make $7,000 a month and I question it, I go out and look at the quality of life they are living. If I go out and they are living in a $300,000 house, driving a new car, paying their bills, sending their kids to school, I tend to believe it. If I go out on $7,000 a month and they are driving a '72 Chevy, I would begin the question the legitimacy of that loan.

GOVERNOR OLSON: So then what would you do with that application?

MR. NABORS: To me, that would be -- I would think that would be fraudulent, okay.

GOVERNOR OLSON: On whose part?

MR. NABORS: Well, I would say it starts with the consumer who told me he made $7,000. We too often want to let the consumer off the hook and say hey, they didn't do anything wrong.

MS. BRAUNSTEIN: Would you then turn it from stated income to "I need documentation"?

MR. NABORS: Absolutely.

MR. WILLIAMS: Can I jump in there? When that loan is sold in secondary market, what the underwriter there sees is just that information that is on the loan tape. They don't have the ability, like Jim does, to actually go back and see whether there is a '72 Chevy or a Mercedes Benz that is there. They have that information, and we have to look at that.

So then you say how do you insure that doesn't happen? We look at what happens, and if Jim sends us a loan that obviously wasn't going to better form and a first payment wouldn't be made, then this is a red mark on Jim and you might not want to do business with him anymore.

And there are actually quite a few, a number of lenders throughout the country that our firm will refuse to do business with. Now, obviously we can't go out and share that information amongst the firms because that would be collusion and against the law. But each individual firm knows who they won't do business with anymore because of products that are like that.

But again, you have to -- the further removed you are from the process, the less your ability is to go back and figure out fraud.

MS. BRAUNSTEIN: I understand that. I just wanted one last question, then I know I want to get to another topic.

But from the other side of the table, when you've seen these loans come in, people have problems with them, Diane and Daniel, I'm just wondering when you talk to the consumers, and you said that you see the stated income loans and oftentimes the stated income has obviously not much basis in reality, is it the impression from the consumer that they misstated their income because they really, really wanted this particular house and it's the only way they could qualify, or are they giving the impression that the lender is encouraging them to, well, you know, if you pad your income a little bit, then you can qualify for this loan?

I'm just trying to get a handle how this is happening. What do you see most of the time with the problem loans that you have seen?

MR. LINDSEY: There is a spectrum, of course, as with all of these situations. And there is occasionally the homeowner that we think was a little too knowledgeable about what happened or involved and proactive, and we say sorry, we're not going to take your case. Overwhelmingly, the answer to that question is the broker said this is the way it's done, don't worry.

And at the other end of the spectrum

you have clients didn't even know the income was misstated, it was changed around later. Or in the case I mentioned earlier, this was a frail, vulnerable woman, probably being close to incompetent due to dementia or another ailment. But overwhelmingly, it's orchestrated by the mortgage broker or some type of loan officer, if you're talking a direct employee of a lender. But usually mortgage brokers because of the way the market works, and usually there is some knowledge or sense on the part of homeowner that, boy, that doesn't look quite right, but they're encouraged this is the way it's done, don't worry. That is just the way it's done in the industry. And they are right, that is the way it's done in the industry.

MR. NABORS: I just need to jump in on that one for second. That plays to our belief that everybody needs testing, they need to be licensed. Every originator needs to be licensed.

I would also say that lenders are now putting their own checks and balances in place on this. There are major lenders that when you do a stated income loan, they look at the job that you put in. And they put the job -- they have a service that they go to and they put in what the job is and what the zip code is, and it comes back and tells them in that area what that job should pay.

So, for example, if they are a housekeeper and in that area you have $7,000 in income. I'm using that because that has been thrown out. And yet their computer says, well, this job typically pays between 1500 and $2500 a month, they themselves will reject the loan.

Because again, getting back to no one wants foreclosures, and those bad actors, whether they -- and again we talk about licensing and testing. And that's why it's important to be more than just mortgage brokers. Because even you said, this happens from loan officers. Anyone that has an incentive to profit by it may be tempted. And we need to restrict that as much as possible, while not eliminating programs that are working for the great majority of people that are succeeding under stated income loans.

MR. ANDREWS: Can I add that one thing the Fed may want to do with respect to the HOEPA regs is at least tighten up stated income loans for certain types of borrowers. Again, some of the more vulnerable people, senior citizens on a fixed income. At least at some level there, something could be done to address some of those areas without going to the broader market where we think that things are working well.

MR. CHANIN: One of the panelists talked about push marketing, and I wanted to talk about disclosures and consumer shopping for these products. Particularly consumers that end up in trouble, either foreclosures or significant problems.

And speaking I guess anecdotally, are mostly these consumers simply recipients of solicitations, or are they shopping for a loan? And if they are recipients, are they coming through the mail?

MR. JAMES: I guess it's my turn. It's changed over time as the federal law has changed. Certainly early on, ten years ago, eight years ago, it was primarily done with cold calling. I think a lot of these large subprimes, three of which we've sued, used cold calling and boiler room atmospheres. And they were commission-driven to produce 1003s.

MS. BRAUNSTEIN: Tom, I'm sorry, when you say cold calling, do you mean telephone or bell ringing?

MR. JAMES: Telephone call. And I think a secondary avenue has been door-to-door sales. You see a lot of that. And a third avenue, of course, is entry through construction, home repair, where there is going to be some significant financing. A forth avenue is through fire loss, where insurance people know where somebody has got to refinance or where there is going to be a significant capital movement. So there are a lot of avenues.

Then, of course, people who are in trouble with their loans, the minute a lis pendens is filed, get a plethora of solicitations. So we had something like 17,000 foreclosures in Cook County last year. All of those people received enormous quantities of direct mail solicitation. Of course, they are going to get rolled in those loans, into worse loans short term, and end up back in foreclosure.

MR. CHANIN: So my question is, it sounds like these are not as one would expect. These are not consumers who are leisurely shopping for a loan. They are receiving information and for whatever reason they apply and receive the loan.

And my question goes to the utility of the disclosure, which we are looking at. But the question is whether changing those disclosures, assuming it's possible to make them more concise and more useful to people, whether that will assist in remedying or addressing this problem in any real way? Or is that simply -- is this market such that that is really not the solutions to these individuals' problems.

MS. THOMPSON: If I could, I first think it's important, that big stack of papers that people get at closing, most of that is not disclosures. Most of that I think the lenders want people to sign for their own reasons. You see pages and pages of indemnification agreements, you see insurance riders, you see "you're giving us the right to correct anything that we decide you filled out incorrectly." So that is the first thing.

So, yes, I think we all agree that that stack would be helped if it was whittled down, but that is not simply a matter of disclosures.

I think there are things that can and should be done with the disclosures that would be helpful even to somewhat less than sophisticated consumers. But I think the critical piece of that that is there be meaningful liability all the way up the food chain attached to violations of those foreclosures.

And one example of why I believe this is you almost always see pretty good compliance with the rescission notices. People get the rescission notices, and they get them usually when they're supposed to get them. There is a little bit of litigation about that, but basically people get the rescission notices. And that's basically not surprising, given that if you fail to give the rescission notices, the secondary market can see that in the file and liability goes all the way up. So everybody is going to make sure those rescission notices are given.

But what you don't see, what I have never seen, even though almost all of my clients have ARMs, what I have never seen is a client walk in with the Fed's adjustable rate mortgage disclosure booklet. Not once have I seen a client walk into my office with that, even the little old ladies who have every envelope that they ever got.

And I think, you know, I think it's not a coincidence that there is no liability for failure to provide the adjustable rate mortgage booklet. So I think you can do something with the disclosures, but there has to be a meaningful cost, including fully assigning liability for failure to do the disclosures correctly.

MR. CHANIN: But that goes to the question of whether people will comply at every level with the provisions. And certainly if there were to be an increase in assigning liability to something, you might get there.

But my question goes fundamentally so if that little old lady received the ARM brochure, would that help her in any real way?

MS. THOMPSON: I think a disclosure to a low income family that the loan, the amount that you could pay on a month on this loan is going to be greater than your total monthly income, would be of use to that family.

I've had people say to me when the

ARM was adjusted up or whatever, "I had no idea it was going to go up. I would never have signed the papers had I realized that." I think that is one simple, clear example where improved disclosures would make a difference. I don't think it's everything, but I think it's important.

MS. BRAUNSTEIN: And would the CHARM booklet have told them that?

MS. THOMPSON: No.

GOVERNOR OLSON: Paulette, you have some questions.

MS. MYRIE-HODGE: I don't have questions, because I'm a regulator and I don't talk to the general public, you know, and I don't see. The only time I ever get anything from the general public is if there is a complaint.

But I do have a concern when I hear the brokers say that it's basically that people are not educated, and they are not. Because I do think that there are brokers there.

I have a neighbor she didn't come to me because I'm a regulator, but she's my next door neighbor and she has been solicited a lot by brokers. And she went to one and they told her you could afford the loan. I know she couldn't afford the loan based on what she told me.

So I do think you're talking about policing and all that, but I do think you guys need to understand that there are people there that go out. And she is not somebody that is older or -- she just doesn't understand this part of the business. She's not an idiot, she just doesn't understand this part of the business.

And there are people out there that they target people like that, and you guys should know that. I don't get to see it on a day-to-day basis because my banks do well and we don't have that. But when we have bankers that are dealing with the secondary market, but they try very hard because they know the Fed will crack down.

GOVERNOR OLSON: Paulette's comment indicates one of our real frustrations here is that as regulators of banks and bank holding companies, overwhelmingly we see with the institutions we regulate very well run institutions that monitor their risk exposures very carefully. We need to say that on behalf of our clientele.

Jim, you had a follow-up comment?

MR. NABORS: Well, I'm going to go right to this point, because there are bad actors in every industry. There are bad actors in the mortgage broker business, there are bad actors who are attorneys, insurance agencies, CPAs.

That's why we truly believe every originator needs -- we need to get rid of them. And getting rid of them is, well, we'll eliminate these products or we'll put these guidelines, they will go away. No. They'll find some other way. We need to get at those peoples.

That's why NAM has supported every state licensing, testing, education of the people that are making the loans. There are always going to be people that are looking for ways to skirt the law, and there needs to be some kind of reporting mechanism so we can get at them, okay. So that we can make it easier to get them out of the industry, too.

But when someone comes in and says, well, the broker, you know, the broker just told me it's okay, all right. You're now hearing this from someone who has a problem. The one thing I've always found is that the great thing about being in

America is you're never responsible for your own actions. You can always find someone who it's their fault.

GOVERNOR OLSON: I don't think that is exclusively American, but we will review that separately.

MR. NABORS: So subsequently, when they're in foreclosure, it's not their problem, they are looking for ways out. I also am concerned with you're talking door-to-door, which I haven't really seen. But Internet, okay, where these loans are being out-sourced and originated outside the country. How is the enforcement arm going to be handled there? I mean, there is an entirely -- the Internet has exploded hugely and is effecting this market dramatically. I think that is one of the issues that also needs to be addressed.

But I do agree, simplify disclosures so the customer understands. I'm not so sure you can go with a thing that says "this payment could go up to more than your income will be." Because at the adjustable period you don't know what their income is going to be. But I would agree that it should be, "at adjustable, this is the maximum your payment could ever be."

GOVERNOR OLSON: Jim, let me stop you.

We tried to add some perspective to this because you folks have the benefit. In the insurance industry there are insurance products that are sold aggressively and there are insurance products that have a variety of pricing. There are other credit instruments. There are credit cards, other types of credit products that are very aggressively sold and there are a lot of fees built into them.

You folks have focused -- I say "you folks," because your perspective has been the mortgage industry. But what are you finding in other products and is your experience with the mortgage industry consistent with that, or is there a difference? I would be interested in what you found.

MR. JAMES: Well, you know, we have the emergence now of the option payment and the nontraditional.

GOVERNOR OLSON: Go outside the mortgage product.

MR. JAMES: Well, I'm thinking of the option payment in terms of the way credit cards have been regulated and marketed.

GOVERNOR OLSON: I see, okay.

MR. JAMES: And the minimum payment and the non-amortizing loan. And I think with those nontraditional products, you are into the credit card-type territory with respect to the way credit will be perceived and the way, you know, you're moving more from a system that ultimately gives you a fee simple absolute with no obligation, to a system of I suppose at the extreme indenture servitude, where you essentially never work your way out of the credit position. Which could be a good thing, could be a bad thing. But that is kind of where I think that area of credit is headed if there aren't some checks put into place.

MR. SMITH: I would just say at Woodstock we looking at credit card lending, and I think our big concern is the targeting issue. The targeting of minority populations alone, moderate income population for these high cost products. And that is where the fair lending aspects of my comments came in, making sure when you look at these high cost products -- and it's obviously the terms and the rates are a big concern -- but the fact that they are being targeted to vulnerable populations is where we have our most significant worries.

GOVERNOR OLSON: Anybody want to comment on that?

MS. BRAUNSTEIN: I have a question. One of the things we heard when we did these hearings years ago over and over and over again consistently were a lot of concerns expressed about single premium credit life. And we tried, obviously, to address that in the last revisions of the HOEPA rules. And I just wanted to kind of do a check here, because nobody raised it in morning. So does that mean we did a good job of addressing it?

MS. THOMPSON: Yes. They worked.

MR. JAMES: It did work. We do not see it anymore. And if ever there was a risk that was not worth insuring --

MR. CHANIN: Can we conclude the hearing on that thought?

MR. ANDREWS: I even complimented you on that in my written statement.

MR. CHANIN: Let me follow up on that a little bit. Non-documented income and fraud in terms of stated income, I hazard to say there may be a consensus, but at least there is a point of view that that may be an issue for us to study a little bit more. And Sandy mentioned the credit insurance issue.

Are there other specific practices that come to mind in terms of significant either new problems or recurring problems of a level of specificity such as that, in terms of abuses other than kind of everyday products, if you will?

MR. JAMES: I think right now we do have some -- a couple of serious areas. One is I think you have to look at the structure of the new variable rate products. The hybrid loans, the 228s that have a three year prepayment penalty that effectively traps the borrower into a year of complete risk inversion. Where there is absolutely no risk to the lender and absolute risk to the borrower. And that is redundant in the variable rate products as the new ones emerge.

I could go into depth with you on what we are seeing, and we are just unwrapping these things and they are new to us. But we are horrified.

MR. CHANIN: So the abuse is the prepayment penalty structure for those transactions?

MR. JAMES: On the 228 with a three year prepay, the abuse is obvious.

MS. THOMPSON: I would echo what Tom said, that we are seeing really an explosion of abuse of the adjustable rate mortgages. The increasingly exotic ones where, as Governor Olson says, the information symmetries are really unresolvable there between the lender and the consumer.

It's an area where I don't think we are going to solve this problem with financial education. And I'm seeing lots and lots of adjustable rate mortgages being sold to people with prepayment penalties so that they are -- it's going to be fully indexed and there is no way they are going to be able to make those payments.

The other thing I'm seeing and I think is starting to be an increasing problem, partly because there has been so much equity, is we are seeing increasing amounts of problems in purchase originations of loans. And because there are not decision rights and because many of the state laws don't cover those loans, it's more like the Wild West. You see very high interest rates, you see very high points and fees. They are not effective tools for consumers to preserve their rights to homeownership if the loan is abusive.

And coupled with that we are seeing for years now, and this isn't news, extremely inflated appraisals where even a modicum of checking by anybody would show that that appraisal is inflated. It's 10 times what the assessed valuation is, it's, you know, 20 times what the house was bought for two months ago. It's not in line with, you know, if you go on to any of the online appraisal services, it's not in line with any of the values given there. You know, there are desk review appraisals that are done which shows the original appraisals used are completely out of whack.

MR. CHANIN: On the other side, if there are any comments on prepayment penalties, and are you seeing a change in the marketplace in terms of use of those for subprime loans? Is there a scenario where they are not appropriate in terms of, for example, for certain ARM products and the like?

MR. ANDREWS: I'll start and say that again, on the prepay area I think this is a fine area for the Fed to do a little study on. Because we do have considerable dispute between the consumer advocates in the industry in this area.

Again, as I said earlier, you can certainly have an abuse of prepay. We've all seen that. As to the things that can be done, limiting the time and amount certainly makes some sense.

And with respect to ARMs, the first adjustment date certainly is something that most of us in the industry would support. Basically what is being suggested in Washington, certainly on the legislative front, is require a choice with or without it, give the consumer some adequate pros and cons so that they can make a more informed choice. Limit the time to three years maximum first adjustment date and limit the amount.

Now, the amount, like a three-two-one type formula, the key is to preserve it so that more consumers can have the option of lowering their rate by a half a point or a point. And we need people to look at both sides of that one.

MR. WILLIAMS: I would say from the secondary market standpoint the market has matured over the past ten years or so where you're seeing -- someone had a meeting the other day with a consumer group and they were telling us that the secondary market, that is the one that is demanding that the pre-penalty be put in place. I would say not unequivocally, maybe in some cases that depends on the structure of the deal.

But by and large the market has matured to the point where assessment of risk is not an essential factor looked into. And when our guys are looking into it, if it doesn't violate any laws, then it's there. And you put that into the pool and you account for it appropriately, you can say, well, there is a two year prepayment penalty and this are how these products typically perform. And therefore, I'm going to assign it this amount of risk. But it comes in, then you do essentially the same thing.

But I want to go to this other larger issue of whether or not there are any specific products that need to be identified. I want to say just on behalf of the secondary market, I know I get into trouble when I say this but I want to say it anyway because I want to be consistent.

Typically if there is a product that is not supposed to be made, our firms won't buy them. If there is a product that doesn't violate the law, our firms are going to purchase them.

And the reasons why they purchase them is because they will be able to adequately assess the risk associated with that product, that pool of products. They will be able to get a rating from a credit rating agency. And the investors internationally, so not just a domestic market but it's an international market, will want to purchase them based on that particular risk assessment and rating that they got from the credit rating agencies.

So to the extent that there are products out there that are abusive, we have been asking this question, I personally have been asking this question for seven years. Let us know what those products are and those products need to be addressed either through regulatory action or via legislative action.

GOVERNOR OLSON: Mike, let me follow-up. This is a real key question, and it's a real key issue. And I think we need to -- and it's brand new.

Forty years ago this year I started in the banking industry and I haven't seen much that is really genuinely new over that time.

But a secondary market buying a nonconforming product is really one of the significant changes. And we are at the front end, all of us, of fully understanding all of the implications of that process.

What can you tell us about -- and let me -- the essence of the question is this. Is risk being appropriately priced? And what happens to the end purchaser of a product, particularly the subprime product, when they haven't taken into consideration all of the risks embedded into that product or in that portfolio? Can you tell us a little bit about how the subprime product gets evaluated with respect to risk and price, and how those products have performed?

There is enough history now so that we should have some performance.

MR. WILLIAMS: Absolutely. I would like to start out by saying that the products have actually performed quite well. And I think they've performed in line with you're sort of conforming

MBS products or CMBS products, commercial mortgage products. And the reason for that is because you have a geographically dispersed pool from which to choose. So you can choose from states and localities across the country.

So when you're putting together a pool, 10,000, 20,000 loans, it's not going to be localized. It's not going to be all from Illinois, all from the Midwest in most instances. It's going to be some from the Midwest, some from the West Coast, some from the south, some from the southeast. So that is the first risk assessment.

The second risk assessment is by the loan future. When you try to put a product together you figure out whether or not you have adjustable rate mortgages, whether or not you have sort of longer term, 15 and 30 years products, and you get those like interests together and you assess risk that way.

You assess risk -- and again, you see a pattern developing here. These are all numbers driven. These are not driven by whether or not you can detect fraud, whether or not there is a defined benefit to the borrower or whether or not there was some deceptive marketing involved. So all of these things are based on the numbers that are presented in the loan file. You have to take -- it tells you what all the loan features are. It enumerates them. You do your due diligence, you sample, and you send it out to a secondary specialist who actually does sampling as well, and they perform a secondary level of pool loan due diligence.

And then you take that and you go to the credit rating agencies and you say to them here is what we have. We have a pool of 10 to 20,000 loans, they are geographically diverse, here is where they are from, here are the products that dominate in this market, and here is what we think in most instances the ceiling will be probably a 2 percent default risk. That's acceptable, right? So you have a default risk, you have a repayment risk, and you have to be able to enumerate that to the credit rating agencies in order to get a rating.

Once you have done that, then you go and you get that rating. And typically these products are highly rated because the performance has been so high and because the assessment of risk has been so high.

GOVERNOR OLSON: And we are still talking about the subprime product. So let me bridge this now.

The fact that the subprime product in the aggregate performs well has a lot of societal value. Because it means the mortgages are going to a broader segment of the population and those mortgages are performing.

Now, that is of no consolation to the borrower who is being taken advantage of. So whereas in the aggregate we can see that the value is great, there are clear instances where people are being abused. So I think that is exactly the point in which we have been trying for years, and all of us I think collectively have been trying to get at, is how we can retain the value of the advances that have taken place in the market and the products, but yet isolate the abusers. And it's a struggle to do it.

But I would be interested if there is anything we haven't said that we want to follow up on with respect to that.

MR. JAMES: I just want to caution, because when we litigated DanCo (phonetic) and we had the opportunity to literally take the entity apart and examine it in the bankruptcy, we could see that the subprime products that had been pooled as subprime were primarily prime. The borrower pool was consistently better than 50 percent A credit.

GOVERNOR OLSON: You mean it was -- the loan characteristics were prime, but the pricing was subprime?

MR. JAMES: The borrowers were prime and the products were subprime. So you can get a very, very profitable product by selling prime borrowers subprime products, which is exactly what your statistics are showing with respect to minority borrowers.

MR. WILLIAMS: Is that possible? I mean, a lot of things are possible. But I have never seen, and again I would love to see a study or -- it doesn't have to be formal, just see the numbers on that, where you would say here is a pool and this is consistent across the board, that that is not an isolated incident.

The other part of that is from a secondary market standpoint, how does one know that is a prime borrower and that it shouldn't be in the subprime pool without actually having to go back and do individual loan level due diligence? And if that is the case, and if that is the answer, then you say to yourself you're putting significant constraint on the secondary market or you're going to have to shift the costs associated with that down to the borrower. And at the end of the day, is the borrower benefited by having less loans available?

MR. ANDREWS: From the lender's perspective, we think, again, there are people out there that are put into a subprime products where they shouldn't be. And that is something that both the lenders and the regulators have to see that that doesn't occur.

That said, though, we strongly disagree with you that there is tremendous widespread existence of that. We've got in terms of when the industry looks at its numbers, one member testified on this I guess about a year ago and showed their international numbers. It lays it out, at least in this company, this is one of the biggies, it just doesn't -- it's not there in the numbers. So there is again something that objective study on the part of the Fed might be a good thing.

And related to that, can I make one comment that there has been this discussion of steering and up-selling and so forth. And one of the things we hear a lot in the public debate is that lenders are putting borrowers -- lenders and brokers are putting borrowers into loans that are more expensive than they qualify for. And the typical example was thrown out there is that when a broker has a YSP in the deal.

And one thing that we think there is a lot of confusion on there -- Jim, you may want to comment -- is that the "qualify for" is very different from "can obtain the loan for". The wholesale rate that is quoted by the lender to the broker doesn't take into account the legitimate and necessary work that the broker has to do and the compensation that they need to be paid for that. They can be paid several ways. One of which is through YSP, one of which is through up-front points and fees.

But the point I'm trying to make is that you just can't simply say that because the wholesale rate is quoted, that you're going to get that. If you go to the lender to their retail shop, you're generally going to have to pay more than if you go to the broker. The lender's costs of hiring.

MR. NABORS: I appreciate that. I wanted to talk about flipping, as long as we come back to it, yeah.

Not all originators offer all products. There are brokers that only originate FHA, VA, conforming loans. There are brokers that only originate subprime products. And if the customer comes in and he's applying for a loan and the broker gives him the best product they have available and it's a subprime product, the customer can chose it or can shop and go somewhere else. That's their right, okay.

And with respect to yield spread premium, I think particularly consumer advocates, with the exception of Margo Saunders of the National Consumer Law Center, doesn't like yield spread premium. But yield spread premium is once I set my fee, the consumer, you can pay it three ways. You can pay it up front in cash. I always found that people that wanted to borrow money usually don't want to pay any money out-of-pocket to borrow it. You can pay out of the proceeds of the loan, you can pay it through a higher rate yield spread premium, or a combination of some out of the proceeds and some through yield spread premium.

It's still my fee. It's not an additional kickback. It is part of my compensation that -- and by the way, yield spread premium, the broker compensation along with the Realtor is the only compensation that is fully disclosed to the consumer. All the other ones are hidden through service release premiums and other forms. The broker discloses what their fee is.

I have to get to the flipping thing because this has been a personal thing for me. I think one of the things you can do is require a chain of title for like the last three to five, ten years, whatever you think. So that would be good for the consumer, that would be good for the broker, that would be good for the lender so they can see how this property has increased.

GOVERNOR OLSON: A chain of title disclosure?

MR. NABORS: Even just on the title search is going to do wonders for the lender that is reviewing these things before final sign off. Because if they sees this thing has changed hands four times in the last nine months and has went from 40,000 to 200,000, they are going to realize they are going to have a problem.

But it would be good for the consumer to know. You realize two years ago, and it's not California, let's say it's Cleveland, Ohio, this property sold for 28 and you're now paying 130. We need to look and see how did that happen. Also, I think the knowledge of that will effect the appraised value of it, because the appraiser will know that there is going to be a chain of title looked at.

One other quick thing. We support giving the customers the right to buy out prepayment penalties. Some even on a 228 with a three year prepayment penalty may chose that product. They realize they may be getting the lower rate and they are planning on only being in that home three years. We are really big on giving them as many choices as possible and not restricting their rights.

So I know I jumped all over the place and I apologize.

GOVERNOR OLSON: In Illinois, when you purchase a mortgage, is there a title search done in addition to title insurance? Are they done together or does one replace the other? What is the prevalence in Illinois?

MR. JAMES: There is almost uniformly now a title search performed that shows chain of title, what loans or encumbrances have been in place.

We are relatively unsophisticated in using that information. The title companies are not, but we are, certainly law enforcement is. We are just starting to develop some expertise at looking at how property has seasoned, how loans have seasoned, and, you know, get some interpretive ability in that way. But we do it now regularly when we get a complaint with a loan file.

GOVERNOR OLSON: Are residences primarily Torrens or abstract title?

MR. JAMES: It's abstract now. We have moved away from Torrens completely. The title companies did that, and so we are with basically I think there are 22 licensed title companies operating in Illinois, one of course is Chicago Title and Trust.

MS. BRAUNSTEIN: While we are talking about flipping, we did make some adjustments in the last couple of revisions to try to prevent the flipping of the same loan over and over in short periods in order to generate additional fees. Has that been effective in terms of --

MR. JAMES: I'd say it really depends on the market where there is tremendous market appreciation as there is, say, in the inner city of Chicago and city and suburbs actually, and on the coasts. Flipping goes on as it's always gone on because there is -- it's appreciation driven to a large extent.

The other thing is the HOEPA triggers are very fine, so they don't capture of a lot of the would-be flipping that occurs. So you've got to think of HOEPA in very much the abstract in terms of taking a bead on an answer to that question.

MS. BRAUNSTEIN: I was hoping for the solemn endorsement.

MR. JAMES: No.

MS. BRAUNSTEIN: Not with flipping, huh? Okay.

MR. JAMES: In fact, we are litigating a case right now with an 80-something-year-old who has been flipped through subprime products once each year, with an incremental increase that covers fees and points. And she's a ward of this state and Susan out there is litigating that with me. And we see something like that, we see Chase holding the bag at the very end when the property is upside down.

MS. THOMPSON: We also see lots of cases of continued loan flipping still. Sometimes even well beyond what the house is worth.

MS. BRAUNSTEIN: Just in general, I know we are running short on time, but we did lower -- and I heard you this morning that in terms of at least this side of the room there was a feeling that the triggers still are too high, we are not capturing enough of the loans. That they should still be lower.

But I was just wondering just for a general sense on has it made a difference, since we did lower the triggers five years ago, has it made a difference on the industry side? Is there any feeling on the part of the industry that there is any increased burden associated with us having lowered the triggers?

And then also, are people finding ways to avoid the triggers and still making high cost loans, but then not being called HOEPA loans because there are loopholes and things that maybe we've missed? So those kind of three general kind of questions, and I don't care which side goes first.

MR. LINDSEY: I guess I can address that in part, because it sort of goes back to some of the things I was saying in my earlier comments. Again, in Illinois, at least since 2001, virtually no HOEPA loans have been made. Because our triggers here both on the fees and the interest rate side are lower.

MS. BRAUNSTEIN: Because of the state law.

MR. LINDSEY: Right. So those are the triggers. Sometimes it's just under, sometimes we think they get it wrong and it generates some litigation. So for the most part, loans just aren't covered by HOEPA.

Occasionally we might see one that is

like on an 80/20 loan, and the 20 at the end has an interest rate that is high enough to be a HOEPA loan. So I think that the reason that the tweak of the single premium credit insurance mattered and worked and helped was because it was really, you know, one piece of a much larger campaign. That particular product got such bad press and was litigated and was also addressed by the Feds, so that really made a difference.

And I think things like flipping, because so few of those loans are covered by HOEPA, it really hasn't made that much of a significant difference in a place like Illinois. So I think that is sort of the difference in those two.

MR. JAMES: I would just like to point out there is a loophole that I have seen in one of the major vertically integrated subprime lenders based here in Illinois that we had the opportunity to sue.

GOVERNOR OLSON: Whose name rhymes with --

MR. JAMES: And the remarkable thing was we got a file where the TILA disclosed an interest rate, I mean an APR that was below the note rate, and I wondered how could that happen. So I called

Kathleen Keiths (phonetic), who explained that because the loan was structured so that if the consumer paid on time, in the subprime market of course, each payment for 12 consecutive months, the interest rate would go down by -- the 12 or 13 percent interest rate would go down by a quarter point. In each of the five successive years it produced APR that was actually below the note rate. Though if I subpoenaed that outfit today and asked for a single loan that had performed that way, I think you know what the answer would be.

MR. ANDREWS: From certainly a lender's perspective on the net benefit test, I mean, the reality is, as Dan said, most of the loans are not made. Therefore, the test doesn't apply.

That said, as I indicated earlier, I think you find today that most lenders are applying their own internal benefit test to all the loans they are making, certainly to the nonprime level. Questions arise, the Feds wording I think was the borrower's interest, essentially the totality of the circumstances. As you know, there is a debate going on worldwide what is the magic word, the tangible net benefit, the reasonable benefit, whatever.

I think at the end of the day having some type of a reasonable benefit test is a good thing, and the question is how it should be worded. And the lenders get concerned over when the word "net" is used, because that suggests an economic mathematical configuration in our loans, and many times there are other factors that weigh in. So the totality of the circumstances just, you know, it works.

GOVERNOR OLSON: One final comment on anything? Jim?

MR. NABORS: Yes, on the HOEPA loans aren't being made in Illinois. Are they not being made by broker and lenders in Illinois, and are they still being made over the Internet? Because a lot of Internet lenders are pretty much ignoring all state laws, all federal laws, just doing what they want.

As far as lowering the triggers, when you lowered the triggers you captured more of the market, and NAM supported the triggers that you came up with.

Our concern is if HOEPA has now become an usury ceiling, nobody wants to go up over it, and if you lower it more, you will capture more loans. You will keep more people from having the possibility of ever owning a home.

Now, no matter what level they're at, some people are going to succeed and some are going to fail owning a home, all right. Our concern is that by putting us in a situation of prohibiting people from the opportunity of owning a home, particularly in the new emerging markets, and basically tell them, "You're going to be a renter for life because we feel you might not succeed. So since you might fail, we are not going to give you the opportunity," is wrong.

GOVERNOR OLSON: I'm going to stop you there.

Paulette, did you have one final question?

MS. MYRIE-HODGE: I don't have a final question, but I have a comment regarding education for consumers, and also just my concern about the new state laws that have come out. As I said before, our banks do well, so we do have a lot of concerns. But I do talk to other regulators because we do need to talk about these things. And I only have one institution in my portfolio that has a concern about a particular state law.

But I have talked to other regulators, and their concern was that the state laws, the way they are being set up, are too restrictive and they are kind of pushing them out of some markets because of the kind of restrictions they have on them. And I would just like to hear what you guys think about that.

GOVERNOR OLSON: We don't have time for a response, unfortunately. But you can include that your written response.

What is the cut off date?

MS. BRAUNSTEIN: August 15.

GOVERNOR OLSON: This has been an excellent panel, I would like to thank everybody.

Just in brief summary, you can imagine from our monitory policy perspective, that the Board of the Federal Reserve tends a lot of time to focus on mortgage instruments, the mortgage market. It has been a tremendous engine of economic growth and the participants in the mortgage field have helped make it that. But it has raised significant and serious issues that we want to be sure we are alert to as well.

So thanks to all of you for your participation. We will now take a 15 minute break. We will be back here at 10:45 and we will move on to the second panel. Thank you very much.

(Whereupon, a short break was taken.)

GOVERNOR OLSON: Just as a reminder to everybody, we are taking pains to stay on schedule. In part out of respect for the people that have made specific plans to be here to participate on this panel, but also, very importantly, to make sure that we have time at the end for people who want to make comments.

And for those of you who may have come in late and want to participate beginning at 3:00 o'clock, make sure that you have registered that intent outside so that you can be recognized.

And we will move through this panel. This panel has a different perspective. It will be very interesting. Not exactly counterpoint, but it will be sort of a parallel look at the issues from people who have examined these issues from their perspective.

And we will do it in the same

progression. We will go clockwise starting with Scott Mason will be the first speaker, followed by Kenneth Posner, Anthony Pennington-Cross. We will then move to Keith Ernst, Roberto Quercia -- he told me he puts the emphasis on the first syl-able -- and then Michael Staten.

So we will go with you to begin, Scott. Again, five minutes.

MR. MASON: Thank you, Governor Olson. My name is Scott Mason, I'm a director of structured finance ratings at Standard and Poor's, a division of McGraw Hill Company. And actually, I'm very pleased to participate this morning in this hearing.

Since beginning our credit rating activity in 1916, Standard and Poor's has rated hundreds of thousands of securities in corporate and governmental issue. We also assess the credit quality of and assign credit ratings to, among other types of assets, mortgage and asset-backed securities.

Over the last century we have taken great care to insure that our credit ratings are viewed by the market as highly credible and relevant. And we will continue to review our practices and policies and our procedures on an ongoing basis to insure that integrity, independence, objectivity, transparency, credibility and quality continue as fundamental premises of our operations.

As an independent and objective commentator on credit risk, we generally do not take a position on questions of public policy. Thus, while we strongly support efforts to combat predatory lending and other abusive lending practices, we do not take a position on what legislative and regulatory actions are best to eradicate those practices.

Nevertheless, we have been closely following legislative and regulatory initiatives designed to combat predatory lending in order to determine how those laws might affect our ability to rate securities backed by residential home mortgage loans.

Anti-predatory lending laws, including 2002 amendments to HOEPA and the proliferation of mini-HOEPAs, basically the laws and statutes enacted by states and local governments, are designed to protect borrowers from unfair, abusive and deceptive lending practices. For several reasons, these laws may also have a negative affect on reducing the availability of funds to borrowers who need cash to support their life-styles.

For example, lenders might reduce their lending in a given jurisdiction to protect themselves from being found in violation of the jurisdiction's anti-predatory lending laws or because lending in accordance with the laws' provisions might be uneconomical. Most importantly, from our perspective, anti-predatory lending laws' imposition of liability on purchasers or attorneys might reduce the availability of funds to pay investors and securities backed by mortgage loans governed by a particular loan.

This would occur if a purchaser or assignee were bound to hold the loan that violated the law, even if the purchaser or assignee did not himself engage in the prohibited practice. Therefore, performing a credit analysis of a structured financing act as backed by residential mortgage loans, we evaluate the impact an anti-predatory lending law might have on the availability of funds to pay investors in a rated security.

To the extent that Standard and Poor's determines that such investors might be negatively impacted, we may require additional credit support to protect investors, or in certain circumstances exclude such loans from our rated transactions.

Given this context and our interest in the ongoing dialog regarding predatory lending legislation, we appreciation the opportunity to discuss our process for evaluating the impact of anti-predatory lending laws on many of these structured financial transactions.

In performing our evaluation of anti-predatory lending laws we consider, among other factors, whether the law provides for assigning liability, what the penalties might be, whether there are clearly delineated loan categories that are covered by the law, and we look at the clarity of the statutory violations. And we also look at the state laws.

The first step in our analysis

whether to write a transaction is to determine whether the law covering the loan assigned liability. We define assignee liability as liability that attaches to the purchaser or assignee of a loan, including a securitization trust, simply by virtue of holding the loan. Typically laws that impose assignee liability permit a borrower to assert --

GOVERNOR OLSON: You're at a very key point, so we want to come back to it, but the five minutes has expired so we will definitely come back. I apologize. But that is a critical point.

MR. MASON: I prefer questions and answers anyway.

GOVERNOR OLSON: We will definitely be coming back to it. You prefer questions for which you can provide the answer.

MR. MASON: Well, of course. Well, anyone who can provide an answer is fine.

GOVERNOR OLSON: Ken Posner.

MR. POSNER: Now I'm looking nervously at my watch.

Has my time started yet?

GOVERNOR OLSON: You have used 40 seconds of it.

MR. POSNER: My name is Ken Poser, I'm a research analyst at Morgan Stanley and my job is to come up with recommendations on stocks for a variety of financial service companies, including mortgage companies. So I don't have a role in the policy process either, but I look at predatory lending concerns as a risk factor for the stocks I cover, and thus it's an important topic for me to understand.

What I will share with you this morning very briefly is a couple of my own personal opinions about how these laws could help or hinder the development of the mortgage market.

The first one I'd like to make is in terms of thinking about predatory lending, there is clearly a valid concern in protecting consumers from abuse. The Center for Responsible Lending has estimated that consumers suffer some $9 billion in lost equity per year from abusive practices.

However, I'd like to point out that the size of the nontraditional market, including subprime, payday, and other controversial loans, now accounts for almost half of the entire mortgage market or some $1 trillion in originations. You could clearly eliminate the $9 million in fees by outlying all of these loans, but that would have devastatingly negative consequences for consumers in the market. So my concerns is look at balancing concerns over views with measures that might curtail or limit the market, which I think would be counter-protective.

The second point I want to make is I observe this market, and I think as you all know, the capital markets are not heavily involved in intermediating or setting the prices on risks for mortgage loans. And the process that investors go through is very complex. The price on loans has to do with, sure, the borrowers FICO score and the type of the loan. But it also has to do with expectations for the local housing market and the interest rates in the broader economic context. And all of this stuff changes very quickly, as you know, in a real-time market kind of basis.

So if you come up with a law that says, well, an interest rate of X percent is fine but an interest rate of Y percent is not fine, well, that might be fine, that might be great this week. But it might be totally irrelevant and inappropriate next week. So I'm very skeptical of any kind of law that would seek to demarcate one part of the market from the other. The prices and the terms change quickly.

The next point I would make to build on that is I would be concerned about laws that limit prices or fees or rates or even prepayment penalties. And why is that? It's because it's been my observation that hurts the market for small loans.

Now, I have the great privilege of covering the Payday Lending space, which is controversial. But nonetheless, consumers are able to get $300 loans for short periods at APRs of 4, 5, 6, or 700 percent. And this business is legal in many states and viewed as a legitimate service to consumers. So if you say we are going to limit the mortgage market to certain points and fees, I hope that you won't have the consequence of pushing people into Payday Lending or other markets which are even more expensive.

And think about it this way. Our data suggests that the average cost to originate a subprime loan is around $3,000 today. So for a $300,000 loan, that is only one point, that is not a big deal. But for a $30,000 loan, that would be ten points. So do you really want to tell the low and moderate income people, who would in many cases be looking for $30,000 loans, that they just can't have them? I think that is the question that has to be asked.

Let me wrap up here. When we look around the world at different credit markets, we find that consumer education and financial literacy goes hand-in-hand with large and vibrant consumer credit markets. So it seems to me that one strategy that could address abuse without curtailing the market would be to focus on things like disclosures, counseling, and education. Because I think the reason people get abused is they don't understand the loan terms, and if people were better educated we would expect the market to actually be bigger and not smaller. So I don't have specific suggestions, but I think that is a very fruitful avenue for exploration.

And if I have 30 seconds left, I will just say that covering mortgage stocks over the last few years, I've seen companies stumble badly over these kinds of issues.

GOVERNOR OLSON: Finish that sentence.

MR. POSNER: Names like Household and Associates and Providian come to mind. The problems at those companies were problems of culture and bad controls.

GOVERNOR OLSON: That's a good stopping point right there. We can also come back to it.

Anthony, again I don't know that I said it at the front of end or not, will each of you identify yourself and who you represent and we will look forward to hearing from you.

MR. PENNINGTON-CROSS: I'm Anthony Pennington-Cross and I'm a research economist at the St. Louis Federal Reserve Bank. So, again, I consider myself somewhat kind of in the middle and I have done a fair amount of research on the performance of the subprime loans and some work on the impact of these state and local laws on the subprime market as a whole.

So I will just start out by saying a concern over predation I think is very understandable in this market. I think primarily it's from two sources. One is outright fraud, and I think we've heard a lot of examples this morning of outright fraud. So one question comes to my mind is when something is obviously fraud, whether the enforcement exists to stop that type of lending.

The other side is that we are talking about the high cost of the subprime and the nonprime portion of the market. And these loans are going to fail at a higher rate regardless, even if we threw out the fraud, if we have legitimate high cost lending.

In addition, these loans tend to be concentrated geographically. And that's somewhat natural, considering that as a society we tend to separate ourselves by income strata. We don't mix the wealthy with the poor on the same streets too well in the United States.

So we have this high concentration of potential defaults and failures in terms of homeownership. And if there are externalities of these failures, which there certainly are, then these costs are being borne by their neighbors and these costs are often borne by the local municipalities which have to deal with the problems associated with abandoned housing on blocks. In fact, it can be very expensive if this process lingers on for a long time. So there are costs outside of those borne by the lender, the borrower, and the secondary market.

So one question is how high a failure rate is too high? What can we stomach in this country? If we can price almost anything, the bankers, the lenders, the originators, we can price the mortgage, we can say this is great. Here is what you qualify for, it's going to be 25 percent interest rate. And we handle pretty well that you have a 40 percent chance of making it through and successfully gaining homeownership. But how far are we willing to go?

So we need to have a policy debate, a more explicit policy debate, about what is too much today. What can we stomach.

So I just want to point out a couple numbers, and these are from the Mortgage Bankers Association fourth quarter 2005. So loans that are 90 day past due for a prime was .44 percent in that fourth quarter. For subprime, it was almost 3 percent, so substantially higher. So is that number too high? I think for some folks it's too high. And I think when we had the advocates over here earlier, I think part of the commentary is perhaps that number is too high. Then we had business on the other side, perhaps that number wasn't too high. So I think there is a disagreement in the community about what number is too high.

But I also want to point out if we look at the delinquency of FHA loans, they are actually currently a little higher than the subprime loans according to the mortgage bankers. In fact, those numbers are almost 3.8 percent for 90 day loans. So we have to be cognizant of the different segments and the different initial risks.

So I think actually in about 2002 HOEPA was extended and strengthened, because if you look at the data of the delinquency and foreclosure rates in subprime were extremely high in that time period. Around 2001 they were up around 8, 9 percent. Today it's come back to about 3, so there has been a gradual dropping of that. And that is when we start seeing a production of state and local laws starting in North Carolina.

So what are these state and local laws designed to do? Well, they are HOEPA style, mini-HOEPA as you heard before. They define coverage, does the law apply, if they apply, then there are restrictions on the types of lending you can do, typically in terms of balloons and prepayments and arbitration.

Now, in terms of the academic research that is out there, everyone found -- and there are three folks over here that all wrote individual papers, and they all found that the first law that came into effect in North Carolina did reduce the amount of subprime credit in the overall market. Future work, which took advantage of the variations of all the laws that were introduced after that, I think now today we are up to around 26 states have these laws in effect. And these laws can be tough in terms of what types of loans they restrict, and they can also cover different segments of the market. And their impact can be positive or negative.

GOVERNOR OLSON: We'll come back to that. That is a great point.

Keith.

MR. ERNST: My name is Keith Ernst, I'm senior policy counsel with the Center for Responsibility Lending. Thank you for the opportunity to testify at this important hearing. Thank you also for the Federal Reserve's role in keeping homeownership protections relevant in the dynamic subprime mortgage market.

Since the last hearing the Fed held on HOEPA much has changed. The subprime mortgage market has grown dramatically, now counting for one out of five mortgages in the country, even as reports of predatory lending practices have persisted and evolved to encompass new concerns.

While the Federal Reserve has taken steps to help combat predatory lending and ensure fair lending practices in the mortgage market, state policy makers have also taken action. We believe the combined efforts of state and federal regulators have done much to combat abusive lending practices, but we also believe much remains to be done.

Today I want to talk about state

predatory lending reforms, their impact on the market, and make a few suggestions for how the Federal Reserve can further protect homeowners.

Since the passage of North Carolina's predatory lending law in 1999, state policy makers around the country have set about curtailing predatory lending, particularly in the subprime market.

To make some judgments about the effectiveness of these laws, one needs to answer two primary questions. And this is important, because I think a lot of where the debate misses each other is in the formulation of what questions we are seeking to answer.

So the two questions I want to lay on the table are, first, are state predatory lending laws having their intended effects? Are they decreasing the incidents of loans targeted for reform by policy makers? I would say that is their essential purpose.

Second, are they avoiding unintended consequences? Most commonly researchers have asked this question by asking about whether state laws have led to a decrease in subprime credit. But I want to caution against interpreting any change in policy that has unintended consequences.

In my experience and in my organization's experience, while policy makers would welcome loans without predatory terms in lieu of those targeted for reform, they also recognize that it is not always possible to substitute a responsible loan for an abusive one.

The research taken to date as a whole shows I believe that state predatory lending laws are accomplishing both of these goals. For our part, the Center for Responsible Lending issued a report in February that analyzed information on more than six million subprime mortgages originated between 1998 and 2004. Principally, we found that states that have implemented significant reforms generally reduced the incidents of loan predatory terms the greatest.

Interestingly, other research has linked changes in subprime loan buying with reductions in push marketing among the least regulated mortgage lenders. We also found in our study that state laws have produced no significant decrease in subprime mortgage originations in 26 and 28 states.

Anthony, I hope you will get a chance to get back to your research, because I think it shows that there is great variations in the experience of different state laws.

Finally, in our studies we found that laws that were associated with stronger protections were also associated with favorable interest rate reductions. Specifically, when we compared states with predatory lending laws, prices in states with predatory lending laws to prices in states without predatory lending laws, we found that 19 states experienced a decrease, albeit slight; 8 had no statistical difference; and 1 had a slight increase. These findings are powerful indications that these predatory lending laws can and do filter loans of their terms while allowing subprime credit to flow.

We'd like to lay five general recommendations on table for the Fed to consider.

First, include prepayment penalties in the HOEPA definition of points and fees.

Second, make fuller use of FTC Act violation to tackle specific abuses.

Third, make further use of HMDA authority to provide additional critical information.

Fourth, in the context of fair lending examinations, urge regulators to focus on discretionary posting.

And finally, we think the Federal Reserve should exercise leadership in this area by encouraging Congress to adopt a suitability standard to ensure that increasingly complex mortgage products are suitable for borrowers needs.

In the interest of time, we elaborate on these recommendations in the subsequent future remarks. Thank you.

GOVERNOR OLSON: Roberto Quercia.

MR. QUERCIA: Thank you. Good morning. I'm Roberto Quercia from the University of North Carolina at Chapel Hill. Thank you for inviting me to testify in this hearing.

Equity based lending is a rapidly evolving area in housing finance, and in my view, because of this, it has the potential for abuse. I believe the state anti-predatory lending laws, such as the one in North Carolina, strengthens consumer protection by prohibiting some lending practices while still allowing for the growth of the subprime industry.

For example, the North Carolina law bans prepayment penalties for small loans, the financing of up-front single premium insurance, and creates a new section dealing with high cost home loans with additional restrictions. Despite fears to the contrary, our study found that the law does not curtail the availability or cost of legitimate credit. Thus, it allows the industry to continue to grow.

Our study asked the essential question that other studies failed to ask: was the overall decline in subprime lending reported by others due to a decline in loans with legitimate terms, or to a reduction in loans with abusive terms?

Our study reveals that although the total volume of subprime originations in North Carolina declined, the number of home purchase loans was unaffected by the law. And while refinance originations did fall, we estimated that about 90 percent of the decline was in subprime loans with predatory features as defined by the law, which is what the law intended.

For example, refinance loans containing prepayment penalties of three years or more dropped 72 percent after the law's passage, while rising in neighboring state by as much as 260 percent. We also found that the total volume of loans to North Carolina borrowers with credit scores below 660, the core of the subprime market, rose in the post-law period by a similar or greater percentage than it did in several neighboring states.

We understand that the mix of loans and lenders included in any analysis can affect results. This is why we have examined changes in specific loan features and disclosed the composition of our study database. We are open to having our analysis carefully reviewed, scrutinized, and replicated. We believe that others should do the same.

In closing, I would like to say a few words about the future. Housing equity is part of a household portfolio and has always been. In the past homeowners have had limited options to tap the equity in their homes to complement their family budgets.

In contrast, today homeowners have many options available: home equity loans, traditional lines of credit, credit cards backed by the equity in the home, and others. These options provide opportunities to homeowners, but can also raise many challenges. The risk of home loss due to a lack of understanding of complex financial mechanisms or due to deceptive or abusive practices requires, in my view, the government play a strong role.

In my view HOEPA addresses the issue of equity based lending from the traditional view of housing finance without consideration to broader consumer credit issues. Because of this lack of consideration, I believe that HOEPA is inappropriate to oversee the industry in a way that allows it to grow, while at the same time provide enough protection to homeowners. HOEPA needs to take into account the increasing intersection of the consumer and housing credit sectors. Thank you.

GOVERNOR OLSON: We are on a roll.

Michael.

MR. STATEN: I'm Mike Staten at the School of Business at the Georgetown University. Those of you who are familiar with me and some of the studies of the North Carolina law, which is all we had to look at four years ago when these studies started coming out, won't be surprised to hear me say something different than what you heard the first two researchers comment.

I think there is no question that the way you pass a law and the provisions you put into it can have an impact on the kind of loans and volume of loans and the composition of borrowers to get those loans across the states. Unlike four years ago when we first started doing those studies, though, now we have this marvelous natural laboratory that those other 26 states provide us around the country. And most of them with enough experience that we can look and see what happened in those states who adopted a little different law.

Our recent study, which I may or may not have time to get into here, finds, like Anthony's study does, that not all the laws are the same. Obviously in terms of their provisions and in terms of their impact. In some states they passed laws that had virtually no impact on loan origination. There are others that have had serious declines in origination in subprime loans, and in particular high priced loans. We have a database that allows us to pinpoint a high price loan as defined by that state law and look at the volume of those loans before and after.

Let me make another comment, though, to address some things that have been said here. Let's begin -- I think the challenge to doing any sorts of research on the effectiveness of these laws has to grapple initially with the fundamental problem. And that is that there is simply no widely accepted and unambiguous definition of the practices the laws are meant to curb. You may even find a feature that you're going to proscribed, but it's the abusive practice you want to get at.

Neither a high price nor the presence of a prepayment penalty nor a balloon payment nor an LTD in excess of 100 percent are evidence of a predatory loan per se. For some borrowers, for knowledgeable borrowers, those can be great tools to get them into the financing they need. They know exactly what they're getting into. For other borrowers, like the stories we heard this morning, they're completely inappropriate.

So if you can't designate a particular term like a prepayment penalty as predatory per se, that makes it very difficult not only from a regulatory standpoint to protect the consumers who need to be protected, but also to facilitate lending in the market to those borrowers who have legitimate needs. And it also challenges researchers coming along after the fact to figure out if the law had the intended effect.

If you look across a portfolio of a million loans and try to identify those that are unequivocally predatory, it's very difficult. I would assert it's impossible to do that, to figure out which loans given the features were a bad fit for that borrower, unless you actually talk to the borrower and get into details of the file. But we can't do that as researchers, and most of the time the regulators can't do that either.

A problem I have with studies that go in and look just for a decline of the types of loans that have the proscribed features is that it's almost result by definition. If you think the lenders are going to obey the law and they're not going to make loans with the limited features, then what else would you expect to see?

The real question is what happens to the borrowers who don't get loans. Do they find other alternatives? There seems to be an assumption baked into these laws that somehow that loan is going to get made, it's just not going to have the objectional features in it. But I would assert and our research tends to show that those loans don't always get made and there are some borrowers that are doing without. I don't think there is nearly enough attention paid to all of that.

My final point and then I will yield, is essentially there is a cost to these pieces of legislation depending on how stringent you make the laws. And the cost is in loan opportunities that never come about. And until you recognize that cost, it's way to easy to pass a law that limits one feature or another and then just drive on. And even observe the fact that interest rates may fall in the market because you've effectively cut out the highest risk, highest rate borrowers that happened to be getting those prior.

With that I will stop.

GOVERNOR OLSON: This is going to be a very useful panel, as was the last one, because it's going to help us understand exactly the issue that we are confronting.

As I said earlier, the growth of the mortgage market, the dissemination of risk exposure in the mortgage market has had extraordinary societal value and has been very positive on the economy.

As I look around the room I don't see many people that are those, if anybody, that will remember, but there was a cartoonist in World War II named Bill Malden. In fact I think he wrote for the Chicago Trib, I think it was his home. He did a great cartoon. Willy and Joe were his two characters and they were sitting in a foxhole. And one of them turned and said to the other, "The hell this isn't the most important foxhole in the world, I'm in it!"

And that's the dilemma, coming back

to the point we had had earlier. The fact that we see extraordinary societal value, it doesn't erase the fact that there is clear evidence of abuses. But they are very difficult to specify and to define, and therefore legislate.

I happen to be a person who believes that there ought to be a very high threshold for legislation and regulation. And so in order to define that threshold, we need to have this kind of an exchange that will help us understand the point at which our regulation can be useful to get at the issues that we want to get at without curbing where it has real value.

Which brings me back initially to this side of the table. And let me start with Scott, because as we said earlier, the secondary market has been so key. And there is -- the secondary market has been, especially for the nontraditional product, and to gain an understanding of the manner in which the secondary market values and prices risk.

So I think the points that you were about to talk about before, we'd like to come back to. And so you can give us an idea the manner in which you assess ratings on the mortgage product. And I assume that it is -- that you do it on a tranche by tranche basis. Because I think that will help us gain an understanding of perhaps where that risk is embedded and how it's priced.

MR. MASON: Right. I mean, our primary concern is protecting our ratings and the risk to the investors in what they are investing in.

So when we take a look at specifically these anti-predatory lending laws, our number one concern is assigning liability. And we look to assign liability and to see whether the originator's bad acts will be passed through to any purchaser of the mortgage.

Because a purchaser of a mortgage essentially in our world in the secondary market, at least in the securitization market, are investors. They are the ones who are, you know, funneling money back to mortgage originators in order for the mortgage originators to lend to borrowers. It looks like we are focused on the subprime space here. Lend money to borrowers who really need money.

Many times when we look at these

transactions, we do it on a loan-by-loan level. However, we don't look into the specifics of the borrower, other than to look at what their credit rating is and what other characteristics there are to the loan.

We do a loan-by-loan analysis of about 75 particular aspects of a mortgage loan. And when we look at that, we look to the propensity of a particular loan to go into foreclosure and what the loss may be on that one. And when we look into those factors, we look to how this loan will pay to a securitization trust.

So when we talk about anti-predatory lending laws, it's crucial to understand what the impact may be of assigning liability. And it's very interesting when we talk about the North Carolina laws being the first and then Georgia came along. And quite frankly, we came out and said with the original Georgia law, we don't understand the law. It's hard for originators to understand the law. Therefore, to say that this potential liability should be off loaded to investors is unacceptable to us, to Standard and Poor's. And we could not rate deals that contained those types of loans.

So I think it gets back to the point of, you know, everyone needs to be very, very conscious of the fact that these laws are meant to protect borrowers. But you have to be careful of the impacts on the secondary markets and how that channels back to funding and the access to equity of the separate laws.

GOVERNOR OLSON: Thank you. We have just been joined by the President of the Chicago Fed, Mike Moscow, who is here in shirt sleeves.

Mike, thank you for being our host here today and I know you're a busy guy. We appreciate the fact that you're here for some part of the program, and it's good to see you.

Ken, build on that, now, from your perspective with respect to the extent you see I guess the development or direction of the MBS marketplace.

There has been explosive growth. One of the things that some of us have noticed, and you would be particularly well poised to address this, is that in an environment of a flat yield curve, it does seem that for the investors that had been typically playing the yield curve in one form or another are now substituting a term premium for a risk premium. And that that has moved people away from other investments to maybe certain tranches of MBS that have a high premium and perhaps without the same evaluation to risk exposures.

MR. POSNER: So that's a question, of course, that nobody can be privileged to know the answer to in advance. But let me tell you a little bit about -- or at least what I know about the capital market, and how the capital market's appetite for mortgages related to securities and how people may be making those kinds of decisions.

I've got to tell you when subprime mortgages are originated they are typically packaged into a pool that may have, gosh, several hundreds or several thousand different loans. And these pools of loans are then securitized. Which means it's put basically into a box and sliced and diced and different securities come out with different risk and return characteristics.

So for $100 million of subprime loans put into a security, perhaps 80 million would come out in the form of Triple A rated securities. So securities where folks like Scott think that the risk of loss to the investor is remote, even if some of these people can't make their payments and go into foreclosure. So the market for Triple A securities, as I understand it, is global and huge. So investors in Asia and Europe and the US, the GSEs, Fannie-Maes and Freddie-Macs are big buyers of those securities as well.

These securities have spreads of around 40 basis point, which actually looks pretty attractive compared to corporate rated Triple A issuers like a GE where the spreads might be closer to ten basis point. Assuming, of course, that Scott and his folks have properly measured the risk and they really are Triple A spread over treasuries.

Now, that is the highly rated stuff. At the other end of the spectrum something like 4 or $5 million of this $100 million would be unrated and therefore the riskiest securities. These securities are often called residuals or retained interest. And if the borrowers can't pay, then these securities get wiped out very quickly.

These securities have appeared to

have found a home in the hedge fund community. And I'm told there are many hedge funds now, there are thousands of hedge funds, and the market for these kinds of securities is actually very deep.

Whether these are good investments or not is a highly technical question and traders are looking at very complex features in the deals. I'm sure the smarter traders will make money in the long term and some of the others won't. But overall, our experts who study these markets think that on average the capital markets are discounting a slowing housing market and somewhat higher loss rates, and that kind of outlook is appropriately reflected in the prices of the securities across the board.

GOVERNOR OLSON: Having spent a good part of my life in Capital Hill, five years at Capital Hill, one the key facts of life is that it takes only a few -- it takes a significant risk exposure in order to see the mortgage portfolios in the broadest sense decline. But it only takes a handful of abuses to generate legislation.

And I hope that what all of us would like to do in the course of this is to deal with these issues through adjustments to the HOEPA regs or through our laws. Or more importantly, even better, market behavior, and we can all avoid legislation. Because at the federal level, that tends to be the last option. I will have to say that that is my personal opinion.

Anthony, getting on that, is there a direction that we see with respect to the various states in terms of how they are -- or is there a direction that you can discern?

MR. PENNINGTON-CROSS: The short answer is no.

GOVERNOR OLSON: Okay.

MR. PENNINGTON-CROSS: Maybe Keith or one of the other analysts can fill me in, but I've tried to look for patterns of laws getting tougher or weaker, and I saw no pattern. So I don't see the direction of where it's going. But I know they all start in North Carolina.

So I get calls in my office from someone in banking regulatory down in Tennessee or wherever they are, especially down in the Eighth District, and they say what happens if we photocopy North Carolina. So I think that's really the starting point for most of these regulations.

MS. BRAUNSTEIN: I would like to ask just one follow-up question, actually of Scott.

You talked a lot about how Standard and Poor's looks at their loans, and in particular the first thing they look at is the assignee liability.

We heard this morning, from that side of the room in fact, from the consumer side, that that is a very important factor to them in terms of protecting consumers. And I just wanted to get a little more clarity from you on that.

Because one of the things I thought I heard you say was that it was particularly difficult if it wasn't clear as to which loans have that liability and how that liability flows. But if that was clarified, then it wasn't as big a problem? Did I hear that correctly?

MR. MASON: The clarity of the loan types covered and the clarity of the standards are very important to our analysis of the impact on secondary markets.

For example, New Jersey, and I don't remember exactly when, but two years, three years ago probably, came out with a law, and it was somewhat unclear as to what constituted a home loan. They had categories of home loan, covered home loan, and high cost loan. It was somewhat unclear as to what constituted those loans.

So the more clarity of which loans are covered makes it easier for us, and for the capital markets really, to understand what the liability is. So that's where I was going with that.

MS. BRAUNSTEIN: I just wanted to be clear because I think that is an important lesson to learn if you go down that road. The clarity part is important.

MR. MASON: Right.

MS. BRAUNSTEIN: Okay.

GOVERNOR OLSON: Let me pose a question in a slightly different way for any of you.

Is there an underlying presumption that everyone is entitled to a mortgage loan? And are we as a society doing a segment of the market a disservice by making the loans readily accessible for people who should probably not have a loan? And if so, if in fact there are limitations, is that a good thing?

MR. STATEN: I will just take a first stab at that. How else do you answer that except to say it's a judgment call? We live in a world where "free to choose" is a revered statement. And there are a lot of borrowers who find a way to make ends meet out there who you wouldn't expect could maybe handle a loan. And certainly one of the things the subprime market, as it's evolved over the last decade, has done is made it possible to loan to just about everybody. Or at least they have taken a shot at it.

I'm not here to argue that some of those loans weren't inappropriate. They clearly were. And I think many times borrowers under estimate or are way too over optimistic about their economic circumstances. Hence their willingness to get into whatever loan it takes to get a low payment and disregard the risk that goes up later. We talked about that earlier this morning.

But I'm not here that putting a ceiling on rates or putting a ceiling or a floor or whatever you want to call it on FICO scores is the best way to handle that problem. It doesn't allow any sort of incentivizing of borrowers of findings ways to make end meets. It doesn't accommodate the prospects for improving their situation. That they may have or private information on that that the regulator certainly doesn't. It's a tough business.

MR. ERNST: I would offer two responses to this question. I think first it's fairly clear to me that state policy makers and even federal policy makers, when they implemented HOEPA, had some at least implicit if not explicit recognition that there are some loans in the marketplace, there are some instances in which a borrower is harmed more than helped by a transaction.

So what I think HOEPA and what the anti-predatory lending laws have tried to do is not in fact set a user ceiling, but they have said look for loans when the rates get high enough, when the incentives for an originator become powerful enough and become tempting enough, there is a possibility that the loan can be made on unhelpful terms. In those instances, we want to introduce additional protections.

For example, in North Carolina and many of these states' laws once a loan passes a certain threshold, once the incentive fees are high enough, borrowers undergo counseling before they enter transaction. With the thought being that this counseling will provide the borrower with the opportunity to have a reality check before they put their home on the line. So I think in this case and in many cases explicitly we have acknowledgment from policy makers that we have some loans out there that do more harm than good.

I think what is the touchstone, what are some of the touchstones that are being drawn on to make that determination? We had a lot of discussions here today about failures of loans, and I think that's one of the touchstones that is looked to and one of the things that prompts concerns.

I would just note we have had a lot of conversations about serious delinquency rates and cross sectional foreclosure rates. I think, Roberto, your NC study on foreclosure showed that fact when you looked at the 1999 retail set that one in five subprime loans in a very large data set actually went into foreclosure. So I think we should think both about the ongoing rates that help measure the success, the health and vitality of the industry.

But we should also think about longitudinal measures like that sort of analysis that tells us what borrowers' experiences have been. Because when we look at things through that lens, we can perhaps understand some of what is motivating policy makers to intervene.

MR. QUERCIA: I read in my closings about how loans should be made, and I don't know how you decide that, but I think there are so many loans that are harmful.

I think the issue of over access to credit for low income families in short term need that is much more powerful, that they don't have perspective. Now, for somebody coming in with low monthly payment for two years, thinking, well, what happened two years from now is beyond I think what their consideration is, given the needs they currently have.

So it seems to me that at a minimum, counseling could help in that regard. Although some of these mortgages, basically some of the more creative ones, are more complex so that probably I couldn't understand them.

So I think the industry is evolving in a way that is providing many opportunities, as it should, and I think it's fantastic. But the downside to that is that these mortgages are so complex that they are always going to read like doing my own income tax. Some of these are too complicated with somebody with kind of the average intelligence to understand what they are signing.

GOVERNOR OLSON: Leonard or Alicia or Sandra?

MR. CHANIN: If I may ask a follow-up, at least I think it's a follow-up. In most of the -- well, certainly the federal trigger for HOEPA coverage is based on rates or fees, and I understand a number of states have a similar approach.

Just using the number that you gave me, Anthony, 3 percent of whatever these particular subprime loans were in default or 90 days late, that means 97 percent were not though.

Has there been an analysis at the transaction level or micro level of the particular factors for, in your case that 3 percent, trying to identify which types of loans in particular are going to be more likely to go into default or at least historically have done so. Which means if a trigger uses a rate that's going to skip a number of -- is going to sweep in a number of particularly legitimate subprime loans as well as potentially abusive loans.

But has there been a finer cut to look at the data to see what particular transaction information would correlate more with default rates or 90 days late payment?

MR. QUERCIA: I can't talk about the study that Keith mentioned. It's coming out in the economic journal, so that my peers would obviously locate it. But we found that in our study that prepayment penalties for small loans and balloon payments actually lead to higher risk of default. So even controlling for other factors that create these loan to value, since other people put into a traditionally mortgage default.

The presence was highly correlative with higher rates. And the key issue is which came first, the chicken or the egg. But the issue is these current rates are indeed basically immoral.

MR. PENNINGTON-CROSS: But I think the literature on the duration and termination of subprime loans, that the primary reasons that these loans go under are the same things that drive prime loans into foreclosure. That being people who haven't been paying their credit cards in the past are unlikely to pay their mortgage in the future. So people with poor credit scores are likely to fail as homeowners.

And one of the issues featuring subprime is that a lot of loans that get into trouble don't default, they actually prepay. So when you become seriously delinquent and you have been sitting in 90 days, there was discussion earlier about forbearance. Lenders don't want to default. And when you look at subprime data, you can really see this, that these loans can hang around for a year or two, 90-plus delinquent. This is a lot of forbearance.

And these loans that hang around tend to end up prepaying, not defaulting if there is any equity in the house they can use. But generally the foreclosures occur by having negative equity in the home.

GOVERNOR OLSON: Prepaying in the sense they are taken out by another lender?

MR. PENNINGTON-CROSS: Yes.

GOVERNOR OLSON: They are not prepaid out of savings?

MR. PENNINGTON-CROSS: Right. So the loan is being paid off. So that assumes that they found another lender.

But that's the bad story. I think the best thing about subprime is to get out of subprime, right?. You had a problem, you needed cash, you took cash out. You paid a premium to get the loan. What you want to do is to prepay this mortgage and get a cheaper rate, either move up the price spectrum in subprime or even out. That is the best case.

There is also the negative side. You're having trouble, you're getting in more trouble, so instead of moving up the pricing spectrum there are folks who are moving down the pricing spectrum. They get in trouble with prepayments, I call them stress prepayments and they have stressed the foreclosure, too. But primary drivers of foreclosures are not having equity, having a poor credit history, and having an economic event.

MR. CHANIN: Let me follow up on that. Is there evidence that those consumers that have refinanced, are they ultimately ending up with foreclosure with a higher level of debt, less equity in their home, or are they getting out of debt?

MR. PENNINGTON-CROSS: Maybe someone else can help. But the one sitting -- this is my own, of course, we look at the refinance loan, so loans that get refinanced. So we see actually that those loans were performing quite well. In fact, better than the purchase loans once you control for all of the factors like down payments and product type. So we didn't find any evidence of that.

But I haven't seen any true longitudinal studies, and I'm trying to think about finding data sources that you can follow the household through time to see the actually event entering and exiting to see this path of clearing or path of failure. I haven't seen anything like that.

MR. ERNST: Maybe I will come back to that point. But the point I wanted to touch on is I think one of the things that we are meeting with a backup behind us is that we have had phenomenal growth in the subprime market over the years, even as states grow more and more protected.

This growth had gone from a virtual blip to more than half a trillion dollars today. And I think -- and it's not only fast growth I think by any measure. So I think one of the things we think about is, I think, while Anthony is right, when you look at what drives foreclosure, I think we all have to pay some attention and I think federal regulators have paid some attention to the question of underwriting here and suitability of loans that are being offered to borrowers.

I think the foreclosure rates are high on a longitudinal, that one in five figure that I cited I think should tell us or should raise some concerns, and I think it rightly does. That maybe the underwriting and the loan products that are offered to borrowers are not quite at the level where we would want them to be. So I think it's more than just purely inherent borrowers' characteristics here.

GOVERNOR OLSON: Alicia, you wanted to ask a question.

MS. WILLIAMS: Well, I don't want to take it off point.

GOVERNOR OLSON: Go ahead.

MS. WILLIAMS: I had a couple, but since you mentioned the fact that this industry has pretty much grown significantly over time, and I think a lot of us would agree with that, and then there are those that will say, too, we have seen an increase in exposure and foreclosures going up in many cities and we have several in our district that really have very high foreclosures.

And so I guess the question that I would ask, because as we were talking about research, I heard Michael say that, well, we don't have a common definition and we may be looking at components. And earlier this morning there were comments made, well, you know you should look at this prepayment, you should look at the single yield, single premiums, do more research.

So I guess the question is -- and then there is always this question of, well, can you get your hands on the data. And now we have 26 states that have implemented regulations and we are saying we can't really find a pattern.

And I guess the question to you is we know there is a problem, so how do we get our arms around this? What type of research can we reasonably do that will really point to the direction all of us should be going, whether we are a credit rating agency -- because I know you have a concern about packaging your loans and the investors that want to buy those loans, they are going to be concerned if there are issues of risk. So what role can research play in that?

Then I also have a question as it relates to the credit rating companies. Where do you see yourself trying to help move this agenda forward? Because at some point it's going to impact you in a way that you're not going to be probably happy with. So how do you deal with that?

MR. ERNST: I will take a stab. There is a lot there, some very great questions. I think a lot of what motivated HOEPA and the state predatory lending laws that have followed it have been concerns about equities stripping. Instances where borrowers, in fact, were losing ground in the transaction. And I think that very much has been a focus of state predatory lending laws today. It's something that we can learn a lot about from the states.

I think what is newly coming into focus now is increasing awareness of issues that relate more to underwriting suitability that relates to loan outcomes. So not just whether the transaction helped the consumer move forward and was a constructive step in their economic life, but whether or not -- and this goes some to externality issues that Anthony was raising -- whether or not there were issues related to foreclosures, and some were touched on, appraisal issues and other concerns from the former panel. But whether these issues can provide some light.

So I would suggest there are two broad sets of spectrums that research can help eliminate. One is the extent to which certain loan features help or hinder borrowers in their effort to build and maintain wealth. And the second is more directly related to foreclosures and loan outcomes as indicators as to whether or not the loan underwriting and origination process is functioning sufficiently.

I think that second question really is just coming more into focus in recent years as we have had enough experience in subprime mortgages to get a sense of what the outcomes were. Because in 1999 and 2000 when North Carolina passed this law, the market size was so small that it was hard to get much insight into those patterns. But I think we are getting more information now as to where those opportunities exist.

MR. MASON: I would agree. If you look at the state of the economy since post-September 2001, it's just been on fire. So it's kind of hard to look back at all of the state laws and see exactly the impact, because people have been building up so much equity in the housing market that there may be some fuzziness of the data as to who is defaulting, who is not defaulting, why are they defaulting. Really, the question is why are they defaulting, right?

And the increase in home prices has probably -- and I think it was alluded to before -- has probably taken out some of the low FICO score implications of how people are defaulting and they're rebuying and they're buying from other lenders. So I think as the data becomes seasoned we will be able to see and as the housing market has now been softening a little bit, I think we will be able to see more of the real impact.

MS. WILLIAMS: Do you feel there is a role that you can play to kind of assist in this whole process as a credit rating agency?

MR. MASON: We honestly don't take steps to push forward any sort of public policy. Our real concern is what is the credit of this loan. What is the credit profile of this borrower, what is the potential of loss on this loan that will inure to the investors in the mortgage backed securities. So we pay attention to the laws, we assess the laws, but we really don't take a stand on public policy.

MR. QUERCIA: If I may add, I think Michael said before the unfortunate event is that there is not a data set that exists that you can use to analyze this, and commitment from the housing finances on the writing perspective.

To make it more complicated, as I mentioned in my remarks, in my view there is an intersection in here that actually creates a problem. That actually consumer credit issues and the housing finance is the other one of the two. So it would be very difficult to tell you to make a study to be conclusive about what you need to do to address this issue.

So I think at best you have to find people with differing opinions to do the study, but I don't think you have in my view a study that would provide an answer.

MS. BRAUNSTEIN: Actually, this was going to be my question. I have to admit, I'm still being somewhat confused by this, which seems to happen to me more and more as I get older. But we see different studies, and going back to North Carolina, which has been around the longest and has been studied most, we have, sitting here in the room, two very different opinions about the impact of that law. And it's hard to sort out kind of what is what when you're trying to make policy.

I was wondering, and I may be sorry I asked this, if it's possible to kind of not through a very long dissertation on your papers -- to kind of sort out, Michael, why is it that you think that North Carolina has restricted credit, and why, Keith, do you feel that it may have prevented some loans being made but the ones it's prevented are the bad ones. And is it possible to kind of sum up what the differences are in some respect?

MR. STATEN: Actually, I think there are a lot of similarities in the study. There have been three different databases that have been used, completely different. There may have been some overlap, but essentially three different databases. My recollection is all of them found reductions in at least the refi side of loans made in North Carolina. Initially in the immediate period afterwards, and now some of these studies have gone further, ours now takes it right up to 2004. It's not the case on the home purchase side, but it was on the refi side. So I don't think there is any disagreement there.

The disagreement comes in whether we think that is a good thing or a bad thing. Frankly, my opinion is somewhat more neutral. I'm not saying necessarily it's good or bad. I'm simply noting that there clearly was a reduction in loans.

And I'm posing a question what happened to those borrowers that didn't get the loans? Did they just not want them? Was it the case that they were in the past targets of what is called push marketing where they were sort of persuaded that this was a good kind of loan but didn't have the burning need, the liquidity need to get it for themselves? Or were there some of them, and our study it suggests it's the highest risk guys, the low FICO guys, that just don't get the loan at all?

I don't have an answer to that, but it's clear there was a reduction.

MS. BRAUNSTEIN: I guess maybe I had it wrong. I've always thought in the past that you were saying this was a bad thing because people who should be getting credit are not getting credit. As opposed to this could be a good thing because maybe the people who didn't get credit shouldn't be getting the loans.

MR. STATEN: I certainly never said the latter. But mostly what we've noted is loans have gone down. And generally when you see that happening as a result of a regulation, generally your impulse is to say there is a problem.

MR. PENNINGTON-CROSS: Can I intervene to make this a little less clear for you?

MS. BRAUNSTEIN: I want to give Keith a chance to respond.

MR. ERNST: Perhaps I would be wise to yield to Anthony at this point. But I want to make an observation. One of the things that has been very clear to me in the studies that have been done to date is in the rejection rates. The applicants who went in and applied for credit in North Carolina were no more likely to be denied credit than applicants in other states without laws under similar settings. And if the law were really the barrier to those loans being made, I would expect a higher rejection rate for applications. Lenders would say, look, we would like to make this loan for you, but the regulatory burdens are too high. Therefore, we have to reject your mortgage.

In fact, we don't see that in the studies. I think there have been some studies that did have a marginal decrease. We had one that did. We went back with data later with another look and said, well, we don't actually find a significant difference in their accounting compared to other states.

But conceding for the point of argument there is a marginal decrease, I think the question becomes is that decrease along the lines that policy makers intended. And that is what our study also tried to take a look at. And I will concede Michael's point that it's very difficult to know with absolute certainty whether you're filtering exactly the right ones. But we've got to ask the questions of the data we have and try to find the answers. And when we did that, we found what looked like a good match up with policy makers' intentions.

MR. PENNINGTON-CROSS: Let me follow up on that rejection comment. My research shows that there are many laws out there that substantially reduce rejection rates, okay. So that is a potentially positive reaction to those laws, perhaps due to additional prescreening by lenders.

We also have to note that rejection rates sometimes are extremely high, over 40 percent, in some states over 50. So it's a substantial issue, this high rejection rate.

So now let me go back. We had a bunch of comments about how the law in North Carolina reduced the flow of credit. Let me also say there were laws that increased the amount of subprime credit. So we had regulations that were passed that actually were associated with quite large increases in subprime. We had other laws that were associated with large decreases in places like Georgia.

So how do we pass something that is regulating a market and have actually applications and originations go up? It doesn't sound like an old-style usury law. That is a point for interpretation, but it's my interpretation that people were uncomfortable, and during this market when they felt it was likely they were going to be predated on. That they were vulnerable, and they felt more comfortable when the law was in place. And when the law covered a large segment of the market, more people tended to apply to this high cost segment.

MR. STATEN: Can I add a follow-up comment to that?

MS. BRAUNSTEIN: Sure.

MR. STATEN: Maybe I'm all wet on this, and those of you in the mortgage business can school me if I am wrong, but when I think about these large national mortgage companies making loans throughout the country, I think of it in terms of the credit card process. I think about the marketing process. We all know how much volume of solicitations we get through our mail, or we get through the telephone in the old days if you didn't take yourself off the list.

If a law is passed that discourages me as a big lender from taking a higher risk because I can't price accordingly, or if I do price accordingly I have to put up with all these regulations, then I'm going to tweak my marketing machine. I'm going to prescreen, as Anthony suggested, and you know they are all doing this. And I'm going to tweak it so I aim to a little different segment of the market, not the high risk guys anymore. The little bit different segment of the market that's lower risk, more qualified. I put more marketing resources into it. My rejection rates go down because they are more qualified, I may actually get applications going up.

MS. BRAUNSTEIN: But is that what's happening?

MR. STATEN: I don't know. But I'm saying that could be the explanation.

Let me just finish. The person is not getting the loan anymore, because they are not getting the call anymore, they're not getting the piece of mail, is the high risk factor.

MR. POSNER: Can I make a point on that? I think some of this debate is barking up the wrong tree. I think there is a fact which I have heard and somebody will jump in and correct that, I think the data suggests that very few HOEPA loans get paid, period.

Now, is that good or bad? I don't know. But the debate so far is about trying to demarcate which parts of the market are good or bad because it's X points or X fees. Meanwhile, the markets that are driving this business are changing every day.

I want to add a comment about what drives subprime loans into default. I'm very skeptical of a regulatory or legislative process that would try to identify that cause and proscribe laws around it. Because in fact investors are studying these issues statistically in real time, and they would tell you it's not just the borrowers' FICO and it's not just the terms of the loans, but it's also the housing market. So booming home prices are going to lead to very different loss profiles than softer housing markets. And it's not just interest rates and the rest of the economy. I'm very skeptical that any research done using databases will be able to replicate that decision making criteria.

So this strategy of trying to say this fee, this point, HOEPA, non-HOEPA, I think is extremely shortsighted. Whereas if we look back at what has gone wrong in the last few years -- I started to mention, I got beeped off -- some of the big problems have been companies like Providian or Household or Associates, and I haven't followed Ameriquest but it seemed to be there had been some issues there. These were problems not of fees or pricing or that kind of stuff, they were problems of cultures and controls at these companies.

And I have no idea how legislation would address those kinds of issues. In fact, what worked really well is consumer activists working together with regulators sensitive to consumer complaints, stepping in and fixing the problems at those companies. So to me that seems like a more fruitful approach. More focusing regulatory reaction to actual consumer complaints.

MS. WILLIAMS: If I can just ask --

GOVERNOR OLSON: Go ahead, Alicia.

MS. WILLIAMS: Because I'm listening to Kenneth, and I guess going back to what Michael said earlier, which I don't think I heard a response to, because I think I heard you say that we haven't identified a practice we are trying to study.

So could you elaborate on what you meant?

MR. STATEN: Well, we don't have an unambiguous definition of what is a predatory term. It's not a high price on a loan. High prices can be fine. It's not a prepayment penalty. It's not high loan-to-value ratio. Those can all be good things in the right hands with the right borrower. But they can be really lousy things, too.

I think that plays, then, any attention to judge whether a law squeezes out some of those terms was effective. Well, is the effect of it it squeezed out those terms, but did it benefit the borrowers? And that is my point.

MR. ERNST: I will recognize it's a challenge. I guess I would say there are many instances in life, safety and soundness is one, where we have a vague concept that we have to try to operationalize. We have to try to find some way to say, well, how are we going to find some guidance, how are we going to provide a regulatory framework that leads to good outcomes, can we find ways to do it.

And I think for researchers our challenge is to say, well, how is this working in the predatory lending context. How are the policy makers trying to get a handle on this, and then to ask questions about whether or not it's worked. And I think we can always work to do a better job of that, but I would say it's not impossible to proceed and try and glean some knowledge from the data that is available to us. It's challenging, but it's not impossible.

MS. WILLIAMS: Are there things that you think the regulatory agencies can use to help facilitate research that you're trying to do in this vein?

MR. ERNST: Well, I do think there are things, and we probably don't want to open the whole Homeowner Mortgage Disclosure Act debate here, but I do think there is additional information that could be brought to light properly.

GOVERNOR OLSON: If I can come back, Keith, you introduced the term "suitability" and then a couple of times you then said "suitability and underwriting." I am familiar with the term "suitability" as it applies to investment products, and specifically not as it applies to any credit product that is carefully underwritten.

In your judgment is suitability necessary in the absence of underwriting, or is it something that we need to have both of?

First of all, I'm not sure that we need a suitability standard in the business if in fact the underwriting is working, but that's my question.

MR. ERNST: I guess where suitability comes from in my comments is sort of a growing recognition that increasing the home mortgage options that borrowers are faced with today are every bit as complicated as the investment options they are presented by investment counselors who are subject to that requirement. We think that a suitability requirement could go a long way towards raising professional standards in assuring that borrowers are being recommended products that serve their interests and their needs.

Now, I think underwriting will also be and will always be a critical component of the process. But just because a mortgage product has been underwritten doesn't mean that -- prudently doesn't necessarily mean that that was exactly or what was necessarily a product, a good indicator that it was a suitability product for the borrower. But I think it's different because suitability goes to what products were recommended to a borrower and underwriting goes to how does the borrower fit into the product that is recommended to them.

MS. BRAUNSTEIN: This is an interesting discussion, because this issue has come up more and more recently in different venues, is that I think our philosophy has been up until now that we have tried through disclosure, through having the disclosures to give the consumers the information that they would need. So that they could make that decision themselves in terms of what is suitable and what is not and do product comparison. As opposed to putting that responsibility on the lender to try and somehow evaluate what is suitable for the consumer, and I would just like to get a reaction on that.

MR. ERNST: Around my point and then I will step away from the microphone. I think actually the flipping standard, we had some conversation this morning about the desire for greater coverage, but I think the flipping standard that was implemented in the last round of HOEPA revisions is in fact a suitability type standard if we stop and think about it. It requests that the loans serve the interest of the borrower, which is the loan suitable for the borrower in these circumstances. So I think we have some precedent in thinking it through.

MR. QUERCIA: My feeling is that many of the mortgage products are so complex, I don't think it's appropriate to put the burden on the borrowers. I think it will make the borrowers have trouble without following the finances and many other things.

GOVERNOR OLSON: Do we have any advocates of behavioral economics at the table who want to speak to how that might impact, how that is impacting the choices?

(No verbal response.)

GOVERNOR OLSON: I don't blame you.

MR. CHANIN: Have there been any studies or research on whether consumer counseling has been of benefit in terms of either pre- or post- in terms of consumer default rates for this market?

MR. STATEN: Well, there have. The one that most specifically addresses homeownership counseling I think is the one that folks did three or four years ago. And they found a definite positive lift if done the right way, and I forgot the details now.

MS. BRAUNSTEIN: They looked at 40,000 loans that are in their affordable goal product, which was targeted for loans.

MR. STATEN: And they got substantially lower delinquency rates on those two or three years out.

MR. PENNINGTON-CROSS: We noticed that that paper is published. So there are technical problems with their selection and documentation in the computer. There is strong support that there is problems with that data.

MR. QUERCIA: I also stand on the reviews. But looking at post-mortgage counseling, and the reason it's most likely to be effective for borrowers that had received prepurchase, before purchase. So there is some kind of connection even after they take their home, or the impact of having received counseling before purchasing a home.

MR. STATEN: There is another study, and it came out in the Feds Consumer Affairs Research Conference last year maybe, on the ability of homeownership counseling to school borrowers to make better choices with respect to prepayment, and I forget the effect on default. But there was some result with respect to timing of prepayment, which suggests that at least it's possible to educate them. It's not maybe going to go all the way to some of these exotic loan products, but it's possible.

GOVERNOR OLSON: I sense the panel is losing a little steam. Maybe that happens at five minutes before lunch and nobody wants to impede on their lunch.

Kim made a point that I would like to just follow up, because I think it's critical. We began, at least I began, the program this morning by talking about extraordinary changes having taken place in the mortgage market just in the last four years. And I would encourage all of us, and it's instinctive for me and it may be for some of you, to presume that where we are now will be a steady state for a while.

But at the pace of change that is taking place, I can only assume that the pace of change will continue to accelerate. There are no destinations, there are only journeys. So I would think that as we look at the changes that are taking place, we ought to keep that in mind that a fix or even an evaluation of today's market may or may not have -- may have limited value as the market goes forward. I will consider that the benediction, unless someone has something they would like to add.

We will now break for lunch, then we are back here at 1:30. And I think the afternoon panel is really important because we are talking about the area of consumer education. And this has to be at the heart of this issue. Then at 3:00 o'clock, again we want to hear from people who would care to speak. And be sure, if you want to speak at 3:00 o'clock, that you have registered.

Thanks very much. It's been a very informative morning.

(Whereupon, a lunch break was taken.)

GOVERNOR OLSON: Welcome back to the afternoon session. We had two, I thought, very good, highly interactive sessions this morning. We've heard from people that represented various points of views that were expressed very thoughtfully and the discussion I think added a lot. This is the sort of dialog I think that we were hopeful to be able to generate from this hearing, so that's an awfully good start.

We're about to start the third panel, the title of which is "Sustainable Ownership: Consumer Education." That sustainable ownership certainly is a societal value. Consumer education is going to go a long way to help achieve that value. So we are looking forward to the panelists.

As we did this morning, we will ask everybody to have their opening statement of five minutes, and that gives us ample and full opportunity to get a lot of dialog and discussion.

Right at 3:00 o'clock we're going to make sure that the people that are here who care to speak would be given a chance to do so also.

We will continue to go in the order from my right to your left, which is clockwise.

So, David, why don't you introduce yourself, your group, and grab the microphone from Michael there, and then we will hear from you first.

MR. ROSE: Okay. I'm unlucky or --

GOVERNOR OLSON: Very fortunate.

MR. ROSE: Good afternoon. My name is David Rose, I'm research director at National Training and Information Center, NTIC.

NTIC was founded by Gail Sacana (phonetic) in 1973 to try to improve the quality of life in neighborhoods across the country. We have been trying to fulfill that mission for the last

30-some years, and one of the things that we certainly learned is that access to credit is central to helping neighbors. But it's not just access to credit, any credit, it's access to good loans. Loans to residents to help them build their wealth and their goals.

There are three points I wanted to try to make today. The first, general consumer education does not withstand high pressure sales tactics, nor do the emotions that are involved in buying a house. Some people are simply not ready to be homeowners and that is a hard truth for many to accept.

As a solution to predatory lending, the arguments for consumer education often blame the borrower. The arguments suggest that if the borrower had known more, they wouldn't have agreed to such a lousy loan.

Often, the real mistake the borrower made was to take the advice of a real estate or finance professional that did not have their best interests at heart. General consumer education will never prepare a borrower well enough to go up against a well-trained finance professional, nor overcome the emotions of falling in love with a home or the willingness to do anything to get one's family into a home or to keep them in a home.

The second point I want to make is that the comprehensive home buyer education can help combat these pressures, but it is a very limited resources.

NTIC works with community groups across the country whose mission it is to improve their neighborhoods. When working with one of our community partners, the borrower receives more than consumer information. They gain an ally that is not interested in simply closing deals, but preparing families for successful homeownership. And the organization is around after the sale to help the new homeowners deal with the inevitable problems of owning a house.

NTIC has developed community corporate partnerships that use the strength and commitment of local organizations to design appropriate loan products and to help families have safer homes.

The third point I want to make is that the industry must be held accountable for its role. Parties that have a financial interest in originating loans dominate the home finance process. It is clear, however, that no one wins in a foreclosure except those investors who pick up foreclosed properties cheaply. Borrowers and neighborhoods lose greatly.

But lenders and investors in those roles that hold the note also lose. They lose financially and in reputation. The industry's willingness to write off a certain number of valid homeowners to originate more loans faster is shortsighted and makes keeping people in their homes secondary.

Today too often the focus is not on finding an appropriate property, an affordable property, but on constructing a deal that reduces payments to what seems like affordable levels. The borrower gets a surprise when the payments adjust or the tax bills rise.

In Chicago after two consecutive years, the reduction in foreclosures started. A preliminary analysis of the 2005 data shows some disturbing results. New foreclosures, for instance, have rose 1 percent in 2005. The number of foreclosures on newly-originated, low-cost conventional loans has increased dramatically, almost doubling from the 2004 number. While new, high-cost loans have nearly disappeared from the data.

The number of ARM and balloon characteristics on these loans have nearly tripled since the 2004 levels. These results raise concerns about the changing face of predatory lending.

A definition of predatory or abusive lending which is geared only to interest rates or fees charged will miss what is going on in the market now. In order to get a small monthly payment, brokers may be encouraging borrowers to accept ARMs, interest-only payment option loans, without the borrower fully understanding the implications of terms.

In conclusion, I would like to reiterate these points. Consumer education is only as successful as it is comprehensive and ongoing. Community groups bring commitment and expertise to keep families in their homes. And industry accountability and regulation must keep pace and prevent the self-interest of the parties to override and prevent sound borrower constituents.

GOVERNOR OLSON: David, thank you. It sounds like you were pretty close to wrapping up.

MR. ROSE: I had one sentence, so I was close.

GOVERNOR OLSON: Whatever you've got left, we'll come back to you.

Mike Shea.

MR. SHEA: Good afternoon. On behalf of 200,000 family members of our sister organization, ACORN, the 150 housing counselors and staff of ACORN Housing Corporation, as well as our board of directors, we would like to thank you for holding these hearings.

These hearings were last held -- I've actually done much more keeping of the trains running on time in policy work. And so because of that, I think I'm fond of certain individuals such as Ben Wallace, the Center for the Detroit Pistons. So I would like to start with some reflections about Ben. Upon losing the NBA Eastern Conference finals to Miami Heat, Ben was asked, "Why, did you lose? The Pistons were a prohibitive favorite, they should have won." So

Ben said, "It was not a matter of skill, it was not a matter of smarts, it was not coaching. It boiled down to a matter of will. We win when we impose our will on our opponent and we lost this series because the Heat imposed their will on us."

I think that is where we are at after six, seven years of battling predatory lending and disparate pricing that is racially based. We know what works. It's five, six elements in the package.

You need good laws. You need laws like we have in New Mexico, New Jersey, Massachusetts. You need very aggressive, tough enforcement, such as the enforcement that happens now in the state of Illinois with Lisa Madigan with her assistants such as Tom James as well as other states. You need suitable products. You need products that are offered to low and moderate income people and racial minorities that fit their needs. And you need lenders who are committed to offering only those products and not unsuitable products.

You also need effective consumer education, combined with one-on-one housing counseling. And finally, you need good post-purchase loan mitigation, such as the Household Foreclosure Avoidance Program.

I'd like to zero in on what we do, which is housing counseling. Our partnership with Citibank and Bank of America, which we feel delivers very suitable products to low and moderate income and minority people and perform well.

Many of these products would in fact be considered subprime products were they out in the open market. Starting with Bank of America, which is our oldest and most robust partnership, through the end of 2005 over 50,000 of our clients have taken out mortgages with Bank of America since we began in 1991 with the old NCNB. Most of the mortgages have been for first time purchasers, but in recent years increasing numbers of refi's.

BMA retains most of our loans in their portfolios. As of March 31, just 1.8 percent of BMA's ACORN portfolio was delinquent 60 days or more, and less than three-tenths of 1 percent were in foreclosure.

What do these loans look like? They are CRA bridge loans qualifying for CRA credit.

Virtually all of those loans come out of urban areas, with the majority of the borrowers being racial minorities. We estimate 37 percent of the borrowers were African-American, 33 percent Latino, 25 percent white, the remainder Asian and others.

Our newest multi-state partnership is Citigroup, and that's only about a year and a half old. We've generated around a thousand loans, several in the pipeline. A sizable portion of those loans are I-PIN loans under the innovative pilot program, and here is the performance.

It's too early to judge the performance, but here is what we have so far. Just about 1.25 percent of the loans are 30 days or more delinquent and just under two-tenths of 1 percent of the loans are 90 days delinquent. The I-TIN portion of the portfolio is performing even better, with just three-tenths of 1 percent being delinquent.

Now -- what does the yellow mean?

TIMEKEEPER: You're under two minutes.

GOVERNOR OLSON: We will get back to this subject. I think that you're on a very interesting subject, how you take us. I won't take any more of your time, but the differentiation between you can take a subprime borrower, bank them into a prime performer. We would be very interested in how you do that.

MR. SHEA: Then I won't brag on our partnerships until later.

So when it comes to curbing predatory lending on a national scale, we believe the real question is does the Federal Reserve and other federal banking agents and lenders have the will to do so. We hope that coming out of this hearings we see a new resolve on behalf of the Fed. If that's the case, then we'd ask you to consider three proposals.

First, we think the Fed needs to help create a massive housing counseling industry throughout the United States. There is only $50 million in housing counseling funds available from HUD. At most, another 15 million is made available through state and local agencies. That is not nearly enough.

Banking agencies should assess a fee to all lenders to help create a pool of funds to build a truly national nonprofit housing counseling industry.

GOVERNOR OLSON: Give us the two topics so you have all three of them in front of us.

MR. SHEA: The second is to amend HOEPA or bank regulations to include a suitability standard.

GOVERNOR OLSON: Okay.

MR. SHEA: And a third is to stop worrying about preemption and right of private action.

GOVERNOR OLSON: Bruce.

MR. GOTTSCHALL: My name is Bruce Gottschall, I'm executive director of Neighborhood Housing Services of Chicago.

What I would want to talk about is our partnership, actually including a couple of our later panelists and about 15 others other lenders and servicers, to prevent foreclosure to troubled borrowers.

The homeownership preservation issue here in Chicago has been operating for about three years, and we have assisted more than a thousand troubled borrowers to stem foreclosure and correct their situations and not be foreclosed on. So over 4,000 borrowers we have assisted in terms of individual counseling to work on preventing that.

We have a 24/7 hot line that people can call in conjunction with the City of Chicago where we counsel people in that regard, and our partner is nationwide through the neighborhood network in states like Ohio and other places. So we have strong experience in that area.

I think I would just like to touch on a few things. We have done some research and surveys with people that we have assisted, and there is some interesting comments around the marketplace and where we are at today.

We know that 50 percent of the borrowers that are foreclosed on never talk with their lender. The lender calls them but they never call back. It's a big problem. We found out that more than 45 percent of the borrowers who contact us but have not contacted the borrower say they don't talk with the lender because they don't feel they can be helpful. They don't understand that the lender has some ways that they can cure the faults and assist them. And even some borrowers think if they call the lender they will foreclose faster. There is a lot of misinformation out there about what is going on.

If you look even further, those who do contact the borrowers, 50 percent feel that the lender really does not have much that they can do for them. So there is a disconnect in terms of that.

We find in our situation that more than 70 percent of the borrowers who are troubled and are in default and heading for foreclosure are due to refinanced loans, so it's the refinance marketplace that is really problematic.

We have also surveyed and looked at those borrowers who contact us and work with us and they find that the third party advisor, someone like NHS, a counselor, is really valuable because they can provide additional information. They can provide the time to look through some solution. They have other resources available for solutions, and they don't have to cut through the various -- sometimes a lender in collection is hard-nosed and beats on the borrower. How then does the borrower go back and talk to them about loss mitigation? So we as counselors don't have that problem to deal with.

We also found that a third of the

people that we work with, when they think about where they are at and why they are in trouble, a third of them thought they never should have been approved for a loan now. They regret that they didn't shop around for a loan, and many regret they actually took out the loan. So the lack of education in that situation I think really demonstrates that. And 20 percent of those borrowers felt that the terms of that loan was some of the cause for that delinquency or default.

Looking at the future and where it's at, and you probably talked about this, but what you might call the boom in foreclosures upcoming. Someone said if 500 billion of subprime ARMs are out there and had been originated in the last few years, those will be coming due in the next year or two. Subprime borrowers to begin with, then, on ARMs after that, rising interest rates, it's a huge, huge problem going forward.

We find that there is a concentration of that foreclosure and hot spots in certain neighborhoods, certain cities. And that although broadly speaking there is foreclosure across the board, certain hot spots in Chicago and other places clearly are there. So a concentration of work in the targeted neighborhoods is important.

Looking at stemming the foreclosure problem and things that need to be done. We are looking at situations where you really need a longer term foreclosure solution. People who have lost a job or had some health issues, they're not going to solve that in a month or two or a few months. So finding new resources, new ways to attack the situation where those borrowers who could in a year or two be able to figure out how to sustain that homeownership, how do we find that kind of solution.

I think the other situation where we now have these exotic products with no documentation, ARMs, you know, interest-only, all those kinds of problem loans that we feel are problem loans out there, really also create a disincentive for borrowers to actually take advantages of counseling. You get a yes now, why do you go through counseling? Even though long term you're going to save money, you're going to be able to be in a better situation. That whole product mix today in the marketplace is extremely problematic.

So that, again, I would reiterate the need for that counseling industry to be strengthened, the enforcement of both state and federal legislation, and then getting at that whole process of the new lending market place where securities and other investors who are so far removed from any negative impact of foreclosures, how do you get at that investor, that system. That creates a lack of accountability for economic problems.

GOVERNOR OLSON: Two things. We will get back to you, but in the essence of full disclosure, I'm on the board of Neighbor Works, and I have a lot of familiarity with what Bruce is talking about.

I was very surprised to learn with the counseling support available to people facing foreclosure, that the difficult, the most difficult issue is finding the people who are facing foreclosure. So that certainly points to the need for greater education.

Ms. Heidi Coppola.

MS. COPPOLA: Yes, thank you very much. Thank you for having a Citibank representative here today.

My role at Citigroup is to work with nonprofit and consumer groups to accomplish three things. To understand the viewpoint and concerns of nonprofit groups and consumer services, to communicate their views and concerns with our consumer businesses so that we have an opportunity to assess our business practices in light of these concerns and views. And to work with consumer groups and nonprofits on pilot programs that serve as a basis for gathering more information and trying new ideas to serve the traditionally underserved.

The partnership with Neighbor Works America, which is what I was asked to speak about today, is a great example of how this model works. After about almost a decade of expanding homeownership for low and moderate income individuals, it became clear in discussions with consumer groups and nonprofit partners, such as NHS of Chicago, that there was a lot of problems. While homeownership was readily attainable, its sustainability was by no means guaranteed.

NHS had the vision to go to data of

those who study the problems in the mortgage market which were leading to unprecedented foreclosure rates with those of us originating and servicing the mortgages so that we could see the impact of the problem on particular neighborhoods.

And they did this in an amazingly objective way. There was no finger pointing, there was no focus on matters outside the control of the servicing and loss mitigation teams. We sat around the table and we focused on what the problem was and how we could solve the problem.

At the NHS table, you didn't have to be a researcher to see what the problem was. Foreclosures are devastating for homeowners and frequently result in loss for the lender or servicer. This was the case, whatever the cause, for the foreclosures, and we were there to fix the problem.

If foreclosures individually are a problem, you can imagine the problem foreclosure clusters were having on whole neighborhoods. Home appreciation declines generally, resale is difficult, that impacts homeowners and lenders. Basic community needs are challenged, small businesses and related infrastructure suffer. Local governments lose money by dedicated resources to problems associated with poorly maintained or abandoned homes. And even the process of administration a foreclosure is costing the government money.

At a minimum, we all saw that there was an alignment of interest among the borrowers, the lenders, the servicers and the local governments. On average, the industry is quoted as saying that there is a loss of about 50 cents on the dollar in every foreclosure. With the servicer input at the table, NHS of Chicago capitalizes on this alignment of interest. And it became very clear to many of us in the lending industry that they were on to something.

As Bruce said, they use the 311 hot line for the City, there is 24/7 counseling, there is local advertising. The Mayor's committed to the program. Lenders and servicers commit to pay for the counseling, and NHS stands as a back up for referrals for cases that are too difficult to be handled through the 311 and 24/7 counseling.

Our experience personally with this

is that in the three years of the program we have had 56 callers that have gone through counseling. And out of that 56, we saved 26 homes. While those numbers don't seem staggering, except if you look at it as a percentage. These are customers who never would have spoken to us. Before they called the NHS hot line, they never reached out to us. So 56 borrowers in the Chicago market actually reached out for help that otherwise wouldn't have, and out of that, over half were able to save their home.

Going forward, we continue to realize that focusing on the 36 or so homeowners having avoided foreclosure without ever having spoken to their lender or servicer is really what we need to focus on.

So we have been working with Neighbor Works America, Chicago's parent, to build what I call the national infrastructure. Essentially it's this foreclosure avoidance programs looking at the specific components. The idea is that it could be replicated in various hot spots, foreclosure hot spots around the country, either in whole or in part.

So we have broken it down into three

different areas. Outreach and education. For this part we are planning on relying on the Ad Council of America in the hope that they can bring public service announcements across the country to foreclosure hot spots across the country with the message being essentially that homeownership is worth preserving and is not as hard as you think. Reach out for help to a lender, a servicer or a third party, there will be an 800 number to support this as well a website. We hope that the Ad Council brings instance credibility, and what we are really hoping for a Smoky-the-Bear-type character that will be associated with this forevermore.

GOVERNOR OLSON: None of those people are young enough to know what that means.

MR. SHEA: Young enough?

GOVERNOR OLSON: Old enough I mean.

MS. COPPOLA: 24/7 hot line counseling, again with an 800 number who will connect the caller to a trained credit counselor who will be prepared to assist with budgeting recommendations.

GOVERNOR OLSON: Heidi, give me the last two points.

MS. COPPOLA: 24/7 telephonic counseling and community-based assistance, which is on the ground referrals to a nonprofit organization that can handle the more difficult situation.

GOVERNOR OLSON: A critical approach. We want to come back and hear more about.

Loretta Abrams.

MS. ABRAMS: Thank you. It's my pleasure to be here today. I'm Loretto Abrams, vice-president of Consumer Affairs for HSBC North America. We have 60 million customers in the United States and we are doing business around five areas of business from banking to consumer finance. And we are an avid member in the communities where we do business and we work hard to make a positive difference to our neighbors and our customers.

I appreciate the opportunity to be here today to share our views, experiences and learnings around financial education. And I will start out by sharing a couple of statistics with you.

While we found that most Americans aspire to homeownership and they see homeownership as a sure path to financial stability and accumulating assets, the pathway is not always very clear. In a survey, we commissioned this last March, one in four consumers told us that affording a home is among their top ten financial concerns. Of particular interest to me in this finding was the fact that 72 percent of the consumers surveyed stated that they understood how to become a homeowner, but only 22 percent said that they understood very well the process of applying for a mortgage loan.

Now, at the opposite end of this spectrum, 26 percent of the people who responded said they didn't know anything at all about how to apply for a mortgage loan. So when we have statistics like that, is it any wonder that we hear people all the time who are in a mortgage product they don't understand or that isn't quite right for them?

So we believe that we can address that disparity through a combination of sound business practices and financial education. And I'm a strong proponent of financial education. We know from many conversations that we have with consumers that it's important that products be helpful and affordable, and that consumers understand the terms and features of their loan.

The good news is today there is more product choice than ever before. The trade off is that consumers don't always have all the information they need to make the choices they need for the product choice that is the best for them.

So we have been educating consumers for over 75 years in one form or another on credit and budget matters, and we are continuing this tradition today. We have a financial education platform called "Your Money Counts." Refund programs for national and regional organizations across the country. We conduct consumer surveys and, I'm sure some of these results are with you today, to make sure we understanding what consumers are feeling and how they feel that their knowledge level is and how we can impact it. We also sponsor programs that focus on credit education, homeownership, pre- and post-homeownership counseling and foreclosure intervention.

Our programs reach kids in elementary schools, college, university students, working families, immigrants, elderly consumers, military families, et cetera.

And I can speak to you a lot today about the specifics of those programs and I will share that in my written statement. But I wanted to get to the fact that share a really quick story about a family in Tucson. Mom and dad, three young kids, all young boys below the age of five. They were celebrating six months getting their first home. She had gone through pre-homeownership counseling and she was very proud and she announced to the whole group of people who attended the fact that she knew her FICO score, she knew what was going to happen in the mortgage application process and at the closing table, and she was able to craft a loan that was right for her, saving money on her mortgage that she's putting into savings to send those boys to college. And she was very proud and we had families in those rooms who were nodding around the table. So they really do get it and they want it.

Four things we learned. One size does not fit all. The programs need to be customized. Find a partner to work with. Partners with community-based organization who understanding the community and the needs and who have credibility within the community.

Move the needle. Don't just screen people. When they live that room, they need to leave with a call to action. We need to tell them what we want them to start doing differently so they can start doing it tomorrow and keep on doing it.

And finally, check back again. See how they're doing. Keep doing surveys like this, keep asking people what they need and how we can help so we can keep on customizing programs and keep on educating people so that they understand their products and choices.

And I made it. Thank you very much.

GOVERNOR OLSON: That was very well done. Thanks to everyone.

Let's come back, if we can, and I think, David, something immediately leaps out from your presentation is a fact that I absolutely agree with. That when someone is emotionally involved in the purchase, something like a home, that it is very easy for a predator to prey on that emotion and sell somebody something that shouldn't get to them. And that education will take you part of the way.

That emotional components is always going to be there. So for the element of it that you don't address through education, how do you address it?

MR. ROSE: Well, that's where it comes down to who is at the table when the decision is made. I mean, it's a broker, it may be a contractor, if it's a home improvement loan, that is acting as a broker for the loan. They are going to use all of those emotional buttons to get you to do the thing that is in their best financial interest in a worst case scenario.

So it's really a question of holding these individuals accountable to a standard that says, "Did you share the range of options with this homeowner?" I mean, I had a heating and air conditioning contractor in my house who wanted to replace my air conditioner for $5000. He was going to charge me 18 percent interest. Now, I knew that I had credit cards at lower interest rates than that, and that I could have charged the services and not involve putting a lien on my house in order to do it. Now, it turns out that another individual that had come in and looked at my heating and air conditioning told me it wasn't a problem. He fixed it for about 50 bucks.

Now, those are the kinds of scams that are out there. Those are the things that are very difficult to train somebody to withstand. The argument he was giving me was, "It's winter, I can do this for you cheaply now. But if you wait when it's hot and you're going to need this air conditioning, it's going to be a lot more money." Those were the kinds of arguments that are used.

So you're not going to be able to prepare the general public to withstand every variation of the scam that a predator is going to come out with.

GOVERNOR OLSON: Mike, coming back to you, you started talking about the need for housing counseling, and we just had time to talk about your other two points. So why don't you just complete what you wanted to touch on on those points.

MR. SHEA: Sure. I'd like to make a short comment, if I may, on the question you asked David as well.

There has to be a suitability standard in our view. There will always be an imbalance in knowledge between the typical consumer and a professional like a broker. It's always going to be the case. And we don't expect when one has a medical problem that you have to read the New England Journal of Medicine and get educated to that level to be able to hold your own when you go talk to a doctor. We expect that there are rules and regulations that apply to a doctor so the doctor is going to do right by the consumer.

We have to have that in mortgage lending particularly. And the reason we favor suitability standards is because the way the industry has changed so fast in recent years.

I mean, we recently were looking at the annual reports of large subprime lenders in New Century, which is now the second largest subprime lender in the country, now has 43 percent of all their loans are stated income loans. Four years ago the last time these kinds of hearings were held, it was less than 10 percent. We have seen subprime lender after subprime lender moving to stated income loans.

So it's a very fluid, fast environment where regulators have to have some ability to rein in that kind of practice. You can't expect that consumers on their own are going to be able to hold their own against professionals.

GOVERNOR OLSON: Bruce, keep going on the subject of the counseling you do for people facing foreclosure. Because that was certainly illuminating to me to understand the reticence of people to come forward when they need help and the role that you and others can play. Then we'll come back to the partnership that you have with financial institutions also.

MR. GOTTSCHALL: I think one of the main areas is the whole getting people in contact with somebody. So that is why I talk about the third-party advisor and the ability through relationships with the City of Chicago, relationships with churches, block clubs, it's a marketing kind of thing that we do to get people calling either to the 311 number, which is the City's service number and connecting them to the counseling, or coming directly to us. And I think that third-party advisor in a non-threatening situation does, as we have seen, bring people in that would not contact the lender directly.

Then the situation is how do you provide the kind of understanding of their particular situation, what kind of resources NHS might have available in terms assistance in the counseling, the ongoing budget counseling, as well as other resources that the small loans, the catch-up kind of resources that the lender would not have.

And then also working with the loss mitigation people at the servicers so that they are proactively working on what resources, what kind of loss mitigation tools they have. There has been a shift over the last few years in terms of that being a much more proactive effort on the loss mitigation side in order to find solutions early on.

We found earlier that there are so many changes out here, that if you're not 60 days past due, we can't really talk to you about any solution. So the process then of the lender collecting, which is the hard-nose-kind of thing, then at 60 days and 90 days, well, now we can talk to you about what loss mitigation there might be. So tools that both the lenders and we are trying to figure out where it's most appropriate to do those loss mitigations resources and working through problems rather than just the, "Hey, you need to pay and this is what we need now."

So that is part of the process, then, where the lender can see the value of using a third-party resource referring somebody, if that's a broker, but also then the third-party resources to be able to contact people and get them into the loss mitigation system and going through the process. So it is a combination.

Truly, there are a lot of people that we can't save. I mean, there are just many, many situations, and part of that is just the lender underwriting process up front.

We haven't talked a lot about the fraud problem, but fraud is an increasing problem through that whole area of mortgage lending, and then the problem of now rescue fraud, where people are in difficulty, in default, and they're being approached with fraud around how to save their home, and it just enhances their loss. So there is that kind of activity.

So all of these I think call for kind of both the public education, but then really also the continuing enforcement and strong reinforcement of what is on the books. As well as figuring out how do you now, if it's not interest rate, what is the loan characteristics that you look at more closely and require disclosures or third-party advisors to assist? Or something that creates the capacity of that borrower to have some additional reinforcement support to be able to counter what might be the push marketing, or if not, clearly incorrect advice that the mortgage broker may be providing to that credit borrower.

GOVERNOR OLSON: Heidi, keep going on that theme, because you are the partner on that. I'm interested in your experience, but could you elaborate on the 50 cents and the dollar loss that you -- because I think that there is some real savings available to financial institutions when they get involved in that process early. And clearly, at least from what I hear, that there are some incentives all around to avoid the foreclosure experience.

MS. COPPOLA: Well, I think the dollar amount varies, but the point is that there are a lot of different costs that get factored into it. Maintaining that -- well, the person in the home is not paying their bills, they are also not taking care of their home. So there is a tremendous deterioration factor. So if we do end up owning the home and we have to sell the home, it's not worth nearly what the home was worth when they took out the mortgage.

In addition, we're paying the costs once we get this home. We have to pay the costs until the home is sold. So we have the cost of maintaining this home. All of this gets factored in, in addition to the fact that there are fixed costs like the foreclosure process and the delay that that, you know, legal costs and just all of these costs add up. And I think that all of this gets factored into this. And if we sell the home at a fraction of what the market value is, it doesn't reimburse us for these costs.

So that in addition to -- I have to say this is more and more becoming relevant, in addition to the reputational risk involved in foreclosing on homes, particularly where you have hot spots where there are multiple foreclosures from your institution. It's just not only a financial consideration, but all around what is good for us financially is also good for the community and good for us from a reputational standpoint.

GOVERNOR OLSON: Heidi, you had a point that I think the financial institutions are realizing, at least among the more credible financial institutions, is the importance of reputation risk. And the reputation risk, I remember 15 years ago as a counselor to financial institutions, was very fuzzy, not very well understood or enforced -- enforced is the wrong word -- managed the risks exposures.

About three years ago a person came to me and said -- and identified the bank she had formally worked with, and said that bank would still be around today if it were not for the reputation risk exposures. So I think that that is an important responsibility that management now focuses on and clearly supports a lot of things that ought to be happening in this field.

Loretta, come on back to your four points, and especially I'm interested in how you go about partnering. Because as you pointed out and as we've seen, the community groups have access the financial institutions don't.

MS. ABRAMS: Right. Well, there isn't one way. We have a number of programs. One of our programs we will talk about is our financial education grant program. There is a million dollars in grant funding every year that we provide to organizations to help support the financial education programs they're running in the community, and there are very few strings. It's an open sort of grant. RFP competitive bid process.

And what the community groups like about that, we look for well-established community groups who have existing programs, who have sustainability, who have strong management. And we just look to support them and not to tell them to change the program or do anything differently. Just to help them to keep what they are already doing, which they decided is good for their community. So that is one of the programs we have.

Another is the adult financial literacy workshop program, where we work with a national organization out of Washington DC, and they find grass roots, community-based organizations who don't necessarily have a program capacity or the capability or a curriculum, and we work with them to submit and to produce workshops using our curriculum. And we then fund those workshops on a per-workshop basis with those smaller community groups. And over time the process of working with us in this program helps them to develop capacity. They apply for other grant funding, they get reputation, more credibility and sustainability within their communities. So that is two ways that we are doing it.

MS. BRAUNSTEIN: I'd like to ask some follow-up questions. One is we hear a lot about teachable moments in financial education. In particular I know -- and today we are focusing mainly on homeownership education.

But in financial education in general, there are a lot of programs out there that teach people and then they administer afterwards some type of test, and they usually score themselves on how well they did based on how people answer these tests. But in fact that may not mean much, because really what we are looking for is behavior change. And if six months later something happens and people don't remember what they learned six months earlier, what good was the financial education?

I was just wondering in terms of what you do, I guess particular the practitioners, Michael, David, what can you tell us about what you've learned about teachable moments, especially in light of, David, what you talked about when people get to the table and they are being bombarded by, you know, whether it be the brokers or the salespeople, how good is that education? How is that holding them in stead? What have you learned about that?

MR. ROSE: I think our approach may be a little bit different. Because a lot of the groups we work with have bank partners that they will help those banks market their products, help them find customers. And it's all part of the home buying education and process.

So in a sense, the lines get kind of fuzzy between who the broker is. In a situation like that it may be that you can call it a community group type of broker in some situations, although they aren't a broker in any formal sense. They are simply putting the homeowner together with a loan officer at a bank.

So I don't have that kind of experience in terms of doing an education program that really withstands those kinds of pressures when you go to a broker who will say anything he or she can think of to originate the loan.

In 1999, just very quickly to follow up, when we started working on predatory lending in Chicago, you know, the conference. One of the individuals we invited to speak at the conference identified himself as a recovering loan shark. What he was is a used cars salesman, from Minnesota I believe, who had been recruited by a lender to be a broker. And he explained how he had been shipped off to California for a 30-day training program. How he was taught this script inside and out.

And he began his presentation by asking everybody in the room how many people would like an extra $500 a month. And you can imagine there were city officials, church people and community groups and bankers, some housing counselors. Everybody raised their hands. And he said, "Would you agree that you want an extra $500 a month, there isn't anything you can say that I don't have an answer for?"

And that kind of arrogance, really, but that kind of persistence in closing a deal is what you may be up against in some cases. I don't think you can prepare any homeowner to stand up to somebody who has that kind of training.

MS. BRAUNSTEIN: Mike.

MR. SHEA: We have been looking at that question quite a bit the last few years and where we are zeroing in on are cash-out refi's. And typically people get trapped in the subprime cash-out refi because and emergency comes up, and typically it's divorce, medical, the car breaks down, or debt consolidation.

For the emergencies, we have to deliver our message and our services almost in a just-in-time fashion. When that emergency hits, people are desperate to get cash. And that's when they are most susceptible to the messages of the predators.

We have tried a number of efforts to copy what the predators do. We bought all sorts of lists. You would be surprised what kinds of lists you can buy. You can buy lists of recently divorced people, so we have done mailings to those folks. We have use automated dialers to those folks to try to reach them and bring them in. Mixed results.

For one thing, it's very expensive. You have to keep doing this time after time, month after month. And that's what the subprime lenders do. We once had a subprime lender tell us they spend $1500 in marketing, if you take their total marketing and outreach and apportion to loans closed, it's about $1,500 a piece. We can't compete with that.

MS. BRAUNSTEIN: That's why they charge such high fees.

MR. SHEA: I'm not sure that we can compete with it. That's why as much as we do more consumer education, I think, to more people than anybody the country and it's invaluable, but we have to have better regulation to stop this.

MR. CHANIN: Let me follow up on that, and Loretta mentioned one size doesn't fit all. Are there different strategies -- I'm interested in your successes, but also your failures -- strategies you have employed for different groups? And if so, what is the demarcation among groups for different products?

You mentioned cash-out refinancing verse first time home buyers, different markets and so forth. Have you gotten to the stage of learning that certain strategies or educational approaches work for some groups of consumers or certain individuals versus others and certain products and the like? And for anyone here actually.

MR. GOTTSCHALL: Well, if I can add just a little bit here. One of the ideas of the 24/7 counseling by phone was that if someone is thinking of a loan and in the middle of the night they see something, they have the brochure, that they can actually call and talk to somebody right then rather than folks getting the call back and the moment is gone. So 24/7 counseling on the programming side is a benefit that we find useful for getting people into the system so then you can follow up.

So we found that the City is actually credible with a lot of people and that 311 number is a number that most people feel okay calling. We found that some of our marketing through churches, we did a preservation Sunday and had churches doing their brochures and doing the 311 calling and do those kinds of things in those places.

I think the other piece in the refinance is a critical area, and you describe 72 percent of the people that we are seeing are people that are in the loan that they are not in trouble with as a refinance. I think typically in a refinance situation people probably don't have a lawyer, probably don't have a third party helping them in that situation. Where with the first mortgage, they may more likely have it.

So maybe there is some way there at that closing moment to really have some requirement or some system where people are getting that advice and getting someone with them judging what can be done. Because clearly that's a very teachable moment. If at that time rather than at some clients you say, well, if you get an 8 percent loan, it will cost you this much, and you get a 11 percent loan over 20 years you're going to save this much. If they are at the closing table if you live here, it's going to cost you $40,000 more in payments. So there is a way at that point.

And I think on refinances, and the cash-out is the place where people, they have a problem. And they have someone got to them around that problem and they did something, and then later, as we see in the numbers, they regret having done that. But they didn't have anybody to work with right then.

So we're looking at whether this 24/7 phone thing is how if one is thinking of refinance, call here and describe your situation. So I think there are those kinds of perhaps opportunities.

But then how do you market it? How do you get it out enough? As you said, $1500 per closed loan is a lot of money for marketing, and competing with that is very, very difficult.

MR. SHEA: A couple of things we found don't work. Direct mail, and actually a guy by the name of David Hill used to be a marketing director of

Fannie Mae until recently, did some research on this. And he found with statistics, what we found that in our experience direct mail typically is highly ineffective. It's almost as effective with Latino families, more so than Mexican-American families, but recent immigrants from Central America in particular direct mail is a total waste.

Radio works in conjunction with events for African-Americans, particularly church-based events. We found that that is a very highly effective way to get folks to come to the events, particularly if you're using radio ads to spur that. Again, it's expensive and you can do that in the little run, but the radio ads in Chicago are very extensive, so it's very difficult to sustain that over time.

MS. WILLIAMS: So as you talked about education, and, Bruce, I heard you mention that you have consumers that don't even talk to the lender when they have the problem and some that even if they talk to the lender, nothing will be done.

So what do you think fosters that belief, that the lenders are not approachable or they won't get the assistance that is needed to help them when they have a problem?

MR. GOTTSCHALL: Well, I think, one, if you look at the situation that someone is in default, maybe they are stressed, what was their relationship with the broker? The broker is the lender is the servicer. So that relationship, although it's unclear, sometimes the troubled borrower is not going to a broker. But there is a relationship there, and if they see the broker that maybe gave them a loan that they now regret.

I think another piece is the collection process is sometimes hard. You want to make sure people are clear that you want to be paid for what you owe me. So that that creates, then, a beginning relationship that if then 60 or 90 days later, they call you and say we really want to kind of help you, how do you get over that? How do you get through that? So it is a difficult kind of relationship that a lender servicer, how do you manage that needing to do both?

MS. BRAUNSTEIN: Excuse me, Bruce. I know that when we talked about these kinds of issues four or five years ago. And since then what we hear over and over again is that the number one problem with getting people in trouble to contact anybody for help is that they are embarrassed. Initially, that they are just ashamed that they are in this problem, and by the time they get around to contacting it's so late down the road.

MR. GOTTSCHALL: After the surveys that they did with people who helped us, that was not as high as not realizing that there was some hope. So if there is the embarrassment and people not wanting to -- and some people believe, well, I can solve it myself. But we found actually it was more you have a feeling about if I talk to somebody, that there is nothing they can do for me. So the lack of hope there was a bigger one than embarrassment. Although embarrassment was in there.

So I think that was slightly different. You have to deal with both of them in thinking about how to approach it.

MS. COPPOLA: That confirmed the Freddie-Mac survey in 2005. There is a survey about why borrowers don't reach out to their lenders. And I think the larger percentage is clearly that at this stage at that time this point in time.

But can I address this range of issues as well? I think that while there is no silver bullet here, at City we are looking at this and making sure there is a consistent message that we get out in multiple ways. So we are relying on the Ad Council, we're relying on our own financial education curriculum and we have about 10 or 12 partners that we provide our curriculum to. We amend the curriculum every year and a half to two years after a survey to find out what is relevant, what is being received well, what people don't understand, what needs to be done. We just did a major revision on predatory lending and how to avoid predatory lending.

I think the message has to be find your own provider. If somebody is knocking on your door, you should definitely shop around and you should always ask for them if you feel you're not in the best position to make a decision. And I think those messages have to be communicated every which way we can think of.

And ultimately, it's like a shifting paradigm. We have to make sure that this gets out there and public awareness is raised so that people understand and that it clicks. When they see the 800 number in their community, they say, "I do remember seeing something. I do have to reach out and call for help, this is probably the right place."

MS. ABRAMS: We are working on some of the same issues together, and educating the consumers just to be aware that there are options and there are certain places so that they know when that moment does happen for them, and it happens with all of us, we are going to hit that bump in the road. And when the bump in the road happens, to know where to go.

It's very difficult to regulate human behavior. People who are going to cheat are going to find a way to cheat. And people who are behaving sort of in a certain manner that maybe isn't always in their own best interests, sometimes we don't know what we don't know.

And that's why education is so important. Getting people in seminars and in workshops to say did you know this. And we see that a lot. We see it every day when just telling people about FICO scores and how it works and how certain behaviors are impacting FICO scores. You hear people all the time about "I didn't pay that $12 phone bill, it's not mine." So just telling people, "Pay it. Still fight about it later, but pay it for right now because it's effecting your FICO scores." Just those kinds of awareness and those kinds of "uh-huh" moments happen all the time. And it might not be a problem for them today, but they find somebody else in the family who has a problem later on.

So as we spread the word, increase awareness of about all of these financial issues and everything that goes along sort of this financial landscape is going to be helpful. Because people will recall when they need it, they will know where to go and get it. And it will be all of these places.

MR. SHEA: Can I add one more thing on this? One of Nathan Hill's most significant points they found was the role of the trusted advisor and how the trusted advisor varies from population group to population group, particularly along racial lines.

So what he found and what we find in our experience in the African-American communities, the trusted advisor that the individuals go to first is the real estate agent. When they need -- definitely when they're buying a house, but also when they're refinancing. In the white community, it's parents and other family members, but particularly parents. Latinos, his research I believe showed that it was church, and church I believe was the first place they would go.

So we've tried to gear our efforts, we try to take that into effect so that we spend a lot of time working with real estate agents. So that when they get that call from a borrower that needs cash and is in danger, they are going to refer them to us or to another counseling agency.

MR. ROSE: I have one more thing. Partnerships with City and SPS and ACORN, the local community organizations that I think do the best work at outreach, have been the ones that incorporate the message into all of their meetings. So they might be having an organizing meeting on crime and drugs or some other issue, but this will be the message that there is a place that they can call who will come in and talk about preparing their credit, repairing their loans is made a part of those meetings. So it's another avenue of outreach.

GOVERNOR OLSON: We have had a couple comments about the teachable moment, but also linking education or financial literacy with the mortgage process itself.

And, Mike, you started to talk about your programs with two institutions. And I heard you say something like -- and I'm not sure if I got it right -- that these are loans that in a different environment would have been subprime but are not now.

Does that mean that the terms have not subprime, the performance is not subprime because of the additional application of counseling? And I would be interesting in hearing the same thing from the two lenders.

MR. SHEA: All of our partners -- the products made available through our partnerships all have several underwriting flexibility, but two in particular that make them unique and that makes them what I would call subprime if it was outside of our program.

One is undocumented income. So with Bank of America and Citibank partnerships, they both accept undocumented income up to a certain percentage of the total income that an individual can have. The reason they accepted it is because they know that our housing counseling will in fact go verify that income as best they can. So if somebody coming to us, we find out what their undocumented income, we call the source or else we make the clients go back and bring us some evidence that that really is there. Furthermore, we make an evaluation that it's going to continue before we then refer that individual to the lender.

The second is underwriting based on corrected information contained in the credit report, but not on the credit score. We pull about 30,000 credit reports a year, and we estimate that 30 to 35 percent of them will contain significant errors in the information and in the credit score in particular. And it's our experience African-American borrowers in particular are likely to have many more errors in their credit report.

GOVERNOR OLSON: Is the source of the loans that have been paid or is it confusion of one borrower's experiences with an unrelated borrower?

MR. SHEA: Both. It's a whole gambit of

things. Both of those examples. And also, vendors sometimes don't report when you pay on time, but when you are late they do report. And we find many more of those kinds of vendors in the African-American community.

What happens with those same people with undocumented income or lower credit scores go to a mortgage broker? In most cases they are going to end up with a subprime loan. And if it's undocumented income, they are likely to be put into a stated income loan. And if they have credit problems, they are likely to be put into a 228 327 loans since that is the bread and butter of most subprime lenders.

And as Bruce alluded to earlier, we are facing a real crisis now. Particularly in California. Our friends at the Center for Responsible Lending says there is six million loans that are going to repost with interest rates over 10 percent between now and the end of the year. One million of those in California along.

Our counseling offices in California, Miami, some on the East Coast, high cost markets are increasingly seeing people come in now with

327/228 that are repost and there is no way they can afford it when they repost. So now they have to refinance out or else they are going to be down that road to foreclosure.

Now, if they come in our program, they would have gotten a fixed rate mortgage, they would have gotten counseling. If they ever get below on their mortgage, behind on their mortgage, we're notified of that fact and we aggressively pursue those borrowers to help them.

MS. BRAUNSTEIN: I have a question about -- this has come up from time to time, it even came up the last time we did these hearings and still comes up over the years. We get asked why in your HOEPA rules did you not require that anybody who gets HOEPA loans has to have housing counseling when they get those loans. And I know that HOEPA loans are a really small part of the population. So I'm thinking theoretically here.

So suppose it somehow expanded to higher cost loans or complex loans, if there was some way that we would or that the government could require people to have counseling that are going to take out these complex products.

And one of the issues that we've always struggled with about that is that there is counseling, and then there is a counseling. And that was brought up by this panel. There is a big difference between spending two hours on the telephone with somebody getting housing counseling, and having comprehensive housing counseling as it was called in -- I think was it you, Mike, that used that term or somebody here used that term comprehensive housing counseling, where it's usually over some period of time and it's much more, much better quality.

And, you know, controlling for quality and quantity and how do you stop, frankly, predatory lenders from printing up business cards that say "housing counselor" and handing them out to their clients and saying, well, the law requires you have housing counseling, so I can do that too. Or my friends John over here does that and he can do that.

I just wonder this issue keeps coming up, the importance of this education, the importance of having somebody like even Bruce at the table with you. Is there a way around these issues? What are your thoughts about this kind of thing and how could it be done in a way to control for quality and substance so that it's meaningful? So that there are there aren't a lot of loopholes and that basically it really isn't very meaningful.

MR. GOTTSCHALL: There are just a couple of things. It is a critical question right now. Freddie some years ago did a study showing the value of counseling as compared to the more limited counseling activity and demonstrated the value. It was very difficult to get anybody to really economically quantify that and recognize that within the system in terms of paying for it, but it was there.

Now, changing situations on my comments on the lending and the getting to "yes" and people saying yes to just about anybody, and now I think one of the secondary market groups is saying counsel may not be necessary anymore for some of their products.

We have a situation where the counseling, you know, question is going to be a critical one. My sense is the transparency question, and a lot of people talk about transparency and how to do that, it seems to me even with a third-party kind of advisor or an extremely public and transparent situation that you can combat some of this. Because I agree with you, how do you certify counseling. Neighbor Works of America is doing that, and that is increasing the number of good counselors. But there is still a lots of opportunities for problems.

So transparency, and then how do you publicly create that transparency. And then managing the brokers who are actually making the bad loans and keeping that in front of everybody so that people are not doing business with the broker who has taken advantage of people and has a high early default, foreclosure record. How do you keep track of those brokers who are causing the problems so they are held accountable on those situations and you can't get financing for the people that are not making -- providing good advice and really working with them.

So that doesn't really an the question, because I don't know how you certify to the point of getting only this six to eight hours of counseling by a certified counselor recognized and really done in a broad case. But on a more limited transparency and public record of some kind that creates more awareness of who is doing good and who is not doing good.

MR. SHEA: There needs to be more study done on this question. But the Bizar (phonetic) study said and I think what our lending partners would agree with us, most effective is one-on-one counseling. You can't beat that. Next is phone counseling, the last is going to a class. And below that is reading a booklet and taking a test. That is the hierarchy of effectiveness.

This is not rocket science. People know this. Bruce's operation is an incredible operation. NTIC has very good operations. They provide quality counseling, put people in houses and keep them there. We do the same thing. I think people know how to do this.

The problem is there is not a funding source or stream or plan to build a nationwide housing counseling system. We work all over the country, and when you say make it mandatory, I have to scratch my head and say, gee, what if I live out in Uma, Arizona and is no housing counseling agency out there, what do you do? That is the big problem. We don't have a national housing counseling industry. I really strongly feel it's partly your responsibility to upgrade that.

GOVERNOR OLSON: We have come back to our lenders now, too, on this issue of counseling at the front end of the mortgage application process, especially for the HOEPA-type borrowers, not necessarily the HOEPA, the HOEPA-type.

MS. ABRAMS: Two things. On the front end of the process we work with a number of organizations who do this and who do this. And we have products that are our CRA products that are designed for the markets. So the people are being counseled all the along while they are saving for that first down payment, and that first down payment is sort of assisted and matched for a particular product.

So you have a record of these people coming to a training or a homeownership preparation class over a period of about six months. It's been shown that those loans do perform better. People know exactly what the process is going to be like. They fully accept homeownership and they agree it's right for them. They know that they are in a product that is affordable and they know how to stay in the home.

On the other side of the coin, we have really good experience with our consumer rescue loan program. And that is a program that we fund with NCRC where we rescue consumers and basically put them in a loan that gives them a fresh start when they have had problems and they're facing foreclosure due to loan problems or servicing problems of that kind. That process requires some ongoing counseling, two or three hours of counseling before the, quote, rescue happens and before they get a fresh start.

And we find that we have pretty good results with that, but we could use more counseling. I think I agree with Mike. It's not a one or two hour type session. It's going to take some a long time. Particularly if people don't have -- if it's for many times they are first homeowners in their family and there is not a homeowner legacy and there is not lot of experience. So the whole process is mysterious and new. So it's going to take longer for some borrowers when they face of these issues, and it's generational and cultural and a lot needs to be addressed and I agree it needs a lot more study.

MS. COPPOLA: I think we focused on this for several years now, but we are just at the point where we try to focus it on the point of view from gaining empirical data so we can use this information. But I do think you have three preeminent financial counselors here and the city has relationships with all three of these organizations and I believe there's tremendous value to that.

But in order to really understand how it has to be structured going forward, I think we need to be able to look at this in more detail and statistically. I don't know if there is all begging your question, if you're asking about the legal consequences of imposing mandatory requirements. Because in terms of a community relations, I don't think we are necessarily the right people to address that and I think it has been addressed or try to. I think there have been legislative efforts that have been filed in this respect for reasons I think that we have stated.

But I think it's proof that there is still value. We are all at the table trying to figure out how to get the product out in best form possible as broadly as possible.

MS. BRAUNSTEIN: There was a strong attempt at that with the creation the HECCI year ago, a national organization, and yet that went down the tubes and I don't know what that tells us. If that was just an isolated incident.

But that was I think people had some fairly high hopes for that. Creating, as you talked about, Mike, a national industry where people would be certified, there would be a national certification of housing counselors and it failed.

MR. GOTTSCHALL: I think Neighbor Works America is working to continue that kind of thing. But you're right, the method and idea that, hey, this is going to be a national network I think got into the fact that some people, and probably those around the table now, would then you have the other computation who is not going to do it in someone is not doing it, they have an advantage. So you have the whole timing problem in terms of what the level the requirement is on some people and not on others. So that creates the dynamic of, unfortunately, lowest common denominator in some cases dictates what happens in the marketplace and that's the problem.

MR. CHANIN: Let me ask a question to the lenders. It's been suggested, questioned a little bit, but suggested there may be some consumer push back at least in certain circumstances to counseling, and let me lay out the fact pattern.

A consumer is approached by a broker or lender and they look at their watch and say in two hours I can get you a loan. So that is one choice, as oppose to going through multiple hours of counseling, classes, whatever else it is, to find if you have a suitable product for a consumer which may be one that has a lower rate and can fix credit score problems those kinds of things.

Is that something you have seen? Is there any validity to that concern, to that argument or --

MS. ABRAMS: I think that consumers are motivated by different things. The ones that are in the workshops, that are coming voluntarily to homeownership counseling, want to be there. Want to be educated, want to be involved in the process.

But I see just as many others that go I don't need, that it's not right for me, I'm not going to do that. Or you're trying to provide people with information and they go, no. So again, we are still looking at it and still looking hard at it.

MS. COPPOLA: But the incentive for many of the consumers who go through financial education through City-sponsored education is a better priced loan. So I think there is truly a character that keeps people like that.

MS. WILLIAMS: I just had one other question.

You know, as I listen to the different types of counseling, and we talked about there is some a couple of hours, there is some that is a little more comprehensive, and comprehensive being very important in the process. And then this thing that we hear sometimes even though you have training, it doesn't necessarily change your behavior, but you can still get in a bind.

And we have a lot of, you know, you

get inundated with a lot of paper, even when you just go through the process in and of itself. And it's pretty frightening I'm sure for many people. It was frightening for me my first time through it. And it's something that Heidi said that kind of made me think that in addition to going through all the training that you go through to sort of maintain your home, that is there a way that in addition to all the papers that you get, that you can have, like, I don't know, the four key things that you just must keep in your mind in addition to everything else that will kind of help you through the process?

And I heard you talk about, well, you know you should make sure that you shop. You should make sure that you know you have options. There are people that you can trust. So they always say that if you repeat the same four basic messages over and over and they are getting it from various locales, and I'm not sure that systemically we do that. I mean, do you think that would help in the process like that?

MS. COPPOLA: You know, it's interesting. I come from a securities law background, and rather the Miranda warnings, when banks got into the securities business and behind every retail broker in a bank branch you had to have three or four points of disclosure. Past performance is not indicative of future performance. Your security deposits are not insured. You remember all these? They are very valid points and we built them into our curriculum as black letter. This pages starts with this heading and then it's repeated consistently throughout.

I think it's an interesting idea. Again, in the securities context we used to add disclosures to the confirm, right, until you filled out the front page and you filled out the back page, and then nobody writes it anymore because it's too much, right.

Mortgage documentation, if I don't read it and I'm a securities lawyer and education and background, if I am not reading that because it's too much, you know that people are generally not reading that.

So I think that there is something to some kind of bullet point. I don't think it's the cure all, but I think if you can boil it down to something like that that gets repeated, people will ask questions about it and begin to understand it.

GOVERNOR OLSON: One of the points that hasn't come out and would have been a good question, had I thought of it, with the prior panel, but let me just test it here as well.

There is an underlying presumption in all of the regulations that we have with respect to mortgages that there is enormous societal value to homeownership and you often hear statistics or you hear statements made. In fact, I think that I know at the Fed we have recited those statistics, that homeownership correlates with other values. Like the tendency of a nuclear family to stay together, perhaps to be involved in the school system or participate more broadly as a voter.

I frankly have not seen the empirical support for that. I suspect it's there, but I haven't seen it. But I would be interested in your real life experience. If you can detect that there is in fact that sort of societal value of homeownership, any of you?

MR. GOTTSCHALL: Well, we clearly have many, many, many examples of people who we assisted in buying homes that bought on the block that was a problem block where they and one or two other homeowners got together and worked on getting the gang off the corner, worked on improving the school, getting involved in the school, beginning a block club. So clearly those anecdotal pieces are there. I think there is empirical information around that.

The other, of course, is the wealth building. Many, many examples of people buying, being able to finance kids going to college and all those other kind of things. That is part of the process.

I think the other one that doesn't get touched on quite as much and there is more regulation around the homeownership thing, is it goes beyond the individual's impact. It's goes to you have a foreclosed house, it's different from taking the car off the block and putting it away. It's an abandoned and vacant building and it's a community asset problem. So the broader regulations and the broad negative impact of homeownership not succeeding because of these kinds of problems is much more graphic and much more dramatic.

So you have both the positive and the much more negative. So that is why the regulation around it and the focus on it and the education is so much more critical -- maybe not more critical, but much more visible in terms of the impact.

MR. SHEA: We have an affiliate organization called Project Vote, which is one of the largest nonprofit voter registration organizations. And in our written comments I will give you the exact data to include it, but they tell us that homeowners are two to one more likely to register to vote and three to one more likely to vote.

GOVERNOR OLSON: All other factors being equal?

MR. SHEA: That's across racial lines.

GOVERNOR OLSON: So if you correct for all the other variables and you can isolate that variable alone, interesting.

MR. ROSE: I think it's true, too, to point out that what we are talking about is successful homeownership. So what doesn't get counted in the homeownership rates, homeownership rate is really a net static. It's the net of those people who got loans and those people who were successful homeowners and those people who lost them.

So where successful homeownership is obviously good for the wealth building of the family and good for the stability of the community, to push somebody into homeownership before they are ready or to sabotage their efforts, that's the down side to it.

GOVERNOR OLSON: I think that's the point that Bruce is making, too. That with that upside, there is a greater down side potentially.

MS. ABRAMS: I have to share another static that came out of my survey. We felt that overwhelmingly people wanted to be homeowners and understood the value. Over 70 percent say that is one of my goals, to become a homeowner. And they spent months looking for just the right house.

34 percent of them spend a week or less in finding the right mortgage to go with that right home. So again, education, and this just continues to underscore the need to help people.

They say they don't understand the process. They want to be homeowners, but they don't understand the process.

There are lots of things we can do to help with sort of bridging that gap. Lots of different ways of getting at that. And we have talked about most of them here today.

GOVERNOR OLSON: Alicia, did you have a question?

MS. WILLIAMS: I might be having a senior moment, but I just want to go back to Michael's recommendations. And I know you talked a little bit about the housing counseling, but I'm not sure I heard your view on I think you said suitability standards for HMDA, and then -- I'm sorry, HOEPA. And then you mentioned preemption and right of private action?

MR. SHEA: I'm a reformed sports junky, so you're going to have to -- the federal regulators should not be the Pistons and the State Attorney's job should not be the Heat. You all should be on the same team. You really should work together.

In the last four or five years it seems like we read more about federal regulators having intramural turf battles amongst each other, and a lot of times that results in lowering consumer protection standards. We read about efforts to preempt state laws, preempt State Attorney General action. It makes no sense to us.

As we look at it over the last four or five years, the most effective enforcement has been by State Attorney Generals and private class action lawsuits. I mean, from where we sit, with all due respect, we just don't see the federal regulators very active in enforcement of the laws that do exist.

So then when we hear various federal regulators saying we have to prevent a patchwork quilt of various laws around the country from being created, we think, geez, what are their priorities? Their priorities should be to stop predatory lending and not protect the banks against the patchwork quilt of laws from around the country. That was what I was referring to.

GOVERNOR OLSON: I suspect we are done. And at 3:00 o'clock -- the reason I say not right this minute, but at 3:00 o'clock, because the Chair needs a break and I'm going to take it. But we will be back here at 3:00 or thereabouts to hear from the public for the open mike.

Thanks to all of our panels. Very,

very useful, very beneficial, and they contributed significantly, each of you.

(Whereupon, a short break was taken.)

GOVERNOR OLSON: The people who have signed up to speak are sitting at the table, and again we will take them this clock wise order.

Brenda Grauer, go ahead.

MS. GRAUER: Good afternoon. My name is Brenda Grauer. I'm the director of technical assistance and training for the Affordable Statewide Housing Coalition and Housing Action in Illinois. We have about 200 members statewide, about 45 of whom are nonprofit housing counseling agencies across the state.

I have the pleasure of being a former legal services attorney having worked for NHS, their profession department, and now in my current capacity to have seen this issue from the consumer standpoint from the standpoint of education, litigation and legislation. I can tell you that all three are definitely necessary components to regulate this problem, to help resolve this problem.

But most importantly, it's legislation. We've seen what has happened as Dan Lindsey and Diane Thomas and Tom James talked earlier today about the impact that state legislation has had in Illinois. What we have been able to regulate for, we don't see those practices.

I was talking to a colleague recently. We liken it to driver's education. For years there has been a requirement for driver's education, and during that driver's education people are told wear their seat belts. Seat belts save lives. They are told the impact if you don't wear seat belts, what will happen.

And yet those warnings and that education has not been sufficient. What has been a significant change in people wearing seat belts and saving their lives has been a rule, has been a law that people are required to wear their seat belts or they get tickets. I can speak to that because I actually got my very first seat belt ticket last week, and I now wear my set belt.

So legislation is an important component here. Things that we legislate against in our Illinois Homeowner Act, lowering the triggers, lump sum credit insurance, common yields and set premiums as part of the points and fees. Those are all things that we are not seeing as much of now. I think it has been effective.

Some of the panelists this morning, Mr. Posner was talking about consumer advocacy groups and their efforts and how effective they have been in litigation, particularly with Household, Providian, Associates. That's after the fact. That's after these lenders have been allowed to rape our communities with the funding, and they have to put some of it back in the form of settlement fees. But clearly they are still allowed to make a profit, they are still allowed to make these loans.

We need not just the education, which is insufficiently funded and not reliable, both in terms of changing requirements, Fannie-Mae pulling out the requirements for counseling now under their My Community mortgage product, which is a first time home buyer program. And the reason why they're pulling out the housing counseling requirements, supposedly, is to be able to compete with the subprime market.

So clearly just the requirement for housing counseling and education is not sufficient. We need it as a component of the tighter restrictions and regulations and sustainability standards is really what is required here.

GOVERNOR OLSON: My goodness. I think you are the grand champion of having your statement come right down to the wire.

I once had to testify before one the house banking committees I think, and I finished my statement right on. That was the only thing I was congratulated on.

Brenda, for you and for everybody else, just as a reminder, these are very short time frames we understand. But each of are you invited to submit your written comments. And that is by August 15, so you have plenty of time.

Teresa Lambarry. Did I say that correctly?

MS. LAMBARRY: Yes, you did.

My name is Theresa Lambarry and I'm from Spanish Coalition for Housing.

GOVERNOR OLSON: That doesn't roll off my Minnesota tongue.

THE WITNESS: And I am the manager, the program manager for the Homeownership and Spanish Coalition for Housing. We have three different counseling agencies. Our main office is on the north side on North and Pulaski. We have one on 18th Street, 1132 West 18th, and one in southeast Chicago. And of course I'm a big advocate of homeownership classes, and especially prepurchase.

But not only prepurchase. It goes hand-in-hand with post-purchase counseling and loss mitigation training also. Because everything comes hand-in-hand. You must start teaching people how not to run into default because they're going to chose a good lender, they are going to chose a good product, a good house, et cetera, et cetera.

And I just wanted to voice what Bruce said. I think it's legislation is wonderful, but homeownership counseling is very necessary. A good curriculum, a standardized curriculum.

We went through with HICCE, and after HICCE wasn't there, we went through Neighborhood Works and Neighbor Works, and we have taken the trainings there. We try to keep on the go and up-to-date with everything that is out there with counseling.

Because it is a very important to sit with a person and be able to explaining a product that they are going to go into. So that they, you know, they decide is this the right thing for you or should you be looking at something better.

That's it. I am very afraid because of what Brenda said, Fannie and HID both want to pull out of no more counseling necessary. And because of the openness and the guidelines being changed in a lot of product, I think that's on the contrary, more counseling is needed.

GOVERNOR OLSON: From the time that I was nominated to the Federal Reserve Board, I have had from everywhere and from all segments of the community, including some of the most financially sophisticated, a reminder of the growing need for financial literacy and financial education. So I certainly agree with your thrust.

Craig Basai, and I have it here. Am I close?

MR. VARGA: Well, that is not even just an pronunciation problem. It's a mispronunciation or misspelling. It's Craig Varga, so it's my handwriting.

GOVERNOR OLSON: If you can, if I can take that squiggly letter and make an R out if it.

THE WITNESS: I apologize. Yes, Craig Varga.

I'm a practicing attorney here in Chicago and I'm here in capacity as general counsel for the Illinois Financial Services Association, a broad spectrum of market funding lenders. We range from large banks to small financial institutions. I also have a practice as a private plaintiff's counsel in defensive lenders in private action and non-private action cases and have litigated many of the issues here. And a few comments I wanted to make about my observation.

I was an invited panelist the last time around in 2000, which I heard some people say was two or four years ago. It was actually six years ago. Time passes quickly for us.

And one of the things I think we took credit for here today was the elimination of single premium credit insurance. I think that's what I put in the category of a loan feature prohibition or a rates/fees control item. I think there has been great concern expressed here today about furthering that course with the Fed in this process because it has true access to credit dimensions to it.

But once you get away from that, and I think the success Brenda refer to here in Illinois from Illinois state legislation is in the nature of a loan feature prohibition or a fee priced control matter. And once you get outside those, and assuming that we're going to look at matters outside that, keep in mind that the whole fundamental of truth in lending rests with all the federal consumer protection statutes. The disclosures statute assumes that borrowers have the capacity to understand what have been preordained disclosures. Disclosures, which if not complied with, have enormous exposure for lender in the litigation context.

Further along that continuum of disclosure is counseling. There has certainly been support expressed for counseling here, but there has also been recommendations from the consumer group that counseling isn't sufficient and we need to have other matters.

In particular, one I'm very concerned about is what I heard from so many groups about is the need for, quote, suitability. To me, and seeing this from the litigation perspective, this is an invitation to after-the-fact subjectivism, ad hoc determinations of what amounts to a predatory loan that no one has been able to define what it is.

And I would caution people that what will happen will be this will become a litigation nightmare, a litigation trap, and can be asserted for leverage in every single case for an after the fact determination. And the dynamics of cost of litigation and settlement and so forth will have this be an enormous bludgeon at the head of lenders.

I think it will also have protective category dimensions because I think telling people that they are simply not educated enough to understand a particular loan product will possibly raise a protective category of considerations that follow along racial lines and education lines potentially.

I think one other comment before I close is I've heard support from some of the consumers groups for there is nothing wrong with private plaintiff cause of action enforcement. I would differ with that. That huge wealth transfers over hyper-technical problems are not good for society or the housing market. And why the federal banking agencies that employ safety and soundness concerns have been so conservative about that, and that has bothered consumer groups.

GOVERNOR OLSON: Craig, thank you very much. Next is David -- Tanner?

MR. TANNER: I'm David Tanner.

GOVERNOR OLSON: I'm going to get one right. Mr. Tanner.

MR. TANNER: Basically, just a consumer, small business owner. And I think I have more questions than I have comments.

Basically, if the consumer has lost $9 billion, how much has the banking system lost?

GOVERNOR OLSON: Good question. I can't tell you that I know the answer to that.

MR. TANNER: I mean, you have brought up that when the consumer has lost 9 billion. Well, how much has the banking system lost based on consumers?

GOVERNOR OLSON: That wasn't our comment.

MR. TANNER: I'm just bringing that up.

I guess the real problem comes to skimming of equity. I mean, I'm sitting in a situation where I have gone through predatory lending, the broker, the whole broker situation, the Realtor teaming up with a broker, you name it. So I'm out a sizable amount of money because of it.

Who am I supposed to call? I've talked to everybody and their brother, and I get nowhere. Where is the information? That's why I'm here today.

That is all the I have to say.

GOVERNOR OLSON: That is part of what these hearings are for, to find answers to those questions.

Carol Downs. Carol Downs has printed her name in perfect lettering, so I'm fairly confident I can introduce her as Carol Downs.

MS. DOWNS: Thank you, Governor. I appreciate this opportunity. My name is Carol Downs, I'm the fair housing coordinator with Interfaith Housing Center of the North Suburbs, which is located out in Winnetka.

A problem that I'm encountering as a housing counselor that is trying to support families that are in trouble with their mortgages, whether it be their initial mortgage or trying to refinance out of a bad mortgage, is that they just don't know that they have got themselves in a bad situation. And much of the outreach that some of these families have received has been through the telephone where some mortgage broker has contacted them, found out their information, that they are in trouble with that loan, and claimed that they are going to help them out.

And it's been too many families that have come to me when it's pretty much way too late to try to do anything about it. And it is too hard for any housing counselor to try to get someone out of a situation after the fact.

We need to do something as far as building the counseling, building that program better. We are a small organization, a nonprofit grass roots, that just does not have the resources to fight this monster of a problem.

I can't tell you how many seniors that I've worked with that have found themselves trying to get into a mortgage where they can refi a mortgage, where they can do some type of debt consolidation or do some home improvement. And they simply are in an ARM where that payment goes up and they are on a fixed income and simply cannot afford it. So the only option that they are given is you need to sell your property.

Well, I'm working with a family now where this is a grandmother who has adopted her grandchildren. There are seven grandchildren in this home. For one, even if she were to sell this property, where would she go with seven grandchildren?

So my hope is that we provide greater funding for the housing industry as far as the housing counselors. There is a major need for that. The 311 factor in Chicago does not address the homeowners in the suburban area.

And there needs to be laws in place where mortgage brokers and lenders are not as -- cannot approach people in any form or fashion and rip them off. And as well as some way of regulating these people from hurting families.

Because they just they can't win after the fact. Litigation is not -- it's helpful, but it's after the fact. And often, even with litigation, there is not much that can be done for that family. Thank you.

GOVERNOR OLSON: Carol, thank you.

Pamela Gilbert.

MS. GILBERT: Hi, my name is Pamela Gilbert and I'm from the Southside Community Federal Credit Union where I'm a housing counselor.

Just kind of piggybacking on what everyone else has said, the main thing that we do need is funding. And funding I believe comes from there being certain legislation passed where there are TV messages and magazine messages, et cetera, et cetera, to let people know they should be getting housing counseling and should be going out and getting more information versus no information.

Right now we have partnered with the Westside NAACP, and also the City Colleges of Chicago Dawson center where we offer a course of the whole process, budgeting, savings, and the whole process.

The whole process actually does go together. If you know how to save, if you know how to budget. If you know how to go out and chose a mortgage person. You know, a lot of people think the first person that comes along is the person I'm supposed to take. If I can get a home, I can get you in a home, you pay $1000 for rent, I can get you in for 900. And they jump on the bandwagon.

But it's where you need to education people and these people just don't know. They come to the classes, we give them the one-on-one counseling. And they're like I just didn't know this. Or they don't know how to clear up their credit.

But they need to be -- you know, it's not a learning process, but it's a presses that when you kind of I guess tell a person enough times, then eventually they figure out I can go out there and shop for a loan like I should shop for a washing machine. I can go out there, I can look at all the aspects of the washing machine in the same way I can look at all the aspects of the loan. To see are there prepayment penalties, what kinds of interest rates these people are giving. Are they first time home buyer programs. And also, you know, is this a loan for me as far as if it's fitting into what I need.

So all that comes away from the whole I guess the top down process where, you know, HUD and the ARISSA (phonetic) agencies are not funding or there is not going to be enough funding, I guess someone in Washington or the state level or whatever gives us more money to get the word out. To say to people you need to get this information prior to trying to become a homeowner, to make better informed decisions. Thank you.

GOVERNOR OLSON: Thank you very much.

Jeri?

MS. FOX: Yes.

GOVERNOR OLSON: Jerry Lynn Fox, if I have it correct.

MS. FOX: Easy. Thank you.

I'm a broker/owner, a small mortgage broker, and I guess that the reason I wanted to talk is I feel a great sense of sadness. I've been here since 8:30 this morning and I don't feel like one of the partners at the table.

I'm working evenings, Saturdays and Sundays, educating folks, trying to access 311 for customers who have fallen behind because they have lost a job, that the primary wage earner lost his job. They want me to refinance them again. I'm refusing to do that. I can't get anyone on 311.

I'm not in Chicago, I'm in Elmwood Park. I've go on the website, I find your non-311 number. I haven't gotten a call back yet. I have now over to date over the course of five months spent 20 hours directly with the consumers, and over 2 hours arguing with the forbearance experts at the lenders before we reached an agreement that was anywhere near reality for those folks, that they could keep this home, that in essence has been in the family for a quarter of a century and who didn't want to lose this home for a lot of reasons. But on the practical matter, where is a family of four going to find rent for $1100 a month? There was some practical issues here.

When we got through all of the screens and the hour and a half, because they don't have a phone there, they can't call 311, they have given up the cell phones, their phone has been disconnected. They are coming in my office. They won't go to families homes because they feel the families are taking advantage of them.

So we're in my office two hours into this conversation after I get everybody together, the forbearance counselor, who has already determined what their monthly payment is going to be, because there are going to have a 12 month repay and all of that, then they say $1500 is what is affordable for you, but your payment is going to be 1624. To which my customer responds, so you're going to lower my payment, right? Because you say I can't afford what you told me. No, we are not going to lower your payment. You have to pay this, but we are not too far off.

I could have used the assistance of folks at 311. I could use the assistance of tapping into some of those programs that are under market interest rates, fixed rate for nonprime. I do business with Citibank, Bank One, two of HSPCs affiliates. Half of my loan officers are Hispanic. We do I-TIN lending. We have to go to lenders that have 10 percent interest rates because

I can't tap in. I'm just small, I can't tap in on any of my large lenders pilot programs, because they are controlled by nonprofit groups that I can't be a member of because I'm a broker, not a bank.

I'm offering myself, folks. I'll be a partner. I will come in and do whatever volunteer work you want. I just want to be able to do a good job for the constituency that I get loans for.

GOVERNOR OLSON: Jeri, thank you very much.

We have one more name here, and that is Susan Ellis.

MS. ELLIS: Hi. I'm Assistance Attorney General at the Illinois Attorney General's Office.

I just wanted to give my emphasis to sort of anecdotally what we have seen in our office the role that good or perhaps better underwriting can do to stop gap some of the predatory lending and abuses that we see.

And one example is we had sort of a rash of foreclosure rescue scams here in Illinois have come on the heels of increased foreclosures, whereby someone in foreclosure, I think Tom James mentioned they get bombarded with direct mailings from people who say they will help save their homes. And what they do is put them together with either a friend or a straw buyer. But at the end the day the person just walks away at the end of the closing with all the equity out of the house basically, and the person ends up losing the home.

But there is always a lender there lending the money that gets turned into equity dollars that gets taken away. And we have seen lenders not realize until they have already funded a dozen or so of those loans that all of these loans the originator was giving them were for properties in foreclosure, and they didn't really look at that. And had they took note of that, they may have look further into loans.

Typically the borrowers buying the properties are also buying other properties, even though they are telling the lender that they are going to be using this property as a primary residence. So even a little more looking could have prevented some of these loans from being funded. Which in these cases would have prevented equity walking out the door.

We have also seen in conjunction with these loans stated income loans, for an example, the 81-year-old-woman who was supposedly making over $5000 a month doing house cleaning. And again, that was funded.

So I think a role of some better underwriting could at least stop gap some of the abuses that we go after. And we are suing these people, but we can't sue them all, and we can't do all that.

GOVERNOR OLSON: Thank you for your help and thank you for your participation to everybody. It's been a very worthwhile panel. A very worth while day. And thank you all for coming. And again, our very heart felt thanks to everybody at Chicago Fed who provides the logistics and the room and the food and everything. And thank you.

Again, if there are any remaining comments you would like to make, that is open to you until August 15. Thank you very much.

(Which were all statements heard or offered at the meeting of said cause.)

STATE OF ILLINOIS)
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COUNTY OF C O O K)

April T. Hansen, being first duly sworn, on oath says that she is a court reporter doing business in the City of Chicago; and that she reported in shorthand the proceedings of said public meeting, and that the foregoing is a true and correct transcript of her shorthand notes so taken as aforesaid, and contains the excerpt of proceedings given at said public meeting.

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Certified Shorthand Reporter

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before me this______day
of________________2006.

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Notary Public