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2 UNITED STATES OF AMERICA

3 **FINANCIAL CRISIS INQUIRY COMMISSION**

4 Official Transcript

5
6 Hearing on

7 "The Financial Crisis at the Community Level - Sacramento, CA"

8 Thursday, September 23, 2010, 9:00 a.m.

9 California Department of Education

10 1430 N Street, 1st Floor Boardroom

11 Sacramento, CA 95814

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15 **COMMISSIONERS**

16 PHIL ANGELIDES, Chairman

17 HON. BILL THOMAS, Vice Chairman

18 BYRON S. GEORGIU, Commissioner

19 HEATHER MURREN, Commissioner

20 JOHN W. THOMPSON, Commissioner

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CHAIRMAN ANGELIDES: The meeting of the
Financial Crisis Inquiry Commission will come to order.

Welcome to each and every one of you. Thank
you very much for being with us here.

First thing I wanted to mention, by the way,
is you will see in the back of the room, a number of wax
figures. In commemoration of Deaf Awareness Week, the
California Department of Education is displaying student
artwork, including wax figurines of notable deaf
people. The displays in the room today were created by
deaf artists to bring attention to deaf and
hard-of-hearing children and celebrate their abilities.

I also, in starting today, would like to thank
Superintendent of Public Instruction, Jack O'Connell,
for hosting our commission as well as the wonderful work
of his staff in accommodating us here today in this
hearing.

Good morning to each and every one of you. I
am pleased to be back in Sacramento to chair this final
in a year-long series of hearings examining the causes
and painful aftermath of the financial crisis. I want

1 to welcome my fellow commissioners to my hometown where
2 Julie and I were born and where we raised our three
3 daughters.

4 Sacramento, I am sad to say, is among the many
5 communities in the country that can show us how one of
6 the safest purchases traditionally made by a family, a
7 home with a mortgage, became the beating heart of a
8 financial monster.

9 By looking more closely today at the start of
10 the boom and bust in this region, I am hoping we can
11 better understand the struggles we now face in our
12 community and across the nation.

13 When we began our work on this commission, some
14 imagined the financial crisis would be well behind us by
15 the time we sent the results of our inquiry to the
16 President, to Congress, and most importantly the
17 American people.

18 Two years, in fact, this week, have passed
19 since Lehman Brothers collapsed and the federal
20 government began funneling trillions of tax payer
21 dollars to prop up the banks. And yet the tangible
22 evidence of real recovery in Sacramento and so many
23 other places is still hard to find.

24 There are 26 million Americans who are out of
25 work, can't find full-time work, or who have given up

1 looking for work. 2 million families have lost their
2 homes to foreclosure and another 4 1/2 million have
3 slipped into the foreclosure process or are seriously
4 behind in their mortgage payments.

5 Over \$12 trillion in household wealth has been
6 wiped away like a gigantic day trade gone terribly
7 wrong. Here in Sacramento County the officially
8 reported unemployment rate is 12.8 percent, well above
9 the national average. 43 percent of homes with
10 mortgages are now worth less than their loans. Small
11 businesses and families are trying to scrape by.

12 And our community, like so many others, is
13 juggling resources to fund our schools, services, and
14 assistance for those most in need of help; yet 3,000
15 miles away on Wall Street, the picture looks a lot
16 rosier. The banks that helped create the crisis by
17 placing enormous and risky bets using some of
18 Sacramento's mortgages as poker chips have now
19 rebounded.

20 It is as if we had a devastating earthquake
21 that left the gleaming skyscrapers of the epicenter
22 untouched while the rubble was strewn everywhere else.
23 Many hard-working people rightly wonder who will help to
24 dig them out.

25 Over the past year, the commission has held 19

1 days of hearings -- in New York; Washington; in
2 Bakersfield, the hometown of our vice chairman; in Las
3 Vegas, the hometown of Ms. Murren, Mr. Georgiou; in
4 Miami, where we were joined by Senator Bob Graham; and
5 now here in my hometown.

6 Before our report is published in December we
7 will have studied hundreds of thousands of documents and
8 we will have interviewed more than 700 individuals from
9 the captains of finance to key policy makers and
10 regulators, to the families and business owners who
11 followed all the rules but ended up losing what they
12 spent years to build.

13 Our journey has been both fascinating and
14 disturbing. We've seen breakdowns in corporate
15 responsibility and failures of corporate management
16 where firms created, packaged, and sold financial
17 products without regard to quality, risk, or
18 consequences.

19 We have peered into a Wall Street world that
20 has become increasingly about trading and betting and
21 less about investing in jobs enterprising sustainable
22 wealth in America. I feel like I have walked into a
23 bank, opened a door, and found a casino as big as New
24 York, New York.

25 We've observed government leaders -- including

1 at the Federal Reserve -- who failed to contain the
2 crisis amid warning signs of risk-taking and subprime
3 lending that was spinning out of control.

4 And we've seen a stunning disconnect between
5 Wall Street and Washington and the rest of the country.
6 Many in authority in New York and the nation's capital
7 claim they, "Didn't see it coming." But if they had
8 paid a visit to Bakersfield or Las Vegas or Miami or
9 Sacramento, they would have seen how the dry rot was
10 eating away at our financial system.

11 Today we will examine the housing and mortgage
12 markets in the Sacramento region during the run-up until
13 the crisis. We will look at the subprime and predatory
14 lending and mortgage fraud. We will examine how
15 mortgages made in Sacramento were shipped to Wall Street
16 and repackaged into investment products that were spread
17 throughout our financial system. And we will talk in
18 the end with representatives of small businesses,
19 homeowners, local government, and community lenders who
20 are struggling now to stay afloat.

21 Let me close with this thought:
22 My father, who will be here with my mother later today,
23 grew up in the Great Depression. Like so many in his
24 generation he was keenly aware of the financial
25 recklessness that made life in this country so hard.

1 His generation learned the lessons of financial disaster
2 so the country could avoid it for decades. It is my
3 hope that we will learn the lessons of our time.

4 Now let me turn the microphone over to my
5 colleague Bill Thomas, who has served this state and
6 nation so ably for decades and has been a very able vice
7 chairman of this commission who has been instrumental in
8 our work.

9 Mr. Thomas, welcome to Sacramento.

10 COMMISSIONER THOMPSON: Thank you, Mr. Chairman
11 and welcome back to Sacramento. I spent four years here
12 in the assembly prior to being elected to Congress for
13 28 years. And the thing that I always enjoyed about
14 this area is that notwithstanding the fact that it is
15 the state capital of California, it is, at its heart, a
16 valley town.

17 And once you get away from the central capital
18 area, there are -- there is a lot in common. You get a
19 little bit more rain than we do down in Bakersfield, but
20 in terms of the type of people that are the backbone and
21 structure of this area, the central valley shares a lot
22 in common.

23 And unfortunately, one of the things they share
24 in common is that between Bakersfield and Sacramento,
25 this area has been -- the San Joaquin Valley and moving

1 into the Sacramento Valley -- the fastest-growing area
2 in California, which meant the building and construction
3 industry was significant in this area and therefore
4 significant damage has been done. So I'm anxious to
5 hear what we have to say at the hometown hearing of the
6 chairman.

7 I also wanted to thank you, Mr. Chairman, for
8 pointing out that those folks standing on either side of
9 the room are actually artwork rather than real people,
10 because they have done such a great job on them I
11 thought this was the first hearing that we had standing
12 room only until you indicated to me that they were not
13 real. I guess I should have judged that by their
14 unwillingness to applaud you on coming back to
15 Sacramento.

16 Thank you, Mr. Chairman.

17 CHAIRMAN ANGELIDES: Thank you.

18 COMMISSIONER THOMAS: Push the button down.

19 CHAIRMAN ANGELIDES: Thank you, Mr. Vice
20 Chairman, for A, telling me how to get my mike on and
21 for those comments. And yes, I wanted to make sure the
22 room was full here today. So we are now going to start
23 our hearing, and today we are going to start off with
24 testimony from Dr. Mark Fleming who is with CoreLogic,
25 which was originally a Sacramento-based company and

1 still employs a significant number of people in this
2 marketplace. Mr. Fleming is going to give us an overall
3 view of what happened here in the run-up to the crisis
4 and the effects in the wake of the financial crisis.

5 Mr. Fleming, before we do that. I would like
6 to ask you to rise and do what we have asked every
7 witness to do in every hearing along our journey, and
8 that is to take the oath. And if you would please raise
9 your right hand.

10 Do you solemnly swear or affirm under penalty
11 of perjury that the testimony you are about to provide
12 the Commission will be the truth, the whole truth, and
13 nothing but the truth to the best of your knowledge?

14 DR. FLEMING: I do.

15 CHAIRMAN ANGELIDES: Thank you very much.

16 Now, we have a timer here and if it works like
17 our other timers, I think you can see -- I've asked you
18 to limit your remarks to 10 minutes so you can give us a
19 good overview of this marketplace -- the housing market,
20 this region's economic marketplace. When the light goes
21 to yellow, there is one minute to go, and when it goes
22 to red, your time is up.

23 So, Dr. Fleming, thank you for being here and
24 you may proceed with your testimony.

25 DR. FLEMING: Chairman Angelides and Vice

1 Chairman Thomas and members of the committee, CoreLogic
2 appreciates the opportunity to testify at today's
3 hearings regarding the causes and effects of the
4 financial crisis, particularly on the greater Sacramento
5 region.

6 CoreLogic is a leading global provider of
7 consumer, financial, and property information,
8 analytics, and services to business and government.

9 At the Commission's request, I, together with
10 our other economists and analysts, reviewed information
11 from the Bureau of Labor Statistics, Mortgage Bankers
12 Association, and our proprietary databases on real
13 property values, real estate transactions, mortgage loan
14 characteristics and performance, liens, tax status,
15 delinquencies, and foreclosures. Although our data set
16 covers all communities in the United States, today we've
17 been asked to focus specifically on the Sacramento
18 market.

19 We are particularly honored to do so given that
20 the original "CoreLogic" was founded in the Sacramento
21 area in 1997 and today employs over 170 people here.
22 Although we are now part of a larger organization that
23 has assumed the CoreLogic name for a broader range of
24 businesses our ties Sacramento remain an important part
25 of who we are.

1 Today I will make five points about the
2 financial crisis and offer some concluding remarks. My
3 first point is that the early signs of distress were
4 seen in Alt-A and subprime loans.

5 At the beginning of the decade, low interest
6 rates allowed borrowers to more effectively leverage
7 their incomes to finance housing. Furthermore,
8 increasingly popular Alt-A and subprime loans including
9 lowered down payments or were originated with
10 simultaneous second mortgages that required little
11 equity from the borrower. Lower initial interest rates,
12 payments options, negative amortization, and low or no
13 documentation features also were offered. These were
14 collectively described as "affordability features" and
15 allowed the borrower to further leverage their income to
16 finance housing.

17 Affordability products and low interest rates
18 gave borrowers the ability to further extend their
19 buying power and buy their first home or a bigger home
20 as well as use home equity for non-housing consumption.

21 In January of 2000 Alt-A and subprime loans
22 made up only 2 percent of the total unpaid principal
23 balance of Sacramento mortgages, comparable to the
24 shares in California and nationally at the time. By May
25 of 2007 the share of Alt-A and subprime in Sacramento

1 was 30 percent compared to 31 in California and
2 21 percent nationally. At the time the Alt-A share was
3 18 percent, significantly higher than the national level
4 and the subprime share was 12 percent, only slightly
5 higher than the national level.

6 As households increased their debt burdens
7 payment shock and their exposure to a declining price
8 environment. Although we cannot discern from our data
9 sets information about sales practices, I should point
10 out that other sources have noted that those products
11 were in some cases accompanied by aggressive or abusive
12 sales practices as prices began to fall in 2007, the
13 first types of loans that exhibited distress were Alt-A
14 and subprime. The percentage of loans that became
15 delinquent and then foreclosed began to rise. Indeed,
16 the overall share of Alt-A subprime loans in foreclosure
17 has remained consistently higher than other loan types.

18 Here in California in the first half of the
19 decade, we experienced below-average serious delinquency
20 rates. In large part benefiting from the significant
21 house price appreciation that was occurring. But as
22 price appreciation turned into depreciation in the
23 second half of 2006, the delinquency rate among all
24 active loans rose quickly and exceeded the national
25 level by mid-2007. The national, state, and Sacramento

1 serious delinquency trends all reached their peak at the
2 beginning of 2010.

3 My second point is that poor mortgage
4 performance drove the housing market downturn.
5 Foreclosed homes and the resulting distressed sales have
6 continued to put downward pressure on the housing
7 market. Monitoring the months' supply of distressed
8 homes is a simple approximately for the shadow
9 inventory.

10 Prior to the crisis -- prior to the crisis,
11 Sacramento's supply of distressed homes was lower than
12 the national average and in line with California as a
13 whole, but as delinquencies rose in 2007, the months'
14 supply dramatically rose in Sacramento to a peak in
15 January of 2010 of more than 18 months.

16 Recently the level has declined at 12 1/2
17 months, slightly below California but still well above
18 the national level. Sacramento is currently fourth
19 among major metropolitan areas for its current
20 distressed sales share of 51 percent, only eclipsed by
21 Las Vegas, Riverside, and Phoenix.

22 My third point is that home prices are
23 stimulated by excess demand and depressed by distressed
24 supply. One can immediately see the unprecedented
25 increase in price levels in the 2001 to 2007 period

1 followed by the decline until 2010 nationally and more
2 dramatically in Sacramento.

3 Most recently remained relatively stable in
4 part because of housing policy actions such as the
5 first-time home buyer tax credit, Federal Reserve MBS
6 purchases resulting in lower mortgage rates, and the
7 impact of government programs to prevent foreclosure.

8 Over the last three months, after the
9 expiration of the tax credit, sales transaction volumes
10 have declined and the minimal growth in prices has
11 waned. It would not be surprising to see further
12 moderate declines in prices as the real estate market
13 awaits the return of buyers, works off the overhanging
14 excess supply of homes, and mortgage services bring to
15 resolution the supply of distressed assets through
16 modifications, short sale, or foreclosure.

17 It should be noted that California, and
18 Sacramento more specifically, is familiar with
19 residential house price volatility. Year-over-year
20 growth rates exhibit much more variation in California
21 and Sacramento than nationally.

22 The fourth point is that we must remember the
23 enduring problem of negative equity. One of the most
24 persistent and troubling effects of the financial crisis
25 is the high level of negative equity many communities

1 now face. Nationally, as of the end of the second
2 quarter of this year, the share of mortgaged homes with
3 negative equity was 23 percent. In California, the
4 share of under water properties was 33 percent and in
5 Sacramento 43 percent -- almost every other mortgaged
6 home.

7 Because many properties are significantly
8 under water and expectations for future price
9 appreciation are low, we expect that negative equity
10 will persist in Sacramento for many years to come.
11 Negative equity reduces mobility, which is the ability
12 of homeowners to sell their home and move for job
13 opportunities or other household reasons.

14 In the short-term, this actually helps the
15 Sacramento housing market as it reduces the supply of
16 distressed homes for sale, but in the long-term it can
17 be detrimental as it reduces the ability of labor to
18 migrate to locations where jobs are available;
19 therefore, negative equity is a drag on the ability of
20 the unemployment rate to fall.

21 My fifth and final point is that the economy is
22 now the driving force of mortgage performance.

23 Today Alt-A and subprime loans are a much
24 smaller share of the overall mortgage market. Moreover,
25 we do not expect a re-emergence of affordability

1 products given the more restrictive underwriting
2 environment. What is happening now is that we have seen
3 foreclosure rates on prime loans increase as economic
4 conditions have deteriorated.

5 One of the best readily available measures of
6 economic health is the unemployment rate. Unemployment,
7 together with divorce and medical events, remains one of
8 the principal causes of mortgage delinquency. The July
9 2010 Sacramento unemployment level was 12.7 percent
10 compared to 12.3 in California and 9.5 percent
11 nationally. During the first half of the decade,
12 Sacramento unemployment levels were typically in line
13 with the national trend, ranging somewhere between 4 and
14 6 percent.

15 In the summer of 2006 as the housing market
16 slowed, unemployment levels began to rise at a faster
17 rate than the national trend. During the recession, the
18 unemployment rate rose to an apex of 13 percent in the
19 first quarter of 2010 and has since only moderated
20 slightly. While the trend of Sacramento and California
21 as a whole is very similar to that of the nation the
22 level remains a few percentage points higher.

23 In conclusion, let me summarize all of this.
24 Declining mortgage rates in the earlier part of the
25 decade were a factor that allowed borrowers to leverage

1 their incomes and afford more expensive homes. House
2 prices responded to this increased leverage by rising in
3 response to the increased demand. Loan products that
4 allowed borrowers to leverage incomes further added to
5 the upward price pressure.

6 Once affordability was no longer possible given
7 interest rate increases and more restrictive loan terms,
8 price growth slowed, overextended borrowers became
9 delinquent, delinquencies became foreclosures, the
10 shadow inventory rose, and home prices decreased.

11 This, in turn, caused the share of borrowers
12 and negative feedback loop to more foreclosures.
13 Private demand for homes declined because housing was
14 viewed as a deflationary asset and many who would move
15 could not because their existing homes were under
16 water.

17 As the economy worsened, more traditional
18 mortgage borrowers also felt the stress of capacity
19 constraints and negative equity, further adding to the
20 shadow inventory. House prices have responded to these
21 pressures.

22 The influence of high unemployment rates and
23 negative equity will likely be the driving force of
24 distress going forward in Sacramento and throughout the
25 country.

1 Thank you, and I will be glad to answer your
2 questions.

3 CHAIRMAN ANGELIDES: Thank you very much,
4 Dr. Fleming. We will now begin the questioning by
5 commissioners, and as is the custom, the chairman
6 begins, even though as we have toured the country it has
7 always been the hometown commissioner, so today we both
8 have chairman and hometown precedent.

9 I would like to start -- by the way, just for
10 the record, let me indicate that you provided some
11 additional exhibits today and so I would like to, along
12 with your testimony and the other charts that you
13 provided, enter those into the record. They speak to
14 the share of unpaid principal balance of loans that are
15 Alt-A and subprime as well as the unpaid principal
16 balance of refinancing. So thank you very much.

17 I would also like to enter into the record a
18 chart prepared by our staff that indicates information
19 about mortgages which were originated in the Sacramento
20 market for non-owner-occupied properties. With no
21 objection?

22 Let me start here, Dr. Fleming. I want to talk
23 about Figure 1, Underwriting Tightness. And as I look
24 at your information, it seems to suggest -- and I want
25 you to explain a little bit about the chart, but it

1 seems to suggest that from a relatively tight set of
2 underwriting standards in 2002 to the third quarter of
3 2006, there was a precipitous drop in underwriting
4 standards. At least that is how I look at this chart.

5 Can you speak about that a little, talk about
6 what it means, and just also in terms of historical
7 standards' perspective --

8 DR. FLEMING: Sure.

9 CHAIRMAN ANGELIDES: -- how this laxness in
10 underwriting standards compares to historical.

11 DR. FLEMING: Right. So we are using as a
12 proxy for the idea of the tightness of underwriting the
13 basically the difference between application levels and
14 originations, also sometimes referred to as
15 "pull-through rates." And under typical circumstances,
16 not everybody who applies for a loan, you know,
17 necessarily ends up getting a loan for a variety of
18 reasons. The lender may decline it, but the borrower
19 might also withdraw that loan application.

20 And in this chart you can clearly see there's a
21 significant run-up in the refinance boom of 2002. So
22 the initial spike in the 2002 period is much more driven
23 by the refiboom. When a refinance happens, a lot
24 more people apply relative to those originations to that
25 spread, or that tightness, that level, it increases.

1 But as you pointed out, chairman, the
2 precipitous drop that occurred basically until 2006
3 indicates that by 2006 most every loan application was
4 actually being originated.

5 CHAIRMAN ANGELIDES: So -- so if I'm
6 interpreting this chart, it doesn't necessarily go to
7 the objective standards, what it goes to is the ease of
8 getting an application approved, correct?

9 DR. FLEMING: Right. The data doesn't tell us,
10 you know, what the reasons are or how that's happening,
11 just that the level of applications is coming in line
12 with the level of originations and so --

13 CHAIRMAN ANGELIDES: So let me just -- let me
14 take this for a minute. In 2002 your index or this
15 underwriting tightness, when it peaks out, what's the
16 ratio of, at that point -- and I don't know if this is
17 the right way to express it -- of loans being applied
18 for and loans being approved?

19 DR. FLEMING: So the tightness index is a 400
20 so it's 4-to-1.

21 CHAIRMAN ANGELIDES: So for every --

22 DR. FLEMING: -- four applications to one
23 origination.

24 CHAIRMAN ANGELIDES: All right. So four
25 applications. Of course, people may be filing multiple

1 applications?

2 DR. FLEMING: Possibly. Absolutely.

3 CHAIRMAN ANGELIDES: Okay. Now, here's what
4 intrigues me: By the third quarter of 2006 -- and are
5 these national numbers, by the way, that we are looking
6 at or is this for our marketplace?

7 DR. FLEMING: This is nationally based upon
8 Mortgage Bankers Association data.

9 CHAIRMAN ANGELIDES: All right. So when you
10 get to the third quarter of 2006, there are actually now
11 more originations occurring than applications in a
12 sense?

13 DR. FLEMING: Yeah, that's, actually --

14 CHAIRMAN ANGELIDES: Actually, that's a
15 statistical aberration, I would assume, but essentially
16 you're saying at that point almost every application is
17 becoming a loan?

18 DR. FLEMING: Absolutely, yes.

19 CHAIRMAN ANGELIDES: All right. Thank you.

20 And historical standards have we ever had that
21 kind of equation before?

22 DR. FLEMING: Well, according to the data here,
23 it occurred back in 1993-94 also, but the overall levels
24 were much lower back then in the first place. And when
25 I looked at this chart, it's hard to see there's really

1 -- at least looking from 1990 forward -- a clear trend
2 or sort of a natural rate that one would expect. It's
3 sort of all over the map, right?

4 But what we can see is also as the financial
5 crisis hit, the underwriting tightness increased
6 dramatically again, and then has waned in the most
7 recent months. So it's sort of -- sort of correlates to
8 the concept of how we would expect the behavior or the
9 anecdotal evidence that people talk about, the behavior
10 of the -- of the availability of credit today.

11 CHAIRMAN ANGELIDES: All right. Let me now
12 turn to some other information you've included about
13 early payment defaults and first payment defaults. As I
14 understand it, you defined early payment defaults and I
15 notice you have both national -- well, you have
16 national, California, and Sacramento data, but you
17 define early payment defaults is a default that occurs
18 within 12 months of origination, correct? And a first
19 payment default is literally that, a default that occurs
20 on the first payment.

21 First of all, when you look at this data from a
22 long-term historical perspective, do we see
23 extraordinarily high levels in this crisis; and
24 secondly, what does that say in terms of the
25 suitability, the appropriateness of the loans being

1 made?

2 DR. FLEMING: I think, yes, that certainly the
3 early payment default rates rose dramatically as the
4 crisis deepened, as house prices went down, negative
5 equity increased, and that's partly an early to payment
6 default in many instances is no different than a regular
7 default, except that it just happened earlier in the
8 life of a loan.

9 If somebody, you know, gets a loan, qualifies
10 for a loan, moves into their home, and six months later
11 loses their job, they may become an early payment
12 default. So there is some level of that that's there.
13 But then, certainly --

14 CHAIRMAN ANGELIDES: Can I -- can I stop you on
15 that. In terms of job loss, the spike really begins in
16 Sacramento, looking at Figure 4, in April of '06. And
17 if my memory serves me, we really don't see the
18 unemployment rate moving up until perhaps the summer of
19 2008; is that a fair assessment, summer/fall 2008?

20 DR. FLEMING: Yes, later than 2006 certainly.

21 CHAIRMAN ANGELIDES: Right.

22 DR. FLEMING: Yeah.

23 CHAIRMAN ANGELIDES: Right. So go ahead.

24 DR. FLEMING: So --

25 CHAIRMAN ANGELIDES: So it wouldn't be

1 attributed, obviously, to changes in the job market at
2 that time?

3 DR. FLEMING: No, there is an underlying
4 current of that, sort of the base underlying current of
5 the EPD rate nationally, then you overlay that with the
6 idea of house price growth or declines. And all kinds
7 of delinquency rates generally go down when house prices
8 are going up, obviously, because the opportunity is to
9 sell or refinance rather than go into serious
10 delinquency.

11 But the EPD rate here certainly correlates with
12 the increase in the Alt-A and the subprime shares and
13 the turn in the housing market and the sensitivity of
14 those loan products driving these defaults.

15 CHAIRMAN ANGELIDES: So you think it was a
16 combination of the turn in the housing market as well
17 as, frankly, the nature of the product and to whom those
18 products were pushed and moved?

19 DR. FLEMING: It was a function of -- so we --
20 we like to think of it as people, the borrowers
21 themselves; product, there is a mix of the product, and
22 -- and the conditions that they're in, the property, the
23 house prices declining. So it's --

24 CHAIRMAN ANGELIDES: It would take all three
25 generally to push these numbers up?

1 DR. FLEMING: Yeah, it's a confluence of those
2 events and that's -- more generally what we've seen here
3 is that that confluence of events that has occurred in
4 this crisis, we have had house price appreciation and
5 depreciation in markets where -- with economic -- where
6 economic health is good and unemployment rates are low
7 and so the impact is less. We've had -- these kind of
8 loan products have been around for quite some time --

9 CHAIRMAN ANGELIDES: But not at this scale,
10 correct?

11 DR. FLEMING: Not at this scale, that's
12 certainly true, but they've been available and have been
13 very successful in, for example, markets with rising
14 houses in a healthy -- house prices in a healthy
15 economy. So it's really the confluence of these events
16 together that is driving the conditions that we see.

17 CHAIRMAN ANGELIDES: All right. Do you have
18 any views on or data on the following, particularly
19 again with respect to Sacramento and perhaps national,
20 by which we can infer some impact on this community?
21 And that is the extent to which foreclosures may have
22 been propelled early on by the fact that in this crisis
23 for the first time and to the extent, as never before,
24 loans had been securitized, sliced, diced so you now had
25 many folks holding these, the extent to which

1 foreclosures may have been propelled early on by the
2 fact that given that loans had been sliced up,
3 securitized, in a sense, when there was a default it
4 went to an automatic trigger so it may have triggered an
5 early rush of foreclosures versus, perhaps, a situation
6 where loans that, at least proportionally, were more
7 held by lenders or at least by folks who held the full
8 loan in the securitization process?

9 Any view as to whether or not foreclosures were
10 propelled early? And along with that, whether today the
11 fact that servicers control many of these loans, it's
12 hard to figure out the original owners, you have a lot
13 of both first liens and second liens, that the structure
14 is now prolonging the process of foreclosure?

15 Any views on that, the extent to which
16 foreclosures -- structure catapulted foreclosures
17 forward and is prolonging it today?

18 DR. FLEMING: In our data, obviously, we don't
19 have information on why a foreclosure is risen, have no
20 idea why the timing of the foreclosure has occurred
21 and -- but the idea that securitization versus
22 portfolioing of a loan would have a differential effect
23 on the foreclosure decisioning (sic) process, I don't
24 have any specific information on that, but I can look
25 into it for you.

1 CHAIRMAN ANGELIDES: Okay. Thank you very
2 much. Couple more questions before I turn to other
3 commissioners.

4 You have noted that we are the fourth in the
5 country in terms of distressed sales. You noted that we
6 are 43 percent of our homes with mortgages are
7 under water, which is almost double the national
8 average.

9 Any perspectives on why we are so uniquely
10 troubled and struggling here?

11 DR. FLEMING: Well, the house price
12 appreciation and depreciation, sort of that roller
13 coaster ride in the housing market was one of the
14 biggest spikes of any market out there. You know, the
15 markets that I mentioned like Riverside and Las Vegas
16 are similar in that regard, but it really has to do with
17 that -- such a large and fast decline from that level --
18 level in the first place.

19 And as you mentioned in your opening remarks --

20 CHAIRMAN ANGELIDES: And you think that's fully
21 related to the extent of the upswing?

22 DR. FLEMING: Right. You know, the factors
23 that drive the up swing push it up to that level, and
24 then, of course, the outcome is, you know, that
25 correction is more severe and that's really driven that

1 negative equity level to such heights.

2 And there is also this component of the
3 seasoning or the age of the housing stock. Markets that
4 have very young housing stocks, newly built homes, are
5 generally a lot more sensitive to the house declines.
6 So places like Sacramento, where there has been a lot of
7 building of new home construction during the boom -- and
8 Las Vegas is another good example of that -- as compared
9 to some of the markets on the East Coast, which have a
10 much more varied tenure stock, or some of the urban
11 areas, more traditional well-defined urban markets where
12 houses were built in the '40s, '50s and '60s, they are
13 much less sensitive to house price declines when it
14 comes to the negative equity measures. So it's really,
15 in Sacramento, a combination of the severe price
16 declines with the young answering of the housing stock.

17 CHAIRMAN ANGELIDES: All right. Let me talk a
18 little about some discussions we've had among
19 commissioners. And again, it's relative to the
20 communities we have been visiting recently.
21 Bakersfield, where, again, there was a tremendous run-up
22 in prices. And then down swipe, Las Vegas, Miami, and
23 Sacramento.

24 And clearly, as we have tried to analyze why
25 the bubble and crash happened in certain locales, some

1 things make sense, obviously, population pressures,
2 demand, what also may make census price differentials,
3 that this market was partly fed, obviously, by the price
4 differential from the Bay Area markets. And I suspect
5 Bakersfield was fed, in certain respects, by overflow
6 from the Los Angeles market.

7 What are the other factors? And if one of them
8 is the presence in the up and the down, the existence of
9 subprime and Alt-A lending, why did it manifest itself,
10 in your opinion, in certain locales across this country?
11 What do you think were the key factors?

12 DR. FLEMING: Well, as you mentioned, the
13 demographics and the -- and the mobility of individuals
14 seeking more affordable places to live certainly helps
15 push on the demand side.

16 You have two other demand factors which I
17 mentioned in my opening remarks. And that is the
18 low-interest-rate environment basically allows
19 individuals to leverage their incomes, you know, more
20 effectively, meaning you can borrow more at the same
21 monthly payment; and therefore, buy more house, stay in
22 the market longer, and do those sorts of things.

23 Same thing with the Alt-A and subprime products
24 where the affordability features really in loan products
25 allowed effectively that further leveraging of one's

1 income.

2 And what, basically, that means is on the
3 demand side of the market where, as house prices rise,
4 what would usually happen is people would leave the
5 demand side of the housing market because they were no
6 longer able to afford to buy a home or the home that
7 they wanted.

8 These two components basically allowed that
9 demands -- people to stay in at the demand side of the
10 market. And so relative to supply, you get that upward
11 price pressure.

12 CHAIRMAN ANGELIDES: All right. My final
13 question, and that is: You -- you talked about the
14 negative feedback loop. Any prospects for the snapping
15 of that in this locale in the near future from what you
16 see in the data?

17 DR. FLEMING: So there -- over the past year
18 there has been stabilization in the price level. The
19 appreciation rates in Sacramento bounce around -- right
20 around the zero line, usually a little bit positive over
21 the past year. And that's the key to, sort of, breaking
22 that vicious cycle is stop those prices from continuing
23 to decline and thus stabilize the negative equity level
24 and basically broken that feedback process of more
25 people going under water and then driving more

1 foreclosures.

2 But now the case is that we have to work off
3 that stock of individuals. Most people who are
4 under water continue to pay their mortgage loans if they
5 can, right? So it's this double-trigger problem that,
6 sort of -- again, the confluence of events issue is that
7 you have a large share of individuals who are under
8 water in combination with high unemployment rates, so
9 they are having capacity-to-pay issues. And when those
10 two things come together, you end up with a delinquency
11 and having to deal with modifying, short-selling, or
12 foreclosing.

13 So stabilizing the economy and getting
14 employment rates down and giving people the capacity to
15 pay with stabilized house prices is probably the best
16 bet going forward.

17 CHAIRMAN ANGELIDES: All right. Thank you very
18 much.

19 I will now turn the questioning over to the
20 Vice Chairman Thomas.

21 VICE CHAIRMAN THOMAS: Thank you,
22 Mr. Chairman. I am just sorting some of these charts
23 because we got black-and-white copies, so I am trying to
24 judge the shades of gray and I got the chairman's
25 colored copy now.

1 DR. FLEMING: We do have some spare --

2 CHAIRMAN ANGELIDES: Just for the record, I
3 don't color copy mine in black-and-white. I cheated and
4 did it on a color printer last night.

5 DR. FLEMING: I do have spare standard color
6 copies if you'd like to bring them up.

7 CHAIRMAN ANGELIDES: Oh, we like to -- we are a
8 lean-and-mean operation.

9 VICE CHAIRMAN THOMAS: And it's a shame we
10 don't have the ability to throw them on a screen so that
11 people can see and understand what we're talking about
12 because I find them very useful, especially in color so
13 you can see the contrast.

14 CHAIRMAN ANGELIDES: Can I mention something,
15 Mr. Vice Chairman, on that point, which is that all the
16 testimony is -- will be placed on the web so that people
17 will have the opportunity to look at the information.

18 VICE CHAIRMAN THOMAS: Will it be in color
19 rather than --

20 CHAIRMAN ANGELIDES: That is the hope.

21 VICE CHAIRMAN THOMAS: Okay. We may be mean
22 and lean, but you've got to be able to read them.

23 On page 6 on your testimony, Dr. Fleming, you
24 indicated that -- it's the second to the last paragraph
25 "...and mortgage servicers bring to resolution the

1 supply of distressed assets through modification, short
2 sale, or foreclosure."

3 Do you have any data on that in terms of types
4 and percentages? We have heard a lot of testimony in
5 the three previous hearings about people who have,
6 because of their changed circumstances, reached out to
7 their mortgage servicers to attempt to either modify in
8 some instances, arrange a short sale so they wouldn't
9 have to fall into foreclosure, or having foreclosure, in
10 essence, sprung on them when they thought they were
11 going through the period of modification and someone
12 comes up and knocks on their door and says, "You have to
13 leave."

14 Do you have any data on that in terms of
15 percentages, or is that something you look at?

16 DR. FLEMING: We don't have reliable data on
17 modifications. And more importantly, data on the types
18 of modifications and the amounts of payment reduction
19 things like that that are occurring.

20 What we do have good information on is on the
21 back end of the market we collect the public record
22 sales transaction activity that occurs in the
23 marketplace. And so -- I think it's on Figure 7, is
24 probably the best one, the non-distressed sales, the
25 different sales types --

1 VICE CHAIRMAN THOMAS: And that's for
2 Sacramento only?

3 DR. FLEMING: Yeah. The green bars or -- how
4 should I say -- it's the top bars are Sacramento added
5 to -- yeah, this is all Sacramento only. So the bottom
6 group --

7 VICE CHAIRMAN THOMAS: Right.

8 DR. FLEMING: -- of bars is regular market
9 sales and so we're watching the sales transaction
10 activity as it's worked its way all the way through the
11 process.

12 Now, a modification would not appear here
13 because basically no distressed sale has been
14 necessary. But you can certainly see the share of REO
15 sales, which are the end result of the foreclosure
16 process, as well as the short sale activity, pick up
17 dramatically in about mid-2007 and are actually
18 planning, as I mentioned, the dominant -- practically
19 the dominant share of transactional activity today in
20 the marketplace, relative to clean arm's-length sales.

21 In terms of modification data, I actually read
22 the quarterly reports that come out from the
23 organization -- the government organization that
24 produces that data where they give a fair amount of
25 information on the success of the mods, the types of

1 mods, and the types of structures that are being given.

2 VICE CHAIRMAN THOMAS: Based on the
3 non-distressed sales, are you able to make any
4 determination -- as I mentioned Sacramento is not only
5 the state capital but a valley town, and in most valley
6 towns, especially if one of the basic economic
7 foundations is agriculture you have seasonal
8 unemployment. And we have both agriculture and oil, and
9 when they are out of sync, you have very high seasonal
10 unemployment.

11 Is there any ability to interpret any of the
12 Figure 7 sales remaining low on non-distressed to the
13 steady employment aspect of government employment
14 vis-a-vis private sector? Or is the government part of
15 Sacramento not big enough? I mean, D.C. is skewed by
16 virtue of that.

17 DR. FLEMING: I think, no, government probably
18 does play a stabilizing roll. Sales transaction
19 activity historically does show very strong seasonal
20 patterns, that's absolutely correct. People tend to buy
21 homes in the spring and summer intending to move in
22 before the school year starts. And you see that in many
23 cases.

24 I think over the last couple of years the
25 seasonality -- and so economists like myself, we

1 actually build models to correct for the seasonality and
2 give you sort of seasonally adjusted numbers. And those
3 models and those adjustments are actually not working
4 very well at the moment because there's all these other
5 kind of forces that play.

6 For example, in the latter part of 2009, we
7 didn't really see very much seasonal effects in our
8 unadjusted numbers because of the large share of
9 activity of people buying up distressed assets. So
10 there probably is an undercurrent of seasonality here.
11 It's likely muted, as you suggest, by the baseline of
12 government being here, but that is also probably being
13 muted by the fact that there are other forces that are
14 interrupting that seasonal cycle.

15 VICE CHAIRMAN THOMAS: In Figure 1 the title is
16 "Mortgage Underwriting Tightness." Is this just
17 original first mortgages or is refinancing in this?

18 DR. FLEMING: It's the -- it's a combination of
19 the Mortgage Bankers Association Applications Index and
20 their originations volumes which is a combination of --

21 VICE CHAIRMAN THOMAS: But on the applications,
22 there's no differentiation or refinancing included or --

23 DR. FLEMING: I think it is included for both
24 apps.

25 VICE CHAIRMAN THOMAS: So all kinds of

1 mortgage?

2 DR. FLEMING: All kinds, yes.

3 VICE CHAIRMAN THOMAS: Okay.

4 DR. FLEMING: Based upon where they collect
5 their data from.

6 VICE CHAIRMAN THOMAS: Okay. And then one
7 that's really cruel, if you look at the black-and-white
8 version of Figure 2 on mortgage foreclosures, because
9 our color pallet ran from black to red and some of the
10 shades of red make it very difficult, but when you look
11 at this in color and you have the description of the
12 kinds of mortgages that wound up being foreclosed on,
13 just talk a little bit about what would have been the
14 typical mortgage of 20 years ago, 25 years ago
15 represented on the chart versus some of the newer
16 creative kinds of mortgages, because when you look at
17 March 10, I think you can interpret the colors for them
18 like start with the line closest to 0 --

19 DR. FLEMING: Sure.

20 VICE CHAIRMAN THOMAS: -- and then the one just
21 above 2 working up to the 14 percent one which is a
22 bright flaming red for a lot of reasons, I assume.

23 DR. FLEMING: Right. Yeah, so to give you the
24 crib sheet, the bottommost one, or the one that's
25 exhibited the least change in foreclosure rates is home

1 equity loan and HELOC as a category so second basically
2 junior liens.

3 CHAIRMAN ANGELIDES: Explain "HELOC."

4 DR. FLEMING: A home equity line of credit. So
5 instead of "Here's a lump-sum second mortgage," it's
6 "We'll set up a line of credit, you can draw against
7 it."

8 The next one on the list is brown it peaks out
9 at just above 2 percent right now. That's your
10 conventional prime market. That, to your point, is the
11 most common -- historically the most common loan type
12 out there. This is your 30-year fixed rate 5/1 ARM
13 7/1 ARM types of products.

14 VICE CHAIRMAN THOMAS: And so in this major
15 recession it was just slightly above 2 percent?

16 DR. FLEMING: It's risen only slightly above
17 2 percent. Now, what's more interesting in the
18 interpretation of these charts is actually the relative
19 change. So it's a bit hard to tell from the chart here
20 directly, but both the HELOC and the conventional prime
21 segments had delinquency or foreclosure rates that were
22 well below even half a percent.

23 VICE CHAIRMAN THOMAS: 0 as early as late '06,
24 early '07?

25 DR. FLEMING: Right, running right along the

1 bottom of the axis.

2 The next one up the list is your FHAVA product
3 type. And again, historically low, but has increased to
4 about just under 3 percent it looks like here.

5 VICE CHAIRMAN THOMAS: And these might be clear
6 reactions to a recessionary period?

7 DR. FLEMING: Absolutely. In fact, how I
8 characterize it often in looking at these charts is
9 these upturns are that sort of traditional reflection of
10 the distress of the economy.

11 VICE CHAIRMAN THOMAS: Yeah, but there has got
12 to be a multiplier applied to a couple of these?

13 DR. FLEMING: Yeah, so keep going up the list,
14 right?

15 VICE CHAIRMAN THOMAS: Yes.

16 DR. FLEMING: The nonconforming prime market,
17 the jumbo market is the next one, just under 6 percent.
18 And you can see that that's actually a product category
19 that's performed extremely well, on par, if not better
20 than conventional prime historically; generally because
21 these are large mortgage balances, but also well
22 qualified individuals, larger down payments, things like
23 that so again --

24 VICE CHAIRMAN THOMAS: Screen purchasers on
25 income and assets showing that it's just a larger

1 mortgage but very similar to the old-fashioned prime
2 mortgage?

3 DR. FLEMING: Exactly.

4 CHAIRMAN ANGELIDES: Mr. Vice Chairman, I --

5 VICE CHAIRMAN THOMAS: Two more lines and I'm
6 done.

7 CHAIRMAN ANGELIDES: No, fine, a couple
8 minutes, absolutely. Whatever time you need.

9 VICE CHAIRMAN THOMAS: Just two more lines.

10 DR. FLEMING: Then we'll leap up to just under
11 12 percent, that's the Alt-A product. And you can see
12 dramatically --

13 VICE CHAIRMAN THOMAS: For the record, just
14 kind of briefly describe "Alt-A."

15 DR. FLEMING: Alt-A, it comes from the
16 "Alternative A paper." It was traditionally a product
17 type that was basically prime borrowers but didn't have
18 full documentation usually. And then more recently
19 became a product space where you had the different
20 documentation levels, the affordability features and
21 things like that.

22 And then finally the last one that peaks out at
23 14 and is now just a little bit below that is the
24 subprime market category.

25 Now, interestingly, subprime, historically we

1 all had an expectation for a much higher level of
2 foreclosure, somewhere around 4 percent to begin with.
3 So it's gone from 4 to 14, about three times worse than
4 long-term expectation, if you will.

5 Whereas, the prime market, which is now only
6 above 2, is 4 times worse than our historical
7 expectation. So in relative change space, it's an
8 interesting concept.

9 VICE CHAIRMAN THOMAS: It is one way to look at
10 it in relative. I think the way most people look at it
11 are the number of houses in a housing tract that are
12 being foreclosed.

13 DR. FLEMING: Yes.

14 VICE CHAIRMAN THOMAS: So what you are really
15 saying is previously there were none and if they are the
16 regular ones they are 2 percent. Before they were about
17 4 houses out of every 100, now they are 14 percent.

18 I think when you think of it as vacant homes in
19 100 home tracts those percentage changes aren't as
20 significant as the empty homes and that's what our
21 concern about is: Could that loan have been modified?
22 Did it have to go to foreclosure? Could they have had a
23 short sale without it going to foreclosure? Because
24 foreclosure means everyone has failed.

25 And there are a lot of people who have

1 testified as we have moved around the country that the
2 folks who hold the paper don't seem to be too anxious to
3 move on something short of foreclosure, and that's one
4 of the things I want to focus on.

5 Thank you, Mr. Chairman.

6 CHAIRMAN ANGELIDES: Thank you Mr. Vice
7 Chairman.

8 Ms. Murren.

9 COMMISSIONER MURREN: Thank you, Mr. Chairman.
10 And thank you for joining us today.

11 I have a couple of questions, one of which --
12 the first one will require reeling back time a little
13 bit, and I was hoping that perhaps you could talk to us
14 a little bit about the collection of data. And in
15 particular, as you looked at the economy, broadly
16 speaking, and also particularly here in Sacramento,
17 before the crisis, were there indicators in your data
18 sets that would have given you pause at that time and
19 perhaps any indications of what would ultimately
20 unfold?

21 And the second part of my question is actually
22 related to that, which is: In your testimony you noted
23 that there were some things that you wish you'd had more
24 information about or that you do now, including sales
25 practices or detailed data on foreclosure.

1 And I wonder if there are areas of information
2 or data that if we had, as a community, as our
3 lawmakers, as observers of the economy, better access to
4 that information we could make more proactive decisions
5 as opposed to retroactive decisions?

6 DR. FLEMING: I certainly -- to your last
7 point, I do believe that understanding what's happened
8 and designing policy and dealing with those, and sort of
9 identifying what to do and how to do things better, in
10 large part should be driven by as much data as
11 possible. And so we are certainly willing to spend more
12 time generating whatever data we can to help you in that
13 process because I think the more informed we are, the
14 better decisions we make.

15 We have only actually been in -- in the -- I
16 don't want to say "in the business," but been actively
17 really mining our public record and loan data sets for
18 this kind of information over the last couple years
19 because of the fact that the crisis has been going on.

20 I think we have been monitoring house prices as
21 sort of that clearing number that identifies the
22 disequilibrium between supply and demand for a number of
23 years. And it was apparent that, you know, house prices
24 were significantly deviating from what would be
25 fundamentally supported. And economists built models

1 design to measure what the fundamental level of house
2 prices should be usually in some way heavily correlated
3 to income -- incomes and income growth because, after
4 all, that's how we usually pay our mortgage obligations,
5 and the relationship with the interest rate to create
6 affordability. And so it was clear that there were big
7 deviations.

8 But that being said, there are other times in
9 the past where we have seen deviations in our data and
10 thought we knew what was going on and didn't. So I
11 think hindsight is honestly 20/20. In looking into it
12 as it was happening, there were lots of reasons that we
13 could speculate on why it would be reasonably that way,
14 but, of course, if, you know, many people who talk about
15 and describe what a bubble is. That's exactly the
16 behavior that designs and creates a bubble.

17 COMMISSIONER MURREN: And so looking at things
18 today where we are, is there a data set that you think
19 would be important to be able to evaluate in order to
20 make better decisions or to at least monitor the health
21 of some of these activities?

22 Some of the testimony we have heard suggests
23 that some of the activities that actually led to the
24 crisis are perhaps having a resurgence, whether it's
25 fraud relating to refinancing or mortgages being written

1 that perhaps aren't as scrutinized as they should be, is
2 there -- and that's just one example, but is there a
3 data set that you think would be useful as we look at
4 things today to determine where we stand and perhaps
5 where we should go and should be collected by a national
6 body?

7 DR. FLEMING: I don't know. I think there's --
8 most of the data is out there is readily available. I
9 think you are pointing to if there are two areas where
10 there is data that, for instance, we don't have, it
11 would be in the modification space to get more robust
12 information on understanding the terms of the
13 modifications. I know that it's available to -- you
14 know, it's available to certain parties. We don't have
15 it, but I think that's key in understanding how
16 modifications should be designed and successfully
17 implemented.

18 And then, more detail, I think you are pointing
19 to the idea of more detail on how underwriting is
20 performed and what are the decisions that go into the
21 underwriting decisioning process captured as data. I
22 think that's something that you would have to address
23 with the mortgage industry.

24 COMMISSIONER MURREN: I see. And you had
25 mentioned the terms of modifications that would be

1 useful if we were able to get more transparency and
2 visibility into that.

3 What is the challenge in that regard? Is it
4 simply that most of that data is held in the hands of
5 the banks and it's not in a public forum? Or is it --
6 what is the what is the hang up?

7 DR. FLEMING: It's just I don't have it.

8 COMMISSIONER MURREN: I see.

9 DR. FLEMING: We collect data from a number of
10 servicers. Many of the charts here are predicated off a
11 cooperative of servicer-collected data. And in those
12 data structures, we don't typically collect a lot of
13 detail about modifications, in large part because when
14 the agreements were negotiated on what data elements to
15 collect. Many years ago modification was not something
16 we were focused on.

17 But I -- you know, the reports that I read from
18 the government have a lot of that detail, so I think the
19 data is there, it's just that I don't have it to do my
20 own analysis with.

21 COMMISSIONER MURREN: I realize you may not
22 have spent a lot of time thinking about this yet, but I
23 am curious as an economist, do you think the ability
24 that people have to modify their mortgages will be an
25 important factor in driving the economy going forward?

1 DR. FLEMING: More broadly, I think it's
2 changed the industry in the sense that we now view the
3 concept of a distressed asset as having multiple
4 outlets. You can modify, you can short sale, you can
5 deed in lieu, you can foreclose.

6 And historically, prior to this crisis, the
7 servicing paradigm was much simpler. It was, "The guy
8 is not paying his mortgage, we are going to evaluate the
9 value of the home, see if the person can refinance or
10 sell."

11 If that's not the case, really foreclosure was
12 the only option. Modification, short sale, these kinds
13 of things really just didn't happen to any significant
14 degree. And so one of the -- the, if you will, benefits
15 of the crisis to the servicing industry is that it's
16 developing -- you know, while going down the road at 60
17 miles an hour -- developing the practices around looking
18 at all of these alternatives, which ultimately can drive
19 a better outcome for both the lender and the borrower in
20 matching the right, you know, disposition strategy for
21 both parties.

22 COMMISSIONER MURREN: But I would guess that,
23 as a result of the complexity associated with that,
24 perhaps then it actually extends the time period where
25 that could be beneficial; in other words, we may not see

1 the benefits of it for a period of time as that's
2 resolved.

3 DR. FLEMING: Yes.

4 COMMISSIONER MURREN: Thank you.

5 CHAIRMAN ANGELIDES: Thank you, Ms. Murren.

6 Mr. Georgiou.

7 MR. GEORGIOU: Can I follow up on Commissioner
8 Murren's last point there? Do you think there are any
9 structural limitations to the ability of servicers or to
10 the motivations of servicers to restructure mortgages as
11 opposed to take them directly to foreclosure?

12 DR. FLEMING: I don't have any date that would
13 help me articulate one way or another.

14 COMMISSIONER GEORGIOU: I look under enduring
15 problems -- the point you made, enduring problems with
16 negative equity. Commissioner Murren and I come from
17 Las Vegas where we don't have 43 percent of the
18 mortgages under water we have 72 percent of the
19 mortgages under water.

20 At what point does the negative feedback loop
21 need to get before it stops deteriorating the process or
22 creating even a worse development in the process going
23 forward?

24 DR. FLEMING: Yeah. So 7 out of every 10 is
25 certainly a significant issue. And I think it really

1 believes -- it's not -- again, the focus on this idea of
2 there's two triggers. Negative equity in and of itself
3 is necessary but not a sufficient condition for
4 foreclosure or distress, some sort of modification.

5 COMMISSIONER GEORGIU: If you combine that
6 with the highest unemployment rate of any state in the
7 nation?

8 DR. FLEMING: Yes, that's the first trigger.
9 So it's the combination of the two. And for those
10 reasons we expect house prices to, you know, an upper --
11 a good scenario would be 0 growth in those kinds of
12 markets because of those downward pressures until those
13 stocks clear.

14 There has to be a floor at some point because
15 housing is unlike typical equities, you know, housing
16 has intrinsic value and there is a floor that's
17 somewhere in there that people will reenter the market
18 and buy it because they think it's, if anything, just
19 the value of the land alone.

20 It's referred to -- some economists refer to
21 this idea of prices in real estate being downside
22 sticky. And it's that concept that at some point people
23 just sort of retreat from the marketplace and rather
24 than prices continuing to fall, they just stabilize at
25 some level.

1 VICE CHAIRMAN THOMAS: May I jump in briefly at
2 that point?

3 COMMISSIONER GEORGIU: Go ahead.

4 VICE CHAIRMAN THOMAS: I think you also have to
5 underscore the tax aspect of the housing versus renting,
6 which is a force that drives, not just the intrinsic
7 holding of the land.

8 DR. FLEMING: Right. Certainly, housing
9 policy, mortgage --

10 VICE CHAIRMAN THOMAS: Thank you.

11 DR. FLEMING: -- the home mortgage deduction,
12 for example, and the capital gains treatment of gains on
13 housing certainly contribute to this idea of home
14 ownership being a good thing.

15 Actually, the interest deduction less
16 stimulates, you know, people buying homes that otherwise
17 wouldn't. I mean, there is some aspect of that, but it
18 also stimulates buying more house than you otherwise
19 would. So there is those kinds of dynamics there.

20 It's -- Las Vegas is a good example of -- I'm
21 not quite sure how that's going to play out. We have
22 never observed, obviously, these kinds of confluences of
23 events occurring. I have to say any forecast that I
24 would make would probably be wrong.

25 COMMISSIONER GEORGIU: I would like to go to

1 Figure 1 of your Mortgage Underwriting Tightness chart
2 to be sure I understand it.

3 So at one point at the peak of the subprime
4 origination period in 2006 you really got just about
5 every loan that was applied for, was being financed and
6 originated? Then it, of course, goes up quite
7 dramatically to only 1 in 4 as of 2008 and to what do
8 you attribute this steep drop thereafter? Is that the
9 first-time home buyer tax credit kicking in? There is a
10 pretty steep drop down to 200.

11 DR. FLEMING: Right. Combination of things.
12 It's the -- after the initial crisis hits and we get
13 through that initial period and, you know, sort of the
14 financial markets become relatively stabilized, many of
15 the government programs that helped to do that are in
16 place, and these originators are sort of back in
17 business, if you will, along with low interest rates
18 first-time home buyer credits, lots of incentives to
19 bring mortgages through the door, I think, really
20 moderated that peak.

21 Now, that's all done in an environment where
22 clearly underwriting standards are today, you know, much
23 more -- much more tougher and purely to the sense that
24 the underwriters are looking at a lot more information
25 and being a lot more cautious in their decision-making,

1 absolutely.

2 COMMISSIONER GEORGIU: Right. If you look at
3 the chart at the end, it's starting to flip upward. It
4 seems to be headed back in an upward direction, which
5 is, again, looking as if the percentage of loans -- of
6 applications that are actually resulting in loans is
7 starting to decline again.

8 DR. FLEMING: Right. So you also have the tax
9 credit explorations, you have the low rates we have
10 recently seen of less than 5 percent. Those are playing
11 into these numbers as it moves around, so there is
12 certainly impacts of that. For example, such low rates
13 were actually -- many people have refinanced from what
14 they thought was a great rated at 5 1/2 or 6 percent are
15 now refinancing into even better loans.

16 Now, these are individuals that typically have
17 equity in their homes and are probably refinancing very
18 traditional mortgage products but they are certainly
19 coming in through that pipe.

20 COMMISSIONER GEORGIU: I think that's all I
21 have for now.

22 Thank you, Mr. Chairman.

23 CHAIRMAN ANGELIDES: Mr. Thompson.

24 COMMISSIONER THOMPSON: Thank you,
25 Mr. Chairman.

1 Dr. Fleming, welcome. One of the interesting
2 things about data is that it gives you perfect
3 hindsight. One of the difficulties, however, with
4 financial models or economic models is they have lots
5 have variability. And even you said your models today
6 wouldn't be very constructive in predicting what the
7 future might be. As we spoke with many on Wall Street,
8 they argued that this tsunami that engulfed our economy
9 was unforecastable.

10 Do you agree with that?

11 DR. FLEMING: It's the black swan concept.
12 Yeah, I don't, you know -- I would never have sat down
13 and constructed a model in 2004 that said we are going
14 to have the worst recession we have had since World War
15 II in combination with the largest -- largest house
16 price decline nationally that actually overwhelms even
17 our largest regional house price declines.

18 And I guess I don't know about the term
19 "unforecastable," but I would not as a modeler have
20 foreseen and thought of possibly creating the stressed
21 scenario of those confluence of all those events to see
22 what might have happened.

23 COMMISSIONER THOMPSON: So let's dissect it for
24 a moment. If you believe, as I do, that perhaps the
25 catalyst to this economic collapse was a housing bubble

1 that burst, could we and should we have forecasted a
2 bubble building and the inevitable collapse?

3 DR. FLEMING: I don't know how to forecast a
4 bubble.

5 COMMISSIONER THOMPSON: When housing prices are
6 rising at 3 to 4 times normal rates -- historical rates
7 of over 100 years, would that not be an indication that
8 perhaps a bubble is building?

9 DR. FLEMING: You know, in hindsight, we would
10 say oh that seemed to be a bubble, but when in the thick
11 of it, it's hard to say for sure there is a bubble or
12 some structural shift that's occurring that might
13 have --

14 COMMISSIONER THOMPSON: So are you telling me
15 that economic models are useless to forecast the future?

16 DR. FLEMING: No, I think the idea that the use
17 of data is informative. I still run the models and we
18 do forecast things like house prices see what they would
19 say to understand the relationships between the things
20 that we view as or believe to be the drivers of those
21 kinds of dynamics.

22 And so I don't call them "useless," I just
23 don't know that I would -- you have to overlay it with
24 your own personal sense of what you think is going on.
25 It's not the only thing one should use.

1 COMMISSIONER THOMPSON: So if the creation of
2 this bubble was somewhat attributable to lax housing
3 standards, are there things that you as an economist
4 would look back on now and say we should have done that
5 we did not do and what would they be?

6 DR. FLEMING: Well, again, it's this idea of
7 this confluence of all these events. All the different
8 driving forces that could be looked at and viewed to
9 sort of gain insight into what might happen.

10 I don't know that I have any particular opinion
11 about what we could have or should have done in
12 hindsight, other than, I think, having all of this data
13 available going forward will help us make better
14 decisions.

15 COMMISSIONER THOMPSON: So you don't believe
16 that there was a housing bubble and there were
17 contributing factors to that? Forget about the
18 confluence of events, I am focused on the housing
19 bubble.

20 DR. FLEMING: Looking back now with the data, I
21 believe clearly the prices levels that we reached were
22 not supportable. And I can identify, as I did in my
23 testimony, a number of factors that helps to create
24 that. But I don't know -- well, I don't know that while
25 it's happening I could so clearly be so sure that it was

1 the case.

2 COMMISSIONER THOMPSON: So if we just stay with
3 the house bubble for a minute, I want to forget about
4 the other ingredients in this confluence, were there
5 things that, in your mind now, in hindsight with the
6 benefit of perfect data, could have been done that
7 weren't done?

8 DR. FLEMING: I don't know. I think you would
9 have to talk to the people who made those kinds of
10 decisions. We purvey the data. We provide it to many
11 institutions. What they actually -- how they interpret
12 and what they do with it is up to them.

13 COMMISSIONER THOMPSON: Okay. Thank you very
14 much.

15 CHAIRMAN ANGELIDES: I would like to follow up
16 on that line of questioning, two things.

17 So take a market like Sacramento. Rather than
18 take it from the perspective of -- how do I say this?
19 House prices are racing up quickly. What would have
20 supported a judgment that those prices were sustainable;
21 in other words, you say it's hard to look back and say,
22 "Gee, it was a bubble," let me flip it the other way.

23 What would have led anyone to believe in 2004,
24 2005, 2006 in this community that underlying economic
25 conditions had changed so as to support 10 and 11 and 12

1 and 15 percent price increases or 20 percent in a year?

2 DR. FLEMING: Right. You mentioned one of
3 them, the demographics. There is the desire of people
4 to move to Sacramento, certainly would be a contributing
5 factor. The fact that there is an affordability
6 capability that people could move from markets on the
7 coast to Sacramento and, you know, basically buy more
8 home for the same value; that in some parts of the
9 Sacramento area it's not inconceivable that you could
10 commute to work in the Bay Area.

11 So there is that extension to, you know, the --
12 I guess the western suburbs of Sacramento could be
13 viewed as excerpts to Bay Area properties. Also, as
14 part of the Central Valley, that was certainly the case,
15 and that's what many people argued was why building was
16 occurring in these marketplaces.

17 So those demographic shifts and the
18 desirability of the marketplace -- anecdotally, for
19 example, many of my colleagues that work here in the
20 Sacramento office, they live in Folsom and Rancho
21 Cordova, sort of in the foothills up to Lake Tahoe, and
22 one of the things that they always reference is the
23 access to the Lake Tahoe area, the Napa Valley, San
24 Francisco.

25 These are all -- as economists we look and say,

1 "Why do people want to move to these places? What
2 drives the demographic shifts in those marketplaces?"
3 And Sacramento had a number of positive benefits going
4 for it at the time.

5 And then on top of that you have very low
6 interest rates, and so that allows you to, you know,
7 basically afford to buy more. So combinations of those
8 factors could be used to argue for house price
9 appreciation.

10 CHAIRMAN ANGELIDES: Well, then, let me ask
11 this question in terms of data: What data was not
12 available to decision makers who wanted to look at it in
13 2004, 2005, 2006, about the extraordinary nature of what
14 was happening in terms of underwriting standards, the
15 number of subprime loans being made. I mean, dramatic.

16 For example, my understanding is, for example,
17 HMDA loans in California, high cost HMDA loans, which is
18 kind of a proxy for subprime lending. These are what
19 are classified as high cost; therefore, many of them are
20 subprime loans. I mean, they doubled to half a million
21 loans in California between 2004 and 2005.

22 What was missing in the information basket of
23 decision makers so that they didn't see what was
24 happening in the subprime Alt-A markets?

25 DR. FLEMING: I can't really speculate on what

1 information decision makers had --

2 CHAIRMAN ANGELIDES: Was that information
3 available if someone had really wanted to get it and lay
4 their hands on it?

5 DR. FLEMING: We certainly had information on
6 the shares of different loan product types.

7 CHAIRMAN ANGELIDES: All right. Any more
8 questions, members?

9 All right. Dr. Fleming, thank you very much
10 for coming here today. Thank you for giving us an
11 overall perspective on the marketplace as a kind of a
12 starter for today's panels that will follow. I
13 appreciate it and I appreciate your testimony and
14 information that has been put on the record and on the
15 web. Thank you very much.

16 DR. FLEMING: Thank you.

17 CHAIRMAN ANGELIDES: All right. We will take a
18 literally five-minute, only, break and as we assemble
19 our next panel of witnesses who are going to be talking
20 about the Sacramento housing mortgage market, including
21 the issues of mortgage fraud and predatory lending in
22 this marketplace.

23 Thank you. Five minutes.

24 ...

25 CHAIRMAN ANGELIDES: The meeting of the

1 Financial Crisis Inquiry Commission will come back into
2 order. And I would actually like to just take a
3 poignant personal privilege and welcome my wife, Julie,
4 and my oldest daughter Megan who have joined us.

5 We will now begin with the next session, which
6 is a discussion of the Sacramento housing and mortgage
7 market as well as issues of predatory and subprime
8 lending.

9 We have four panelists with us today.
10 Ms. Karen Mann, who is an appraiser by profession;
11 Mr. Thomas Putnam, who had a career of 30-years-plus in
12 housing and in the mortgage business in this region and
13 Northern California; Mr. Kevin Stein who is with the
14 California Reinvestment Coalition; and Mr. Ben Wagner
15 who is a U.S. Attorney for the Eastern District of
16 California.

17 What I would like to ask each of you to do now
18 is to please rise and raise your right hand so that I
19 can do what we have done with all witnesses in the
20 course of our 19 days of hearing, and that is to swear
21 you in.

22 Do you solemnly swear or affirm under penalty
23 of perjury that the testimony you are about to provide
24 the Commission will be the truth, the whole truth, and
25 nothing but the truth to the best of your knowledge?

1 (All sworn.)

2 CHAIRMAN ANGELIDES: Thank you very much.

3 We are going to go from my right to my left to
4 start this off. And, Ms. Mann, we are going to start
5 with you.

6 Now, there is a timer here, as I explained
7 earlier on. We are going to ask each of you -- you
8 provided extensive written testimony. I thank each and
9 every one of you for that testimony. And now we are
10 going to give you the opportunity to provide oral
11 testimony of no greater than five minutes. You will see
12 at the one-minute-mark-to-go, the yellow light come on.

13 Can you see that, Ms. Mann? And if not, I will
14 wave. I will wave.

15 THE DEPONENT: That would be great.

16 CHAIRMAN ANGELIDES: And then when your time is
17 up, the red light will come on. So, Ms. Mann, if you
18 will please start your testimony, thank you very much.

19 MS. MANN: Thank you.

20 Good morning, Mr. Chairman, Vice Chairman, and
21 members of the Commission.

22 As a citizen of this wonderful country and as a
23 real estate professional, I thank you for allowing me a
24 few minutes of your time this morning.

25 First of all, let me touch briefly on my

1 experience. In the last 30 years I have appraised
2 18,000 residential appraisal reports. I have reviewed
3 within my firm 45,000 appraisals. I have appraised over
4 800 church properties, plus another 4- or 5,000
5 commercial properties.

6 I have earned several professional designations
7 and am a qualified expert witness from Superior Court,
8 IRS, and bankruptcy court.

9 One of the changing incidences in my career was
10 in 1994. I attended an appraisal institute conference
11 in Atlanta Fannie Mae were the speakers. Fannie Mae
12 stood up and told all of the appraisers in the room that
13 "We won't be using live appraisers down the road, so you
14 might want to gear up yourselves for the changes that
15 are coming."

16 Those words echoed in my head since 1994. One
17 thing I knew for sure is I knew that change was coming
18 this document that you have, the testimony I have given
19 you, I sent a copy to my sister for her to read. She
20 called me yesterday and said, "You know, Karen you've
21 said all of this for years. This shouldn't be a
22 surprise to anybody. You've told everybody in the
23 family. In fact, I've heard you talk about it in your
24 office."

25 So what I'm telling you -- what I'm sharing

1 with you is based on my personal observations for the
2 last 30 years. By 2004 I was already experiencing
3 stomachaches anticipating the down drop that we were
4 going to experience.

5 Now, I am an optimist by nature. To think that
6 I was already thinking about the fall in 2004 when
7 things were still going up, that tells you something.
8 That tells you that I was used to looking at prior real
9 estate cycles. I began telling anyone who would listen
10 about the banking debacle would far outcry the savings
11 and loan debacle.

12 So what really happened? What is the bottom
13 line here? The bottom line, I can sum it up in two
14 words, easy money. Easy money. We had an increased
15 dependance on credit worthiness. We did not really
16 consider the collateral value. The easy money was
17 amplified when the requirements for the live appraisal
18 was eased to only loans exceeding \$250,000 with the
19 implementation of the di minimus back in the '90s.

20 Easy money was great with strong employment,
21 strong demand, and increasing prices. Easy money with
22 the elimination of the independent third-party impartial
23 valuation person. Easy money with the use of statistics
24 which can be manipulated. Easy money with the lack of
25 oversight from bank regulators.

1 Appraisers tried to warn the regulators.
2 Appraisers tried to warn by two different petitions. We
3 had a permanent reversal of HVCC petition which to date
4 has over 123,000 signatures. Back in 2001 appraisers
5 got together and had a petition with about 11,000
6 signatures with voicing our concern about the HVCC.

7 HVCC was passed and then in our industry, true
8 havoc truly began. Veteran, legitimate, professional
9 appraisers were no longer the preferred appraisers. The
10 new appraiser was the one that would take 50 percent of
11 the fee, fill out a form so it would comply with the
12 lender's requirements, and it didn't mean that it was
13 accurate, honest, or true.

14 The middleman, the newcomers to the business,
15 was the appraisal management companies. Now, they are
16 predominantly owned by banks, so the fox was back in the
17 hen house. Even under the most recent Frank-Todd Act
18 recently passed, the state regulators do not have to
19 overview the AMC's owned by banks. The banks are pretty
20 much free to go do what they want.

21 The use of BPOs, brokers' opinions of value,
22 further denigrated the valuation process. Thanks to
23 HVCC, my client base of mortgage brokers, bankers, and
24 other people that I've worked with over the last 25, 30
25 years, I can no longer really do business with them

1 one-on-one. So that was a lot of frustrated work.

2 What about the people? Let's really think
3 about the people that were involved -- that's one
4 minute, okay -- and then identify consequence of the
5 effect to the American public and the snowball effect to
6 homes. Over 2.7 million homes have been foreclosed on.
7 75 percent of those are reported to be owner occupants.
8 What happened to the 6 million men, women, and children
9 that were displaced that no longer have a home? I can
10 also testify that within my own family, my daughter and
11 four grandchildren lost their home as well.

12 That's it, right?

13 CHAIRMAN ANGELIDES: Thank you very much,
14 Ms. Mann.

15 And we will go to Mr. Putnam now, please.

16 MR. PUTNAM: Thank you, Mr. Chairman, Vice
17 Chairman and Commissioners. Appreciate the opportunity
18 to be here today. I have been an active participant and
19 observer of the Sacramento mortgage market for 25, 30
20 years, and I come and share thoughts with you from that
21 perspective, a participant.

22 I've served in the public sector as an analyst
23 with the legislature as a member of the California
24 Housing Finance Agency doing affordable housing. And
25 I've also spent the last 20-years-plus in the private

1 sector working for a variety of mortgage banking
2 companies.

3 I have worked with both retail groups that
4 worked primarily directly with consumers and wholesale
5 operations that worked through the brokers, which is
6 part of the make-up of the mortgage business. I want to
7 cover three of the questions quickly that were raised by
8 your staff and one is what is the big trends that
9 affected Sacramento? What were the changes in the
10 mortgage market and how did that impact Sacramento, and
11 then what were some of the business practices that I
12 observed that created problems?

13 First of all, the big trends, Mr. Fleming --
14 Dr. Fleming touched on some of them, but for -- the four
15 big ones for me were: We had a tremendous unprecedented
16 increase in population. When you look at the mid-'90s
17 into the mid-2000s, 2005-2006, you had a 60 percent
18 increase in population, which created enormous housing
19 demand and mortgage demand in our area.

20 You also had, parallel to that, the job growth
21 which was related, of course, people were coming here
22 for the available jobs.

23 The second piece was the make-up of that
24 population increase. Traditionally, it has been from
25 organic growths, the births, and people who already

1 lived in the Sacramento Valley. But we saw a different
2 make-up coming into Sacramento due to the great
3 disparities between house prices -- the median house
4 prices that were in Sacramento at the time, and
5 primarily the Bay Area counties, but some from Southern
6 California.

7 So this changed the nature of the mortgage
8 borrower profile in Sacramento. It changed the level of
9 affluence, sophistication, and interest in alternative
10 products that had not been seen in Sacramento before and
11 I think that was a big factor.

12 The third big factor is just the sheer size of
13 growth of the mortgage market. We went from a good
14 doubling nationally, and Sacramento reflected that,
15 where we had the largest mortgage markets since
16 2002-2003 that the mortgage business has ever seen. So
17 we had huge influx of mortgage capital and the type of
18 the mortgage capital changed which I will talk about in
19 a little bit.

20 The fourth factor that I think is important,
21 too, is along with that there was governmental efforts
22 to expand home ownership. There was great interest in
23 serving underserved ethnic groups, in serving
24 underserved income groups. And I think that led to some
25 changes in underwriting, changes in marketing that

1 affected the Sacramento market.

2 So you take those big factors and you overlay
3 them of what was going on in the mortgage products if
4 you start in the mid-'90s around 80 percent, 80, 85
5 percent of the mortgage business was what we consider
6 agency product. Subprime and Alt-A were pretty small in
7 those times.

8 And if I can digress into mortgage vocabulary a
9 bit, but I think it's useful, mortgage lending has
10 always been about how we look at the credit, the
11 capacity, the capital, and the collateral. And if you
12 look at those categories, you will see serious erosion
13 in the underwriting standards through the period not
14 only from the change in the mix of the type of mortgages
15 that were being made, but also within each category you
16 had erosion of underwriting standards from their
17 traditional.

18 So real quickly, a prime is a high-quality
19 credit a 680, 700 traditionally. You had capacity where
20 people had jobs with underwriting ratios that were in
21 the 33, 38 area. You had capital where people were
22 making 10 to 20 percent down payments. And you had
23 collateral where you had full appraisals, independent
24 appraisals. And all of that changed across the capital
25 types and in the mix of the mortgages changed

1 dramatically.

2 That led to -- you overlay that into the
3 mortgage practices real quickly that I observed created
4 disincentives and adverse incentives with the lack of
5 management control, the lack of market disciplines. You
6 had incentives in the system that overweighed and took
7 over and controlled the internal risk management
8 systems.

9 For instance, on the incentives loan officers
10 were paid on overages. Overages, basically, they were
11 rewarded to charge up on loans either higher interest
12 rates or lender-beneficial terms. You had managers that
13 were paid for volume profitability market share, loan
14 quality was either a non-existent or very small
15 category.

16 Underwriting -- and the consumers were part of
17 this too. There was great motivation to take advantage
18 of rapidly rising prices. I think that led to a
19 tendency of borrowers to leverage their houses as much
20 as possible, misstate loan information, and try to get
21 into that house as soon as possible to take advantage.
22 So you put the changes --

23 CHAIRMAN ANGELIDES: If you could wrap up,
24 Mr. Putnam.

25 MR. PUTNAM: I'll wrap up real quick.

1 -- the changes in the marketplace, the changes
2 of the mortgage types, and the criteria and the market
3 incentives that were in place that got overwhelmed with
4 the significant flows of mortgage. And I think that's
5 what I would attribute many of the changes that led to
6 the problems today.

7 CHAIRMAN ANGELIDES: Thank you.

8 Mr. Stein.

9 MR. STEIN: Chairman Angelides, Vice Chairman
10 Thomas and members of the Commission, my name is Kevin
11 Stein. I'm the associate director of the California
12 Reinvestment Coalition. Thank you for this opportunity
13 to testify.

14 CRC advocates for the rights of low-income
15 communities and communities of color to have fair and
16 equal access to banking and other financial services.
17 CRC has a membership of 280 non-profit organizations and
18 public agencies across the state.

19 Problematic mortgage lending has long plagued
20 the region and the state. Back in 2000 CRC interviewed
21 125 subprime loan borrowers in four California cities
22 including Sacramento and reviewed their loan documents.
23 We found that many of these borrowers were victims of
24 bait-and-switch tactics, high points and fees, yield
25 spread premiums, and prepayment penalties.

1 We found that one-third of the subprime
2 borrowers in this random sample were likely victims of
3 predatory lending.

4 In the ensuing years, subprime and option ARM
5 loans saturated California communities. As the chair
6 noted, in 2000 we had doubling of subprime loans in the
7 state as compared to 2004 and we estimated at that time
8 that the average subprime borrower in California was
9 paying over \$600 more per month on their mortgage
10 payment as a result of having received the subprime loan
11 and, of course, this has had a disproportionate impact
12 on communities of color.

13 In Sacramento in that year, most of the home
14 purchase loans originated to both African-Americans and
15 Latino borrowers for higher-cost subprime loans. Around
16 the same time, the lending industry began to push option
17 ARM loans as an affordability product in order to
18 increase profits and increase demand by selling loans to
19 people for whom the complex option ARM product was never
20 intended.

21 Nowhere was this dynamic more clearly on
22 display than in the summer of 2006 when the Federal
23 Reserve convened HOEPA hearings in San Francisco. At the
24 hearing, consumers testified to being sold option ARM
25 loans in their primary non-English language, only to be

1 pressured to sign English-only documents with
2 significantly worse terms. Some consumers testified to
3 being unable to make even their initial payments because
4 they had been lied to so completely by their brokers.

5 In analyzing a large sample of securitized
6 loans that were originated between 2004 and 2007, we
7 found that adjustable rate loans, low doc loans, and
8 stated income loans were much more prevalent in the
9 cities of Sacramento and Stockton than in the national
10 sample as a whole.

11 Predatory mortgage lending was so systemic that
12 the largest lender in Sacramento County and the state,
13 Countrywide Home Loans was sued in 2008 by the State
14 Attorney General for engaging in a pattern and practice
15 of defrauding California borrowers into taking out loans
16 they could not afford and did not understand.

17 And even today we see that Fannie Mae and
18 Freddie Mac are trying to force banks to buy back
19 billions of dollars of bad loans that did not meet basic
20 underwriting guidelines. We should view all of these
21 loans as presumptively predatory.

22 For over a decade, CRC and its members have
23 urged regulators to address the challenges of predatory
24 lending before communities were further impacted. Among
25 the unheeded calls we have made, we have urged the

1 Federal Reserve to investigate the practices of subprime
2 subsidiaries; bank holding companies to clamp down on
3 abusive lending practices, to lower HOEPA thresholds and
4 expand consumer protections, and to extend HMDA
5 data-reporting requirements to shed more light on
6 whether discrimination was occurring in lending and
7 servicing.

8 We also urged the OCC and OTS to retreat from
9 harmful preemption decrees and rulings which prevent the
10 mortgagors in this state and local entities from
11 actually protecting their residents, and urged them to
12 change overly narrow interpretations of the CRA so that
13 community reinvestment and fair lending exams would
14 reach the practices of non-bank banks such as
15 Countrywide and H&R Block.

16 Finally, we had urged all regulators to
17 investigate lending disparities and prohibit steering of
18 borrowers into expensive products, to allow for more
19 public input bank review process, and to force banks to
20 develop predatory investment screens in order to stop
21 bank purchases and investment in predatory loans.

22 Last week, RealtyTrac confirmed that seven
23 California metro areas were again among the top ten
24 communities most impacted by foreclosure in the nation.
25 The list included Sacramento at No. 10 and communities

1 in neighboring and nearby counties including Modesto,
2 Stockton, Merced, and Vallejo-Fairfield.

3 What borrowers need are sustainable loan
4 modifications that come with principal reduction, but
5 despite all the pledges of aid, industry initiatives and
6 government programs, the bottom line is that loan
7 servicers are not subject to any meaningful rules,
8 oversight, or penalties; and as such, are failing to
9 help families stay in their homes.

10 CRC has conducted six surveys with non-profit
11 housing counselors in the state and these reports
12 routinely show that loan modifications are not
13 happening.

14 In our latest survey released in July, most
15 counselors report that the federal HAMP program is not
16 working; that foreclosures are still occurring while
17 borrowers are negotiating with their loan servicers; and
18 servicers routinely lose documents and ask them to be
19 re-faxed while at the same time the servicers are
20 frequently denying loan modifications because borrowers
21 supposedly have not provided sufficient documentation;
22 and that generally outcomes for borrowers are poor, but
23 disturbingly, the outcomes appear worse for borrowers of
24 color than for white borrowers.

25 On this last point, we feel it underscores the

1 critical need --

2 CHAIRMAN ANGELIDES: If you could wrap up,
3 Mr. Stein.

4 MR. STEIN: Sure.

5 -- the critical need for data, as some of the
6 commissioners were suggesting.

7 One final issue just to highlight that often
8 gets overlooked are the impact of foreclosure on tenants
9 who really have had nothing to do with this crisis. The
10 national banks as trustees and the large loan servicers
11 are probably responsible for evicting tenants on a daily
12 basis unlawfully, and we think something needs to be
13 done about that.

14 And in conclusion, we hope the Commission will
15 issue strong findings and recommendations to the nation
16 that will subject financial institutions to greater
17 transparency, accountability, and fair lending
18 scrutiny.

19 Thank you for this opportunity.

20 CHAIRMAN ANGELIDES: Thank you, Mr. Stein.
21 Mr. Wagner.

22 MR. WAGNER: Thank you, Chairmen and thank you,
23 Commissioners. Good morning and thank you for the
24 invitation to speak before you today about what we as
25 prosecutors in the U.S. Department of Justice have seen

1 in the Eastern District of California concerning
2 mortgage fraud and what we've done to combat it.

3 Currently, communities in the Eastern District
4 are suffering some of the worst effects of the
5 mortgage-related financial crisis in the nation.

6 This year several of the top 10 per capita
7 foreclosure cities in the country are in this district.
8 As Mr. Stein just noted, it includes Sacramento, it also
9 includes Modesto, Merced, Stockton, Bakersfield, and the
10 Vallejo-Fairfield area. Many communities in this
11 district are dotted with foreclosed homes, with
12 depressed property values and serve as magnets for
13 vandalism and petty crime.

14 The mortgage fraud schemes we have seen in this
15 district take a number of forms. We are prosecuting
16 mortgage industry professionals like mortgage brokers
17 and lenders who lied and created false documents to
18 increase their already-generous commissions; real estate
19 agents who inflated undisclosed payments to themselves;
20 buyers and sellers of homes who lied to extract equity
21 from homes or simply to strip cash out of the
22 transactions; real estate investors who lied to finance
23 property-flipping schemes; home builders who lied and
24 used straw buyers to get properties off their books in a
25 downturned market; organized crime associates who have

1 used fraudulently obtained financing to buy homes for
2 use as indoor marijuana farms; and even a policeman who
3 is charged with submitting false information to obtain
4 two different mortgage loans.

5 We have seen a variety of schemes including
6 cash-back schemes, straw-buyer schemes, builder-bailout
7 schemes, and foreclosure-rescue schemes. One thing that
8 we have learned is as the housing market changes, the
9 nature of the fraud schemes also change.

10 So the crime that we generally refer to as
11 "mortgage fraud," in fact, reflects a number of
12 different schemes that are constantly evolving as the
13 market evolves. We have devoted significant resources
14 to fighting mortgage fraud in this district and I am
15 proud of what we have achieved.

16 These prosecutions are extremely complex and
17 time-consuming they are labor intensive given the
18 document-heavy nature of mortgage lending transactions
19 and the number of persons involved in each transaction.
20 Most of our mortgage fraud prosecutions involve multiple
21 defendants and wide-ranging conspiracies involving
22 multiple real estate transactions.

23 It's important to note that although the extent
24 of the mortgage schemes that occurred during the 2004 to
25 2006 period is clear as we sit here today, it took the

1 drop off in the housing markets to bring specific
2 criminal cases to light.

3 As long as home values were increasing and it
4 was possible to sell a house at a profit or to easily
5 refinance a house with an adjusting mortgage, there were
6 very few complaints to law enforcement. Lenders did not
7 have reason to audit their files for fraud when loans
8 were being repaid in full.

9 In my office, we have been indicting mortgage
10 fraud cases since 2006 and launched investigations
11 before that, but our mortgage fraud enforcement efforts
12 really accelerated in 2007 and 2008 once the backsliding
13 markets brought the fraud into high definition.

14 In May of 2007 we initiated a multi-agency
15 mortgage fraud enforcement task force in Sacramento, and
16 in the following year as a result of the work of that
17 task force, we indicted 49 defendants with felony
18 mortgage fraud crimes which was among the highest number
19 charged by a single U.S. Attorney's office in that
20 year.

21 Today we have two active task forces dedicated
22 to fighting mortgage fraud. One in the Sacramento
23 division and the other in our Fresno division. Last
24 year, President Obama created the Financial Fraud
25 Enforcement Task Force comprised of multiple agencies.

1 And this year starting on March 1st and ending in June,
2 the Financial Fraud Enforcement Task Force through the
3 Mortgage Fraud Working Group, on which I serve as a
4 co-chair, oversaw a coordinated nationwide takedown
5 entitled "Operation Stolen Dreams," which resulted in
6 federal criminal charges against over 1500 defendants.

7 In our district, 46 defendants were charged
8 with felony mortgage fraud offenses during the
9 3-1/2 month sweep period.

10 Several participating district attorney offices
11 in this region also participated in that operation and
12 filed criminal charges. Federal, state, and local law
13 enforcement agencies in this district have dedicated
14 significant resources to the effort against mortgage
15 fraud.

16 Mortgage fraud is the highest criminal priority
17 in my office and I've assigned additional assistant U.S.
18 attorneys to handle mortgage fraud cases and I have
19 sought and received additional resources for this
20 effort.

21 Despite all that has been accomplished, much
22 remains to be done our investigations are active, we are
23 indicting two defendants this morning in our Fresno
24 office charged with mortgage fraud offenses.

25 Next week, my office and the Financial Fraud

1 Enforcement Task Force will be hosting a mortgage fraud
2 summit in the Fresno office and in the Fresno courthouse
3 and the following day will be in Los Angeles. These
4 events will bring together law enforcement regulators,
5 the public, federal and state local agencies, industry
6 participants, advocates, and member of the public to
7 share information and strategies, look at trends, and
8 enhance collaboration.

9 In conclusion, the Eastern District of
10 California has been hit very hard by the mortgage fraud
11 crisis and people in our communities have suffered the
12 consequences of it, but my office has devoted
13 extraordinary resources to persuing those who have
14 perpetrated mortgage fraud and we continue to increase
15 our efforts, follow new trends, and achieve significant
16 results and. I thank you four your time.

17 CHAIRMAN ANGELIDES: Thank you very much. We
18 will now begin the questioning. I will start the
19 questioning and we will move on to the other
20 commissioners. So first of all, let me ask some of you
21 on the panel a question on the lines of what did you
22 know and when did you know it?

23 Much of what we have heard, in fact, apropos of
24 Mr. Thompson's questions were that many people
25 particularly policy makers and people on Wall Street

1 said they never saw it coming. I want to get a sense of
2 what people saw and felt at the ground level.

3 So first of all, Ms. Mann, in your testimony,
4 you talked about concern about the growing gap between
5 home prices and wages; about the fact that sales prices
6 and essentially sales peaked in late '05; you saw
7 dramatic changes in underwriting, in fact, you noted
8 that you were troubled by the fact that folks were being
9 qualified at introductory rates, the teaser rates versus
10 their full ability to pay.

11 Just tell me -- I guess you started laying
12 people off in, what, 2004, 2005?

13 MS. MANN: That is correct because I was
14 anticipating -- I knew that once it stopped, once it
15 would turn, it would turn very rapidly. In looking back
16 at the prior trends in real estate in the '80s and the
17 '90s, and even as far back as the '70s, you could see
18 that there would be a normal trend where there would be
19 a peak, and then it would hit at the very top and then
20 it would go down.

21 Well, consistently, if you look at the trends
22 over and over, you will find that the bigger the peak,
23 the bigger the fall. And you hate to put it that way,
24 but that's exactly what happened. So I saw we were
25 running up for four or five years of a very large

1 tsunami, for lack of a better word.

2 I anticipated that the fall was going to be
3 intense, much like the savings and loan debacle in the
4 early '90s. I anticipated the banking debacle to
5 actually be worse, so once I observed that the market
6 just started to change, housing prices were starting to
7 change, the increase of inventory in 2005, I pulled back
8 the reins and said, "It's time. It's starting now."

9 CHAIRMAN ANGELIDES: All right. Mr. Putnam,
10 you talked about the lack of market and management
11 discipline. You said essentially the industry's evolved
12 in a way that harmed consumers, the industry, the
13 stability of the system. I think you said in your
14 interview with our staff that there were, "no brakes on
15 the system."

16 You had indicated both regulatory gaps as well
17 as a failure of the industry to police itself. When did
18 you see and what did you see in terms of the wheels
19 coming off the mortgage market?

20 MR. PUTNAM: Well, from my perspective it was
21 in 2002. I had been employed with a mortgage banking
22 company that was primarily involved with agency Freddie
23 Mac, and FHA loans, and we were purchased by Washington
24 Mutual in January of 2002. And I worked with Washington
25 Mutual for five months and that was my first experience

1 with a portfolio under a very aggressive lender who was
2 very active in the subprime, Alt-A product.

3 And one getting exposed to those new products
4 and also being exposed to the separation of the loan
5 originators and underwriters and operations, there was
6 very little understanding of what the risk of the loans
7 were. In my opinion, there wasn't any accountability
8 for the local manager on what happened to the loans as
9 you were working on.

10 For me that was eye-opening. And I left that
11 in May of 2002. I was much more comfortable in a
12 mortgage banking setting that was dealing with primarily
13 agency and not government loans.

14 CHAIRMAN ANGELIDES: Let me ask you one
15 follow-up question. The matter of yield spread
16 essentially rewarding people for riskier, higher-priced
17 loans, when did that seep into the marketplace? When
18 did that become a predominant way of compensation?

19 MR. PUTNAM: Well, it's, I think, in the
20 mid-'90s it was a part of -- it was part of the
21 compensation. I think it's always been part of the
22 commission structure and the compensation structure so
23 it was there.

24 I think the natural break was that when 85 or
25 so percent of the market was agency- and

1 government-related lending that those tended to be more
2 competitive and it was more difficult to sell more
3 spreads. So it was -- it kind of -- the market
4 disciplines kind of --

5 CHAIRMAN ANGELIDES: There was a much more
6 narrow spread.

7 MR. PUTNAM: Yeah. And then after that you had
8 subprime and Alt-A, they were often proprietary products
9 of different savings and loans or mortgage companies.
10 You could only get that product that place, so it took
11 away the pricing disciplines and allowed people to come
12 out with new and innovative products, but had bigger
13 spreads that allowed for more yield spread premium
14 overage opportunities.

15 CHAIRMAN ANGELIDES: Mr. Stein, let me ask you
16 a question about interaction with regulators. You
17 mention in your testimony that you were in touch with
18 the Federal Reserve about HOEPA, and for the folks in
19 the audience, that's the Home Ownership and Equity
20 Protection Act that sets some standards, at least in
21 law, and there was some regulations adopted in 2001
22 presumably to protect people against predatory lending.

23 Talk to me a little bit about what you saw and
24 was conveyed to regulators specifically around the
25 issues of predatory lending, high-cost lending, and kind

1 of in what sequence.

2 MR. STEIN: Well, I mean, the communication
3 with legislators took various forms. And one of those
4 that you are referencing is there is a formal process
5 where The Fed is seeking comments on the regulations
6 that it has authority over, like under the Home
7 Ownership and Equity Protection Act.

8 There was a few such processes over the last
9 decade, and our organization and many like us throughout
10 the country would continue to raise concerns about the
11 kinds of loans that borrowers were coming into local
12 legal aid offices, local housing counseling agency
13 offices with, and highlighting those for the regulators
14 and urging that the regulations be strengthened so that
15 HOEPA -- HOEPA, in essence, is kind of like the federal
16 antipredatory lending law. And it's important but it
17 has been limited in that it does not reach enough
18 transactions to -- the triggers for what -- when the law
19 kicks in are very high.

20 So one of the issues that had been raised is
21 that the triggers need to be lowered and I think The Fed
22 actually did lower the triggers at one point. But the
23 general idea is that through that process and many
24 others, community groups had tried to communicate to the
25 fed and others that there was a lot of bad lending as

1 the other panelists have noted. The underwriting seemed
2 to have gotten worse, people were getting abused, and
3 that more needed to be done, that the legislation and
4 regulations that were in place were not sufficient.

5 CHAIRMAN ANGELIDES: During what time frame did
6 you begin to communicate these concerns?

7 MR. STEIN: I started at CRC in 2000. I would
8 say from 2000 on there's been -- on we have submitted -- I
9 think I went back, dozens of comment letters there have
10 been hearings on various regulatory processes and even
11 in kind of a bank merger context we are always raising
12 concerns about fair lending issues.

13 You know, one particular issue -- there is
14 fraud but also just the very nature of subprime. At
15 best subprime is higher cost, but the question is are
16 people who are getting the subprime loans really not
17 entitled to a lower-cost product? And as subprime
18 really expended, one of our concerns was that a large
19 number people who were getting stuck with these
20 higher-cost loans really had credit profiles that might
21 qualify them for lower-cost loans.

22 And as you mentioned, the Long Beach Mortgage,
23 one of our issues was looking at the larger bank holding
24 companies where you have -- you have different lending
25 entities owned by the larger financial institutions, and

1 many of them own subprime lenders like Long Beach
2 Mortgage.

3 And one of the things that we found, and I
4 think to some extent, the Federal Reserve in their
5 analysis confirmed, that you have subprime lenders that
6 seem to be doing a lot more business in the
7 neighborhoods of color with borrowers of color, and who
8 are affiliated with prime lenders who are kind of the
9 opposite and there is really no communication between
10 the two.

11 So if, for example, Long Beach mortgage is in
12 certain neighborhoods in Sacramento but there are people
13 there who might qualify for better loans, isn't it
14 incumbent upon Washington Mutual to make sure that
15 borrowers are getting the best loan product that they
16 deserve and not the loan product that's being offered to
17 them by the broker that happens to be coming to their
18 door?

19 So there are a lot of issues that have been
20 raised, and it's hard to try to keep testimony to 5
21 minutes and to 10 pages, but I think suffice it to say
22 that there has been a lot of communications from
23 community groups and others to The Fed in particular,
24 but the other regulatory agencies about the fact that
25 more needs to be done.

1 CHAIRMAN ANGELIDES: Mr. Wagner, let me talk to
2 you, then I am going to swing back to all the other
3 panelists about the issue of mortgage fraud.

4 So in some information or estimates that have
5 been provided to us, it has been indicated that perhaps
6 the losses annually at the peak] from mortgage fraud
7 may be in the range nationally of 100 billion to
8 137 billion.

9 We heard it in Florida earlier this week that,
10 of course, SARs, which are Suspicious Activity Reports,
11 only about a third, 20 to 30 percent of the institutions
12 making mortgage loans were even required to file these,
13 so if there were 60,000 being filed a year, probably
14 means there was really upwards of 180- to 240,000 had
15 you covered the full market. It was also indicated that
16 very few frauds are really detected at origination; and
17 therefore, there could be great extent.

18 So here is my question that struck me as I've
19 learned more and more about this issue: It seems to me
20 that the environment was created where there was a
21 ripeness for fraud; that the minute there was the
22 proliferation of no doc, minimum documentation loans --
23 it used to be reserved for people with extraordinarily
24 strong credit histories, perhaps credit histories with
25 that lending institution -- you actually created a

1 systemic risk of widespread fraud.

2 And particularly in the context of falling
3 underwriting standards, what someone described in
4 Florida as hot-potato financing where the originator is
5 not holding on to the loan.

6 So I guess one of the questions that I have for
7 you as you look at prosecuting mortgage fraud, during
8 the S&L crisis, a lot of the focus was on the
9 institutions themselves. We heard in Florida that in
10 the S&L crisis there were about a thousand priority
11 felony convictions, but they really went to the
12 institutions who drove the products.

13 To what extent are your prosecutions looking at
14 originators, lenders, and the very moving of these
15 products that created the opportunity for fraud?

16 MR. WAGNER: I don't know much about the S&L
17 crisis. I'm happy to say that was before my time. But
18 in terms of prosecuting lenders, we are pursuing -- as I
19 mentioned in my testimony, we are pursuing people
20 involved -- in all walks of life who were involved in
21 mortgage fraud. That includes lenders we have charged
22 employees. In fact, Mr. Stein mentioned Long Beach
23 Mortgage. We have charged people from Long Beach
24 Mortgage.

25 So we're are looking at lenders, at brokers, at

1 real estate agents, that they're -- it really was -- I
2 agree with your assessment that there was kind of a Wild
3 West atmosphere going on in the middle part of the
4 decade that involved a lot of people, some of them at
5 lenders.

6 In our case, in our district, there were a lot
7 of unlicensed individuals who were working for loan
8 brokers or working for real estate agents who don't
9 appear on any regulated list of licensed individuals and
10 they are often the biggest problem. There was very
11 little oversight of them, and a lot of our cases
12 originated with sort of fly-by-night new operations that
13 began in this district.

14 Now, in terms of the Eastern District of
15 California, we really look for specific evidence of
16 specific crimes by specific individuals. We don't -- we
17 are not market regulators and so we are not -- we are
18 not basing our prosecution decisions on kind of larger
19 market issues. We look at specific targets and specific
20 cases.

21 In my particular district, relatively few of
22 the banks and lenders have headquarters in this
23 district. And so there is a lot of activity and so we
24 are pursuing a lot of the employees who are active in
25 this district. But in terms of the larger entities and

1 their policies and so forth, those are generally cases
2 that would be venued in districts where those banks are
3 located, if I understand your question correctly.

4 CHAIRMAN ANGELIDES: Well, yeah, but so my
5 question is also -- I mean, you have an institution,
6 Long Beach Mortgage, which has come up a couple of
7 times, 100 percent dependent on mortgage brokers. They
8 are offering a product, it seems the opportunity for
9 fraud is ripe. I guess the real question is to what
10 extent can this be attacked systematically?

11 MR. WAGNER: I don't know the answer to that.
12 In terms of the '04-'06 period, again, as I mentioned,
13 as prosecutors, we -- I completely agree with what you
14 were saying. There was a ripe environment for fraud in
15 the real estate industry during that period, no doubt
16 about it, we are seeing that very much in our cases that
17 we prosecute today.

18 Back in '04, '05, '06 in that period, again, our
19 interest is in specific -- you know, following specific
20 leads for specific defendants. And we -- as I mentioned
21 in my testimony a few moments ago, we were seeing --
22 although we got some leads and we did open some cases in
23 2004, we received very few leads to open specific cases
24 during that period because the market was increasing and
25 generally no one was suffering a loss; and therefore, we

1 were getting very few reports.

2 And in 2006 when the market turned and we began
3 getting quite a large number of leads, I think we got on
4 it very quickly here in this district and have been very
5 active ever since.

6 CHAIRMAN ANGELIDES: You have been with the
7 U.S. Attorney's Office for how many years?

8 MR. WAGNER: I've been there since 1992.

9 CHAIRMAN ANGELIDES: So just very quickly, in
10 January of 2003, MARI, which is the -- associated with
11 the mortgage brokers, sent out a survey to their members
12 saying they were seeing in 2003 a moderate to
13 significant increase in fraud.

14 The FBI warned in September '04 that there was
15 a "epidemic" that could leave us with losses as big as
16 the S&L crisis. Ms. Mann referenced that.

17 By '06, MARI, again, this industry-related
18 group said, "Competitive forces were leading to products
19 that have the potential for fraud."

20 Did you proactively in this office in the '04,
21 '05, '06 -- and actually, again, the industry-related
22 group in '06 looked at 100 loan files and found that
23 60 percent of the incomes were exaggerated by more than
24 50 percent, were there any investigations opened during
25 that period, to your knowledge?

1 MR. WAGNER: Yes. I mean, in my district we
2 opened investigations in 2004, but I don't think it's a
3 result of those reports. I am personally not familiar
4 with the FBI report in 2004.

5 Again, our role as prosecutors, we have no
6 involvement in the real estate, housing industry at all
7 as regulators in oversight except to prosecute
8 criminals. So our decisions and our prosecutions are
9 really driven by specific information. And so we really
10 did not -- we did not -- you know, we don't, on the
11 basis of a report -- I mean, kudos to the FBI and to
12 MARI for identifying, I think what was a very real
13 problem, but it wasn't brought home to us in terms of
14 actionable cases.

15 Again, we have to find cases that are beyond a
16 reasonable doubt, specific individuals to the
17 satisfaction of a unanimous jury. So it's a fairly high
18 standard and we are looking for evidences in specific
19 cases as opposed to assessments of the state of the
20 industry.

21 CHAIRMAN ANGELIDES: So very quickly, then, I
22 just wanted to ask you, and I'm running short on my
23 time, probably over my time, but let me quickly ask
24 Mr. Putnam and Ms. Mann, I know you probably don't have
25 data, but what were you seeing in terms of what you

1 thought might be fraudulent transactions in '04, 05,
2 '06, '07 time period very quickly? Ms. Mann?

3 MS. MANN: Not so much in the way of mortgage
4 transactions, what I saw was the preponderance of
5 unqualified appraisers out there, perhaps providing
6 appraisal reports that were not as reliable as the more
7 experienced appraisers.

8 Also, the lending institutions did away with
9 chief appraisers or review appraisers, so you didn't
10 have somebody really going through the appraisal report
11 and looking for the pertinent data to verify if the
12 appraisal was accurate or not.

13 CHAIRMAN ANGELIDES: So you are saying the
14 environment was ripe for appraisal fraud?

15 THE DEPONENT: Yes, it was ripe for a fraud and
16 also for the inexperienced appraiser to just get one
17 passed.

18 CHAIRMAN ANGELIDES: All right. Mr. Putnam,
19 very quickly.

20 MR. PUTNAM: I think we -- "fraud" is defined
21 as somebody breaking the rules. And I think rather it
22 was a combination of fraud it was also a combination we
23 were changing the rules. And so a lot of the low doc,
24 no doc, the credit, we quit looking at things and so we
25 defined a fair amount of the fraud away. And so by the

1 time it hit the mortgage system, unless there was a
2 clear misstatement of something, it wasn't fraud it
3 was --

4 CHAIRMAN ANGELIDES: Because the stand -- the
5 benchmark of what would constitute a fraud --

6 MR. PUTNAM: It was only given information
7 which the lenders were requesting.

8 CHAIRMAN ANGELIDES: Very interesting
9 perspective.

10 Final and really a "yes" or "no" very quickly
11 -- that's a very interesting perspective that the bar
12 was so lowered as to eliminate what would historically
13 would have been fraud in the marketplace.

14 Very quickly, "yes" or "no," do you get many
15 referrals from regulators? I know you are not a
16 regulator; do you get referrals from regulators?

17 MR. WAGNER: We get a lot of --

18 CHAIRMAN ANGELIDES: You get the SARs?

19 MR. WAGNER: We gets SARs from lenders, yes.

20 CHAIRMAN ANGELIDES: I am asking have the
21 regulators referred cases to you?

22 MR. WAGNER: I am sure the answer is yes, but I
23 could not give you a quantity on that.

24 CHAIRMAN ANGELIDES: Because one of the things
25 that was said to us in Florida by former S&L regulators

1 is the regulators have to be the sherpas to law
2 enforcement. You can't expect law enforcement to find
3 it, you got to expect the people who refer what they see
4 as problems.

5 MR. WAGNER: Just one sentence on that very
6 briefly. Part of the issue here is that the regulators
7 primarily that we were looking at is the Department of
8 Real Estate and California state regulators. And so
9 sometimes there is a disconnect between the state
10 regulators and the federal enforcement.

11 We've tried to bridge that and, in fact, in our
12 task force, one of the first things we did in 2006 was
13 to invite DRE, the Department of Real Estate, in to be
14 our, sort of, eyes and ears in the industry to help us
15 generate a more smooth referral process to federal
16 enforcement.

17 CHAIRMAN ANGELIDES: Thank you very much.

18 I would like to call on the Vice Chair now, but
19 just very quickly before I do, I'd like to recognize
20 Assemblywoman Mariko Yamada who represents Yolo County
21 and Sacramento who has joined us.

22 Thank you for being here, Assemblywoman.

23 ASSEMBLYWOMAN YAMADA: Thank you.

24 VICE CHAIRMAN THOMAS: Thank you, Mr. Chairman.

25 Based upon earlier statements that some of you made, I

1 just think we need to put it on the record that the
2 Financial Crisis Inquiry Commission's statute
3 responsibility is to examine and explain the financial
4 crisis, not in the statute to make recommendations as to
5 what should be done.

6 Although I think we are all in agreement that
7 if you examine something and you report it, what is left
8 out or not structured can provide that kind of
9 information. I can assure you that it's frustrating to
10 a certain extent, but when you are created by Congress
11 on a partisan vote with partisan panel, you do
12 everything you can not to deal with issues that invite
13 partisan separation. And coming up with solutions is
14 and always will be one of those.

15 Ms. Mann, I have been really shocked, Gary
16 Crabtree, you may know Gary Crabtree down in
17 Bakersfield, he reported much the same concern that you
18 had in terms of what was happening with appraisers who
19 thought they were professional, did a thorough job and
20 gave answers to the best of their ability, were honest.

21 I think when you look at medicine and the role
22 that drugs have played increasingly in medicine, we have
23 focused on pharmacists in terms of, one, their
24 knowledge -- their pharmacological knowledge, but as
25 people are more and more taking multiple drugs, their

1 reaction between them and the rest. I always thought of
2 appraisers in a similar role in housing, because
3 whenever you think about buying or selling a house, the
4 first thing you ask is, "What's it worth?" And if you
5 can't get a grounding in a kind of a professional way,
6 then you just out to sea.

7 You also mentioned on page 15 in your testimony
8 the great desire to keep people in the homes, having the
9 homes occupied if you aren't keeping them there because
10 of what happens -- as Mr. Wagner said -- to foreclosed
11 homes in tracts that get vandalized and drag down
12 various properties.

13 We heard testimony over and over again,
14 especially in Las Vegas, but to a certain extent in
15 Miami, and we heard it in Bakersfield as well, that
16 there were people who were ready, able, willing to try
17 to modification, even going so far as a short sale to
18 get rid of the property and get people into it. But it
19 was very, very difficult to do.

20 And what we heard, especially in Las Vegas and
21 to a certain extent Miami, is that there would be this
22 eventual foreclosure, then a very quick one-day, two-day
23 resale at a significantly higher price, which I assume,
24 based upon that kind of a behavior pattern, your
25 argument that the problem was easy money may, in fact,

1 carry over to this business of not modifications, not
2 short sales, but foreclosures because of the money.

3 Any reaction?

4 MS. MANN: Oh, yes, I absolutely agree. I
5 have seen and I know way too many people that had a
6 short sale in process, they sold their home, and
7 conversely the bank takes it back at a much lower
8 price. And I've seen both scenarios, where the bank has
9 actually ended up auctioning the home while it was in
10 escrow for a short sale at a lower price than what they
11 could have gotten for the short sale, or somebody comes
12 in and fixes the home up and sells it for \$50,000 more.

13 That just happened across the street from my
14 own personal residence. So I am seeing that there are
15 opportunists in the market going up and there is
16 opportunists in the market going down. The bottom line
17 is we need to be watching out for that.

18 VICE CHAIRMAN THOMAS: Thank you.

19 Mr. Putnam, what happened in our area, and
20 again, I am referring to the Valley, basically
21 Bakersfield and Sacramento, was that for -- and it's
22 easier for people in Sacramento to follow a flatland to
23 San Francisco and vice versa than it is people in LA to
24 go over a 4,000 foot mountain range to come to
25 Bakersfield. They go up to Palmdale and Lancaster.

1 So for a very long time, the housing market was
2 basically a local realtors, local builders, and you saw
3 advantages moving up. But as we got into the 21st
4 Century, we had an enormous influx of national builders
5 and nationally affiliated realty and therefore mortgage
6 folk.

7 And what happened was lots that were for 30,000
8 all of a sudden got outbid up to 100,000, and the very
9 cheap local costs of housing began to escalate, which
10 then created a portion of that.

11 Did you see that in this area as we moved up 80
12 to Lindsey and then to Auburn and on up the slope? Did
13 you see national builders coming in or had they been
14 here for a while?

15 MR. PUTNAM: Yes, national builders tend to
16 come move with movement in sales prices and movement in
17 demands. So Sacramento came on the radar in the late
18 1990s as population and job growth occurred, yes. And
19 it did change. I think where you see that the most is
20 out the travel patterns the -- out 580 around Manteca
21 and Ripon and Tracy became overnight bedroom communities
22 for San Jose.

23 You had Fairfield, Vacaville, Dixon corridor
24 coming up where people could still commute to Walnut
25 Creek and job centers there. Elk Grove got a little of

1 both. You could sort of get to the East Bay pretty well
2 from South Sacramento, and you got tremendous growth in
3 those areas.

4 And I -- so the -- in hindsight, of course,
5 then you look at -- that's where the major increases in
6 new homes were, that's where the land was, but it's also
7 where the traffic patterns were, and also those would
8 have been the greatest declines in house prices over the
9 last three years.

10 VICE CHAIRMAN THOMAS: Mr. Stein, I came to
11 Bakersfield in 1965. I taught at the college there for
12 10 years and I said that Sacramento was not just the
13 State capital, it was a valley town. And frankly, one
14 of the things you can do in valley towns, if you have
15 never been in one, is to get in a car for one hour,
16 drive around the larger town or city area.

17 You can then sit down with a map and using
18 railroad lines, freeways, natural barriers, rivers, or
19 whatever, you pretty well establish the demarcation, not
20 only in terms of ethnic and color communities but also
21 economic communities it's very familiar. You can do
22 that in San Francisco, Los Angeles and San Diego as
23 well, but when the concentrations are as large as they
24 are in those metropolitan areas, you don't have a
25 communication network like you do in many valley towns.

1 And so what I did in working with a lot of the
2 ethnic and, as you say, groups of color was to know that
3 there was a network, there were churches, there were the
4 centers, and word-of-mouth was one of the quickest ways
5 to get this information around.

6 And I'm wondering as we look at these patterns
7 in your testimony, of 56 percent of the Latinos, 57.9 of
8 African-Americans were in the higher subprime, weren't
9 they asking people what these are? Didn't they
10 communicate with each other? And it just seems to me
11 that my immediate assumption -- reinforce this or not --
12 was that it tended to be people from similar groupings
13 preying on these people; and therefore, they didn't ask
14 the kind of questions that outsiders, if they had come
15 in the area, would have asked. Is that an accurate
16 assessment?

17 MR. STEIN: I think that's exactly accurate.
18 Our -- what we have gathered is that's the very dynamic
19 and you certainly see it in linguistic communities,
20 immigrant communities where it's almost a necessity.
21 And the brokers were really kind of the bad actors here
22 so someone could see an easy market speaking the same,
23 language as somebody else and borrowers develop a sense
24 of trust.

25 Also, I mean, the role of the broker, too, just

1 by its very nature, consumers reasonably believe that
2 the broker is looking out for their interest. You go to
3 a broker because a broker has access to various loan
4 products and not to one particular lender who offers
5 that particular lender's products.

6 But what we saw during this time is that the
7 interest of the brokers was in many ways contrary to the
8 interest of the consumer. So if it wasn't -- didn't
9 make sense for me to buy a house, it's -- the broker
10 might not necessarily tell me that because then they
11 won't make any commission. They might get a yield
12 spread premium and charge me more from the lender. They
13 might induce me to fold in my credit card debt to
14 increase the loan balance.

15 And so the system was really kind of, in that
16 way, stacked against the broker. People definitely had
17 this feeling of trust that you kind of alluded to and
18 it's kind of affinity communities preying upon each
19 other.

20 I think the one last thing to say about it is
21 also I think for some -- and we found this when we
22 actually interviewed borrowers in 2000-2001 -- that many
23 borrowers felt that they -- that the mainstream
24 financial institutions were not available to them. For
25 whatever reason, rightly or wrongly, they -- most of the

1 borrowers who had subprime loans we contacted just
2 because we bought lists of subprime borrowers. They
3 didn't go to a mainstream financial institution because
4 they didn't think that that institution was there for
5 them. Maybe it wasn't in their community, maybe they
6 had prior bad experience.

7 So yes, in answer to the question, yes.

8 VICE CHAIRMAN THOMAS: Mr. Wagner, you were
9 nodding your head as he was talking. I assume you are
10 getting some evidence as you go after these various
11 fraud activities.

12 MR. WAGNER: Yes, we don't keep statistics,
13 obviously, by race or ethnicity of the victims. But
14 anecdotally, I can tell you within this district, we
15 have seen a number of cases in which the victims are
16 clustered in particular immigrant communities or English
17 is the second language communities, so that's consistent
18 with what we found.

19 One observation I would add to that is that not
20 only are members of communities of color or English
21 second language often targeted as victims, and again, as
22 Mr. Stein was saying, often by people in their own
23 communities, but they are also often recruited -- I
24 think for the same reasons -- often recruited by
25 fraudsters to serve as straw buyers in cases.

1 So we often see clusters of straw buyers and
2 people who I think have very little understanding of
3 what they are getting into.

4 VICE CHAIRMAN THOMAS: And with the easing of
5 the kind of standards where you didn't go out to
6 third-party appraisers or the rest it just made it a
7 whole lot easier to keep it in house in terms of
8 structure?

9 MR. WAGNER: That's right. And as I mentioned
10 earlier, particularly during this time period, in the
11 middle part of this decade, they were often brokers,
12 lenders who would have a number of people working for
13 them and would hire people from those communities who
14 spoke those languages to facilitate that process, yes.

15 VICE CHAIRMAN THOMAS: Thank you very much.

16 Thank you, Mr. Chairman.

17 CHAIRMAN ANGELIDES: Mr. Thompson.

18 COMMISSIONER THOMPSON: Thank you,
19 Mr. Chairman.

20 Mr. Stein, I would like to pursue a line of
21 questioning with you about federal preemption. In
22 another role for me, I have served on the National
23 Infrastructure Advisory Committee, which advises the
24 President and the Congress on issues around national
25 security, particularly post 9-11.

1 And in that group we rely greatly on what we
2 call "first responders" because we know that if
3 something is going to happen locally, it's the local
4 firefighters, it's the local police, it's the people at
5 the local level that are likely to not only see it
6 first, but have to respond to that calamity when it does
7 happen.

8 So I want to take that analogy if I might and
9 apply it to what happened in the lending environment in
10 the 2004-2008 timeline. So can you speak to what
11 preemptive activities occurred by federal regulators and
12 what actions were taken by them to stop or block, if you
13 will, the reflection that there was predatory lending
14 going on?

15 MR. STEIN: A couple of -- I will mention a
16 couple of things. So we talked about HOEPA is the
17 federal anti predatory lending law in a way. What was
18 happening as the bad loans started to increase, state
19 legislature was trying to pass their own predatory
20 lending legislation, and they kind of modeled it after
21 HOEPA.

22 So -- I was suggesting there were weaknesses in
23 HOEPA, so states tried to kind of fix it and get it
24 right at least within their states. And the OCC, the
25 Office of the Comptroller of the Currency, in particular

1 was protective in essence of the national banks who now
2 make up such a vast majority of the presence of
3 financial institutions in our communities in saying
4 that, for example, the state of Georgia should not be
5 able to pass a law that would affect the obligations of
6 national banks operating in the state of Georgia.

7 So the principle, obvious to all of you, was
8 that -- you know, their feeling was that national banks
9 shouldn't be subject to 50 state local laws, and they
10 carved out a doctrine that was a great expansion in the
11 view of many community groups and advocates of their
12 historic position on preemption. That had a
13 trickle-down effect.

14 So in Sacramento during this time, most of the
15 years there was legislation around predatory lending,
16 and one of the issues that would always come up is,
17 "Well, if this passes, the national banks won't be
18 covered because of OCC preemption. The federally
19 chartered thrifts won't be covered because of OTS
20 preemption."

21 So we would be, in essence, creating a
22 competitive disadvantage for state licensees, for
23 lenders that are not federally chartered. So it was --
24 in a way, the preemption created a race to the bottom
25 and the argument of the control of the currency's office

1 at that time is we don't want national bank disfavored,
2 disadvantaged by these state and local policies. But
3 what they wound up doing was bringing everybody down as
4 a result.

5 One other example. In -- a few years ago the
6 Attorney General for the State of New York sued four
7 large lenders citing the very data that we and other
8 groups use, the HMDA data, saying, "It sure seems like
9 in the state of New York, you four large lenders are
10 charging more to Latino borrowers and African-American
11 borrowers than to white borrowers."

12 Three of the banks were federally chartered
13 under the OCC, and the OCC, in essence, stepped in and
14 prevented the Attorney General -- which is really kind
15 of unbelievable, I think, to think about, that the OCC
16 was saying to the Attorney General in the State of New
17 York that he had no ability to enforce the Fair Housing
18 Act, Federal Fair Housing Law against national banks,
19 that that was their responsibility. And they were
20 successful.

21 And I don't know what fair lending actions have
22 been taken against those three national banks as a
23 result, I think nothing has been done.

24 COMMISSIONER THOMPSON: So to stay with the
25 analogy of first responders for a moment if I might,

1 what level of local visibility and on-the-ground
2 coverage did those federal agencies have to have a sense
3 of what was going on in the local market?

4 MR. STEIN: That's a good question. I mean,
5 the federal banking regulatory agencies do have offices
6 in California in a few communities, and they have
7 communities affairs people who actually are out in
8 communities and working in the way that they can to
9 promote positive community development.

10 COMMISSIONER THOMPSON: So it's not like they
11 were oblivious to it or could not have seen these
12 actions?

13 MR. STEIN: Not at all. I mean, getting back
14 to the earlier -- an earlier point, the -- they were --
15 they were involved in federal -- national regulatory
16 processes. They were inviting comments and receiving
17 comments from us and from many, many others about the
18 bad lending that was occurring from, you know, 2000 on.

19 So they certainly knew. We had conversations
20 with all of them and their folks were out in the
21 communities. And also, on the specific preemption
22 issue, the OCC, I believe, submitted for solicited
23 comments on whether the public agreed with its intention
24 to kind of move more aggressively to preempt state and
25 local governments. And I'm not sure how much they

1 really looked at those comments.

2 COMMISSIONER THOMPSON: Thank you.

3 Mr. Putnam, can you comment on the role of the
4 government's push for home ownership and the
5 participation of the GSEs in that process and how it
6 might have contributed to challenges in this local
7 market or elsewhere?

8 MR. PUTNAM: Yes. And I think that's related
9 to some comments earlier. It's tricky when you get into
10 looking back on this stuff and whether lending was --
11 there was two themes going on. Now we look at it as far
12 as some of the outreach to the ethnic and lower-income
13 groups as predatory.

14 At the time it was viewed as helping
15 underserved populations achieve a share of the of the
16 American Dream and so it's kind of tricky to both look
17 at it from when I was in it before and look at it now
18 because at the time it was an admirable thing. I think
19 the companies were trying -- saw it as additional
20 business opportunities certainly, but also saw it as
21 part of a general push to bring people into this
22 wonderful market that house prices continued to go up
23 and we didn't want to leave people behind.

24 So there was that theme. I think it's a matter
25 of balance. What came out of that was changes to

1 underwriting that, I think, at the time attempted to
2 address the different, maybe, cultural and ethnic
3 differences that were obstacles to home ownership.

4 At the time, the GSEs, the agency -- Fannie and
5 Freddie were reviewing how down payments -- the source
6 of down payments changed, that you before had to come up
7 with money from your own accounts. And there was
8 allowances for group funds where cultural groups could
9 band together and provide money and that was an
10 allowable down payment.

11 I think new cultural groups and immigrant
12 groups had less depth of credit so credit approaches
13 changed where you could either have less number of
14 account where you could measure someone's credit
15 background. And you could come up with what they called
16 "alternative credit," where you could go -- maybe if
17 people were not participating with banks or people that
18 were lending institutions that were reporting to the
19 credit bureaus, you could take documentation from
20 jewelry stores or cell phones and other forms of debt as
21 a measurement of one's credit background.

22 So I think those things contributed. They were
23 admirable at the time. I think they -- and you have to
24 also say that it greatly expanded credit opportunities
25 for millions of people in America it's just over time as

1 we race to the bottom, I think it just got out of
2 balance and there weren't market disciplines.

3 COMMISSIONER THOMPSON: What I am looking for
4 is cause versus effect. So the government's desire to
5 have more home ownership, was that the influence or was
6 it just sheer greed by those who were originating
7 mortgages who found creative ways to finance and take
8 advantage of normal outside liquidity in the market?

9 MR. PUTNAM: I think from the agency point of
10 view it was an incremental change. If you look back,
11 the initial -- in 1999 the agency underwriting started
12 changing. If you look at the 2003 annual report of
13 Fannie Mae, they were addressing under served markets.
14 So you could see they were moving that way to try to
15 address, I think, the other part of your question about
16 chasing the money. And I think there were other -- that
17 the rise in subprime and Alt-A players were chasing a
18 profit opportunity.

19 COMMISSIONER THOMPSON: So you had to weigh
20 50/50 and lean one side or the other, greed versus
21 government influence, which would have the heavier
22 weight?

23 MR. PUTNAM: Well, the -- in the subprime and
24 Alt-A, I think the greed would weigh. And they were
25 they came from 10 percent of the market to 50 percent of

1 the market by 2000 -- you know, 2005. The agencies
2 were --

3 COMMISSIONER THOMPSON: And that happened to be
4 the fastest growing segment of the market?

5 MR. PUTNAM: That was the fastest growing
6 segment, so --

7 COMMISSIONER THOMPSON: And so greed drove that
8 as opposed to --

9 MR. PUTNAM: And market opportunity and demand
10 and it wasn't -- I mean, it was capitalism, I guess, at
11 its best or worst, depending on how you look at it now.
12 There was plenty of money and people met the need. And
13 then the agency part, I think it was more incremental as
14 they were trying to address some of the goals they were
15 wrestling with.

16 And I think there was a little, by 2003 and
17 2004, market share concern that these non-agency players
18 were rising up to be half the market. The GSEs were
19 looking at "What's our role? And maybe we ought to
20 expand it a little bit more." And there was that kind
21 of pressure.

22 COMMISSIONER THOMPSON: Thank you very much. I
23 appreciate that.

24 VICE CHAIRMAN THOMAS: Could I just take one
25 minute --

1 CHAIRMAN ANGELIDES: Absolutely.

2 VICE CHAIRMAN THOMAS: -- and compliment
3 Mr. Putnam for walking through the affordable and
4 accessible housing minefield as adroitly as you did.
5 I've rarely heard someone explain it in a way that
6 covered not just commendable goals but clearly horrible
7 goals in the way that you did. And I am not being
8 facetious.

9 It's hard for people to talk about it because
10 they tend to go to the polar opposites, and you did a
11 pretty good job of talking about what seemed to be good
12 on affordable and accessible, and how it slipped, and
13 the creative aspects that occurred. The problem was
14 just a whole lot of creativeness. Thank you.

15 CHAIRMAN ANGELIDES: Mr. Putnam had referred to
16 the four Cs earlier, right, collateral capital,
17 capacity, credit, and I guess there was a fifth,
18 charitable.

19 COMMISSIONER THOMPSON: Corruption.

20 CHAIRMAN ANGELIDES: Good point. I was going
21 to say there is two ways to phrase that, "creativity" or
22 "corruption."

23 Mr. Georgiou.

24 COMMISSIONER GEORGIU: Thank you,
25 Mr. Chairman.

1 Mr. Putnam, I am struck at the bottom -- the
2 pages of your testimony aren't numbered. It's the
3 bottom of page 4 of your testimony where you respond to
4 question 3 from our staff. You state: "However, the
5 lack of effective market and management disciplines in
6 the late '90s through 2005 period created adverse
7 participant incentives that harmed the consumer,
8 undermined the viability of mortgage lending companies,
9 and threatened the stability of the mortgage finance
10 system."

11 You know, we have heard a lot of testimony over
12 the last many months of public sector failures of
13 regulations and so forth, but we have also heard
14 testimony regarding a decline in market discipline that
15 could have controlled this increase in mortgages which
16 have now failed us and been securitized into a variety
17 of products that have ultimately failed us.

18 It strikes me that historically the public
19 sector, you know, can, to some extent, be relied upon to
20 regulate. That's an important process. But at the end
21 of the day, the private sector is usually more
22 innovative and more creative and more -- and sometimes
23 more deleterious to the process. So looking for market
24 discipline is an important factor.

25 On the next page you summarized -- in my view,

1 fairly accurately -- several points. Loan officers were
2 often paid on overages, collecting additional fees for
3 selling the consumer a higher interest rate or
4 additional lender-beneficial terms leading to the
5 tendency of some loan officers to maximize commission
6 and expensive consumer interest.

7 Appraisers were hired by loan officers who had
8 direct financial stake in the outcome of the appraisal.

9 Mortgage managers were incentivized on
10 loan-production criteria, on volume, market share and/or
11 profitability, and not generally on loan-quality
12 criteria.

13 And underwriting personnel were incentivized on
14 volume, and post close loan performance evaluation was
15 weak.

16 Can you comment on why it is that lenders who
17 are looking to maximize the likelihood of these loans
18 actually being repaid would participate in a system that
19 seemed to increase the likelihood that they would not be
20 repaid?

21 MR. PUTNAM: I think your first assumption is
22 the one that's flawed. And that is that the lender
23 wasn't always concerned with the performance of the
24 loan. Partly -- I think primarily to the rise and the
25 sophistication of the securitization process, there was

1 much more emphasis on the production of the loan, on
2 doing the loan that would meet the criteria of the next
3 party you were selling it to, and then that party would
4 take the loan and do what it was going to do with it.

5 And from an origination production point of
6 view, which I spent my career, there wasn't a lot of
7 long-term concern about what happened to that loan. It
8 wasn't going to be yours and it was somebody else's
9 problem. And so I think the securitization model
10 contributed somewhat to that in that it created distance
11 between the lender, who was responsible for the lending
12 decision, and the borrower. And I think that
13 contributed to that breakdown, and so there wasn't the
14 accountability on either side that maybe there used to
15 be.

16 And I am not naive about it, but the savings
17 and loan debacle all the felony convictions showed that
18 the savings and loan executives knew exactly who their
19 customers were. So maybe that's not such a great
20 system, either, but the securitization, I think, led to
21 separation of the folks who were getting the money and
22 the folks who were responsible for actually making the
23 lending decision and that created adverse impacts.

24 COMMISSIONER GEORGIU: I guess you make that
25 point in your -- really in your third point, increasing

1 the distance between lender and borrower, which really
2 you say here, "Lenders increasingly saw borrowers as
3 data points in a MBS prospectus," rather than as
4 individuals who could be relied upon to pay the loan
5 back.

6 Ms. Mann, you are nodding your head there.
7 Could you tell me, why would a lender who wanted to
8 maximize the likelihood an originated loan would
9 ultimately be repaid pressure an appraiser to overstate
10 the collateral value of the home to be financed so as to
11 increase the amount of the loan made?

12 MS. MANN: To do the loan. To do the loan so
13 they could make the commission and get on to the next
14 one, and if the appraiser did not work with them, they
15 would find somebody that would. At one point we would
16 receive 20 or 30 faxes in one day from lenders or
17 mortgage brokers from all over the State of California
18 asking if you can hit this number, if you can hit this
19 value, you can do this appraisal report.

20 Well, in our office we threw those faxes away,
21 but I am sure that there were some appraisal firms that
22 said, "Oh, I wonder if we can hit that." But that was
23 the goal. I mean, the goal was hit the number and it
24 didn't mean it was a realistic number or not.

25 COMMISSIONER GEORGIU: All right. And, of

1 course, overinflated appraisals ultimately assisted in
2 moving the bubble, expanding the bubble over time.

3 MS. MANN: They didn't help, did they?

4 COMMISSIONER GEORGIU: No. Mr. Wagner, day
5 before yesterday we were in Florida and we heard from
6 the U.S. Attorney there and some other witnesses and
7 this concept of control fraud was raised. I don't know,
8 are you familiar with that term?

9 MR. WAGNER: I am not, although we see so many
10 different schemes in this area.

11 COMMISSIONER GEORGIU: It's really -- it's an
12 attempt to move up the chain of secure -- go from the
13 lowest level of fraud that occurs at origination, and
14 maybe as perpetrated by either borrowers or brokers or
15 both, up the chain to people more in control of the
16 process and the acquisition of the fraudulently induced
17 loans and to ascertain how high up the chain people were
18 either aware of or consciously not aware of the
19 processes that were leading to loans that ultimately
20 were fraudulent and were purchased up the chain.

21 You testified that not too many of the
22 originating entities were headquartered in this
23 district, so you really don't get that high up the
24 chain, but has there been discussion in the Department
25 of Justice in any way of attempting to move up the

1 chain, if you will, in the prosecutions?

2 MR. WAGNER: Yes, there has. I know in talking
3 to the FBI agents and some of my work with the mortgage
4 fraud working group which is the -- which is part of the
5 Financial Fraud Enforcement Task Force, there has been
6 discussion about that. And I know that there are there
7 are agencies that are investigating those types of
8 cases. I just don't, myself -- for this district,
9 that is not a focus of our mortgage fraud efforts, so I
10 don't personally know much about that.

11 But I do know that those -- the short answer is
12 yes, there are those efforts underway within the
13 department.

14 COMMISSIONER GEORGIU: Right. I mean, it's
15 not uncommon in the prosecutorial world to start with
16 low-level people try to flip them and move up the chain
17 for people that understood the process going higher and
18 it's done in drug distribution and a variety of other
19 matters.

20 And I guess I would just encourage you to, you
21 know, encourage your colleagues to take a look at that
22 because I think that some of the experts that we heard
23 from Tuesday seemed to think that that was a difficult
24 problem; that had the purchasers at all the levels along
25 the chain exercised a greater degree of diligence in

1 purchasing fraud-free products there would have been
2 obviously less economic incentive at the bottom to --

3 MR. WAGNER: I certainly agree with that. And
4 your analogy of going up the chain, which is what we do
5 in a lot of cases, applies here to a degree. I think
6 there are some things that are different about it in the
7 sense that the conduct of individuals farther up the
8 chain may well be negligent or willful indifference to,
9 sort of, the quality of the package.

10 What we look for, for criminal prosecution, of
11 course, is a false statement made with deliberate intent
12 to defraud someone, and that comes into sharp belief in
13 the types of cases we are dealing with where you have
14 phony documents and forged signatures and false
15 statements about income, that sort of thing.

16 The type of activity that you are talking about
17 higher up the chain, it's a much more gray area because
18 the -- proving fraudulent intent is going to be much
19 more difficult in those cases where you don't have
20 affirmative false statements.

21 There may well be cases where there are
22 affirmative false statements, as I mentioned, we are
23 interested in pursuing those, but it's a little bit
24 different than going up, say, an organized crime or
25 narcotics chain where the person at the top knows that

1 they're part of an organization which is deliberately
2 violating criminal law.

3 COMMISSIONER GEORGIOU: Right. Understood.

4 Can I just follow-up with one thing with
5 Mr. Putnam?

6 CHAIRMAN ANGELIDES: Absolutely. I yield two
7 minutes.

8 COMMISSIONER GEORGIOU: Thank you.

9 I want to just follow-up on this last point
10 that you made. And again, from your written testimony,
11 "The development of securitization, proprietary FICO
12 scores, automated appraisal systems, and automated
13 underwriting systems tended to 'outsource' the lending
14 decision and to dilute and reduce the accountability of
15 the lending institutions...From the borrowers' side, the
16 borrowers often did not understand where the funds were
17 coming from. They often dealt with the loan broker
18 first, another lender at loan closing, another lender
19 for the first payment, and another lender or two for
20 later payments. This has led to a subversive shift in
21 both how borrowers regard their mortgage obligations and
22 how lending institutions regard their customers."

23 Could you elaborate on that briefly?

24 MR. PUTNAM: Well, I think the tremendous
25 growth in the mortgage market, partly driven by the

1 demand of consumers, partly by the consumers, partly by
2 the participants that were profiting from it led to
3 innovative new ways of lending.

4 And through that period, against a backdrop of
5 rising house prices, I think we as a lending industry
6 felt that we created -- could create some new, faster,
7 more efficient tools to perform the traditional risk
8 assessments. And some of them, the FICO scores, the
9 automated appraisals, the drive-by appraisals, we moved
10 to things that were shortcuts, and it was based on a
11 presumption that the credit score was predictive and we
12 could reasonably anticipate what people would do.

13 We underwrote people's incomes by they were
14 going to keep their job and continue it, especially
15 extra reliance on overtime and bonuses that we just
16 thought would continue. And I think there were flaws in
17 how it was -- how we took ideas and then ran them too
18 far, and that and doing it in an automated, faster,
19 higher-volume ways just took the element of assessing
20 people's risk and accountability by the loan officer, by
21 the institution, by the bank just -- it broke down and
22 it was shifted to the next purchaser of whatever that
23 loan or that mortgage security was and people didn't pay
24 attention.

25 COMMISSIONER GEORGIU: You know, I remember

1 about a year, almost a year ago now, when we did our
2 first introductory hearing and my introductory remarks
3 alluding back to the "It's a Wonderful Life" film that
4 we all harken to at Christmastime.

5 And I guess it strikes me again that we have
6 gotten so distant from an evaluation of the true credit
7 worthiness of borrowers at the institutions. And this,
8 you know, is, I think, one of the underpinnings of what
9 occurred in this financial crisis, is that we simply
10 haven't done what I would say is qualitative as well as
11 quantitative analysis of people's ability to repay.

12 And I think you seem -- your testimony seems to
13 support that to some extent. We will hear more about
14 that this afternoon. That's why I am asking you about
15 this. I don't know if you're going to be able to stay,
16 but there are a couple of witnesses this afternoon who
17 allude to this absence of what they call "soft
18 underwriting" that really enabled people to evaluate the
19 ultimate ability of borrowers to repay.

20 Thank you very much for your courtesy.

21 CHAIRMAN ANGELIDES: Thank you, Mr. Georgiou.

22 Ms. Murren.

23 COMMISSIONER MURREN: Thank you, Mr. Chairman.

24 Thanks to all of you for spending time with us today. I
25 would like to talk a little bit about a subject that I

1 have been spending a lot of time pondering, and that is
2 what is considered by some to be this, sort of, notion
3 of a deregulatory environment that we were in.

4 And I am especially struck, Ms. Mann, by your
5 testimony because you lay out very clearly what you
6 believe to be moves that were made; in other words,
7 taking it from, sort of, the notional aspect of looking
8 at deregulation or the environment into specific
9 actionable items that can be pointed to.

10 And I was wondering if you could comment on the
11 first instance that you cite in 1994 where there was a
12 proposed rule change that increased the di minimus
13 appraisal threshold from 100,000 to 250,000, which
14 thereby would exempt more real estate loans from
15 requiring an appraisal by a certified professional.

16 And you state that there was vast concern
17 conveyed by appraisers, and I am curious about to whom
18 were those concerns raised and in what manner, if you
19 could talk about that.

20 MS. MANN: Thank you. The appraisal
21 organizations, the Appraisal Institute, the American
22 Society of Appraisers, and the other organizations, a
23 part of The Appraisal Foundation voiced concern to
24 Washington D.C. In fact, I was on a panel. We went to
25 our legislators to voice our concern in 1994, 1993,

1 about the dangers of raising the di minimus to
2 \$250,000.

3 The reason that we were so concerned is because
4 if you look nationwide, you have to figure how many
5 homes are less than \$250,000. It's a lot, perhaps not
6 in the coastal area of San Francisco or New York, but in
7 the interior, in the homeland areas, it's just
8 phenomenal.

9 And we saw the possibility or the danger to the
10 home -- the consumers, the homeowners, and the
11 opportunity for something other than appraisal products,
12 perhaps drive-bys, or just statistics to come up with a
13 "value" based on the fact that it's less than \$250,000.
14 It really doesn't matter anyway. So it almost got
15 rubber-stamped.

16 So that was a big concern of ours as a
17 profession in looking out for the consumer.

18 COMMISSIONER MURREN: Then subsequent to that,
19 you cite where between 1994 and 2003 that bank
20 regulators referred the real estate appraisal oversight
21 to state regulatory agencies. And I guess my question
22 to you on this is: Do you feel that it would have made
23 a difference in the evolution of the financial crisis?
24 If this had not occurred, what would have been
25 different?

1 MS. MANN: I actually don't know what would
2 have been different, but I will tell you that on the
3 state side the states did not have the funding nor were
4 the states organized or have the backing to go after the
5 concerns that -- the potential fraud, the licensees, the
6 states were just absolutely underfunded and they were
7 overwhelmed by just having brand-new licensees in the
8 system.

9 So it was really kind of a "too bad." It was
10 the federal side had a plan and the plan ended up being,
11 "Okay, well, we just don't have time for this. Here,
12 Mr. State, here's -- each of you states, figure it out."

13 And some of the states including California
14 really haven't figured it out as well as they could have
15 or should have.

16 COMMISSIONER MURREN: Prior to that change,
17 though, you could argue that many of the agencies in
18 particular areas are undermanned or -womaned or
19 -powered. Would you say that there was a very great
20 distinction between when it had been in the hands of the
21 banking regulators, and then ultimately when it was in
22 the hands of the state entities?

23 MS. MANN: On the appraisal point of view side,
24 there was a bigger fear cast among appraisers knowing
25 that somebody this the federal government could be

1 overseeing and would be overseeing your work. Or as, if
2 you know, that there is nobody on the state level to
3 really go after you, guess what, it's a free reign.
4 It's Wild Wild West. And that's and the attitude was
5 "Well, who is going to come and get us? I guess, well,
6 let's just go ahead and have a play day."

7 So that was probably the biggest issue is the
8 fact that the perpetrators really knew, who is going to
9 come after them?

10 COMMISSIONER MURREN: Further then in 2003 and
11 '05, you note that bank regulators who, I guess, still
12 had some oversight or some ability to write requirements
13 for appraisers, that they changed the functions to be
14 both appraisals and evaluations, with an evaluation
15 being, in my mind, sort of like a market comparable as
16 opposed to actually going on site and doing a full-on
17 appraisal. And that, again, the appraisal industry was
18 very concerned about this.

19 And I would ask again: How were those concerns
20 conveyed and to whom?

21 MS. MANN: The Appraisal Foundation group, the
22 Appraisal Institute, the American Society of Appraisers,
23 the American Society of Farm Managers, and the National
24 Association of Independent Fee Appraisers lobby in
25 Washington on a regular basis when these issues come

1 up.

2 The reason I know that for sure is that they
3 sent out notices to all of us appraisers so that we will
4 also lobby our representatives to let them know that
5 this is not in the best interest for the consumers of
6 the United States.

7 COMMISSIONER MURREN: Thank you.

8 And to Mr. Putnam, similar line of thinking in
9 trying to evaluate the sequence of events. You had
10 mentioned that the bar was lowered. What bar were you
11 referring to specifically -- and I assume it was
12 mortgage origination standards -- and who was setting it
13 at the time it was lowered?

14 MR. PUTNAM: Are you talking about the
15 underwriting piece or in terms of the regulatory scheme?

16 COMMISSIONER MURREN: I would actually be
17 interested in your comments on both.

18 MR. PUTNAM: Well, on the regulatory structure,
19 it's complicated. I think there is plenty of blame to
20 go around on both the federal and the state. There were
21 issues of exemption preemption, that the federal
22 regulators were not allowing the state to act.

23 But the facts are that the early and worst
24 abusers of subprime were almost all state-licensed
25 entities. The New Century, the Long Beach Mortgage,

1 Fremont, even the early Countrywide were state licensed,
2 and they came out of this period of innovation that at
3 the time the banking regulators were not as interested
4 in.

5 Now, it changed, and that's what makes it
6 complicated because many of those parties either went
7 out of business or were purchased later by banking
8 institutions that came under OTS or Office of
9 Comptroller of the Currency.

10 So it's a tough thing. It's very contentious,
11 but the issue of the proper regulatory setup is mixed.
12 Both make mistakes. And if you look at who performed
13 the worst acts, it was spread through.

14 I think you do need some kind of basic national
15 standard, and then some allowance for the states to
16 address their local needs. But the hodgepodge made it
17 very difficult to keep track of anybody during those
18 go-go years.

19 COMMISSIONER MURREN: And then on the mortgage
20 standards piece of it.

21 MR. PUTNAM: The mortgage standards. For the
22 agency stuff it was fairly centralized and it was a
23 fairly public process and so there were changes
24 announced and debated and you could follow those pretty
25 well, and to the extent they were 80 percent of the

1 market or 50 percent of the market, keep a pretty good
2 handle.

3 As those -- Alt-A and subprime grew, those were
4 increasingly put into mortgage-backed securities that
5 were sold through private -- called "private label"
6 going directly to Wall Street and there weren't -- that
7 was pretty much whatever the terms were of the -- you
8 know, what the descriptions and the prospectus about
9 what those loans were like and what the borrowers were
10 like. There was not great standardization.

11 While I made reference to subprime and Alt-A
12 categories, there was a wide variation in any individual
13 portfolio or mortgage-backed security of what was in
14 there.

15 COMMISSIONER MURREN: But there was no
16 diminishment of the regulatory regime that led to this?
17 If things weren't the way they were, the market just
18 evolved beyond it; would that be fair?

19 MR. PUTNAM: Yeah. Yes.

20 COMMISSIONER MURREN: Okay. Thank you. Just a
21 follow-up question as a loan originator, how did you see
22 your obligation to report fraud when you saw it?

23 MR. PUTNAM: Well, at the local level you were
24 supposed to turn in loan documentation to your company
25 that you were certifying was the best of your

1 knowledge. So there was a little bit of check at that
2 point.

3 So if you knew something to be directly wrong,
4 you generally -- if you wanted to stay in the business
5 as loan originator, you generally shied away from that.

6 However, that gave lots of room for how you
7 approached the question on a no doc loan, for instance,
8 you know, how you phrase the question. "What is your
9 documented monthly income?" is different from "What was
10 your best month that you have had in the last year?" or
11 "What was your income last month including salary, bonus
12 and overtime," which may or may not continue versus --
13 so in my experience, there was very little fraud.

14 It's -- I go back to the definition, it's got sort of --

15 COMMISSIONER MURREN: Who did you have to -- if
16 you saw it, who would you have to then or feel an
17 obligation to report it to? Was it just your company?
18 You didn't feel there was no obligation to report it to
19 any outside entity; is that right?

20 MR. PUTNAM: No, you would generally not turn
21 in the loan. You would work with the customer and if
22 you were uncomfortable with it because you thought it
23 might reflect badly on you, you generally just ended the
24 process. And it didn't show up a lot of times. You
25 just passed and the borrower went to somebody else.

1 COMMISSIONER MURREN: I see. That's helpful,
2 thank you.

3 Could I have two more minutes?

4 CHAIRMAN ANGELIDES: Yes.

5 COMMISSIONER MURREN: Thank you.

6 I wanted to follow-up on -- with you today,
7 Ms. Mann, if I could. So now we are in a situation
8 where you mentioned that there are a lot of appraisal
9 management companies that themselves are held by the
10 banks. And I'm wondering, is it true that there is no
11 disclosure requirement to state that if you are
12 originating a loan, that the appraiser that you are
13 using also has some connection to you as a lender, is
14 that right, so that the customer may not know that?

15 MS. MANN: The customer may not know.

16 COMMISSIONER MURREN: And is it possible for
17 you, in follow up perhaps, to give us a list of these
18 appraisal companies and the banks that hold them so that
19 we could take a look and see how they are connected to
20 one another?

21 MS. MANN: I could do that as a follow up and
22 send it to your offices. I would be more than happy to.

23 COMMISSIONER MURREN: That would be terrific.

24 One final question. The unintended
25 consequences of the recent regulations that have passed

1 about appraisals, could you talk about what opportunity
2 the appraisal industry or individuals have had in
3 actually crafting those rules? Because you mentioned
4 that it didn't work out the way everybody had hoped, at
5 least not so far, and perhaps you could refresh us on
6 what rules recently went into effect with regard to
7 changes in the appraisal system or processes.

8 MS. MANN: I can give you just a little bit of
9 information that was regarding the Frank-Dodd Act. I
10 know that the major change which has come to the
11 appraiser's attention is that appraisers are supposed to
12 finally be paid at market rates, not at a rate
13 determined by the AMC.

14 In the past, the AMC comes to us and says, "I
15 will pay you \$275 to perform an appraisal." In fact,
16 just this week I received a request for \$325 for a 6,700
17 square foot house. My normal fee on something like
18 that is over \$1,000 because of the complexity of the
19 assignment.

20 So they are saying, "No, we are only going to
21 give you the \$325." And the problem is that on the --
22 thanks to Reg Z, you have to show every expense on the
23 homeowner's truth in settlement statement. Well, the
24 appraiser's fee and the AMC's fee is lumped currently as
25 one figure. So the borrower thinks that they're paying

1 \$700 for an appraisal report, when actually the
2 appraiser gets 250 and the AMC, the appraisal management
3 company, gets the balance.

4 So that's going to be an interesting thing
5 because according to this new Dodd-Frank Act that has to
6 be detailed so that you can see what the appraiser got
7 and what the management agency got as well.

8 In addition, there's other more detailed --
9 I have it in a handout that I would be more than happy
10 to give to you, the overall synopsis of the pros and
11 cons for appraisals, but those are the two biggest
12 highlights.

13 COMMISSIONER MURREN: That would be terrific.
14 Yeah, we would like that.

15 CHAIRMAN ANGELIDES: Yes, if you would provide that,
16 I know you have been in touch with our staff, we would
17 appreciate it.

18 MS. MANN: I would be happy to. Thank you for
19 asking.

20 CHAIRMAN ANGELIDES: Mr. Thompson.

21 COMMISSIONER THOMPSON: Ms. Mann, if I might go
22 back to the 1994 lobbying efforts. What impact, in your
23 mind, was the move from appraising properties at 100,000
24 to above 250 or 250 have on the industry?

25 MS. MANN: On the appraisal industry?

1 COMMISSIONER THOMPSON: Yeah.

2 MS. MANN: It was really sad because we
3 realized there were so many homes of the lower-priced
4 homes that were not getting the opportunity of a fair
5 observation.

6 And may I point out, if you look at a property
7 from the exterior, the exterior of the book isn't always
8 what you think it is.

9 We have had properties that look really nice on
10 the outside with new windows, new paint, and we go in
11 there maybe a month or two months later and realize that
12 there is no toilets, there is no light switches, there
13 is no chandeliers anymore, the sinks are missing.
14 Literally, the home has been gutted.

15 So we realized immediately that there was a
16 large segment of the American population of homeowners
17 that were really getting ripped off of having a real
18 fair assessment of their real estate, and that was a
19 tragedy.

20 COMMISSIONER THOMPSON: But that was going to
21 cause a loss of revenue for the industry, obviously.

22 MS. MANN: Obviously. And the appraiser --

23 COMMISSIONER THOMPSON: So it was enlightened
24 self-interest to a degree, right?

25 MS. MANN: Yes and no. Yes, we were looking

1 out for ourselves, but we were also looking out for the
2 public. And we realized that, okay, appraisers are not
3 going to do this work. Who is going to do the work? Is
4 it going to be drive-bys? Is it going to be broker
5 opinions?

6 And yes, it has been both of those. It has
7 been evaluations. They are trying to call appraisals
8 something else. Either you can have an appraisal as
9 defined by the Uniform Standards of Professional
10 Appraisal Practice, which we have to adhere to, or use a
11 more inferior product.

12 COMMISSIONER THOMPSON: But to be fair, while
13 it certainly was helpful to those who were acquiring or
14 buying a home, it was also helpful to the industry to
15 make sure that that dollar level stayed low because it
16 kept the revenue performance or opportunity for the
17 industry as high as possible enlightened self-interest.

18 MS. MANN: It certainly could appear that way,
19 that the appraisers would have less work, but we will
20 eventually start appraising it when it's in foreclosure
21 too, so...

22 COMMISSIONER THOMPSON: Got it. Thank you.

23 CHAIRMAN ANGELIDES: Mr. Vice Chairman.

24 VICE CHAIRMAN THOMAS: Follow-on to that, I do
25 want to underscore the date and the amount when you were

1 back in 1993, 1994 at \$250,000, significant number of
2 homes below 250. I mean, even in San Francisco Marina
3 and a few other areas, Nob Hill, that's a significant
4 number on the quantitative aspect of the homes that
5 dropped out of the appraisal process.

6 And I would love to see someone do a study on
7 once that number was cut, how quickly homes below 250
8 moved up towards the 250 threshold and how many crossed
9 the threshold because that could really tell you just
10 how much enlightened self-interest or on the other side
11 of any issue those folks who could make some money
12 without the nuisance of an appraisal. It always cuts
13 several different ways.

14 Thank you very much, Mr. Chairman.

15 CHAIRMAN ANGELIDES: Yes, a couple of quick
16 round-up questions from me, or comments.

17 First of all, I want to ask you a very quick
18 question, Mr. Stein. You talked about option ARMs being
19 allowed and the prevalence here in Northern California.
20 We were kind of the home of the option ARM business.

21 Refresh my memory. Did the OTS take an action
22 to allow that kind of product? Wasn't that one of the
23 reasons some companies migrated to OTS?

24 MR. STEIN: Well, the option ARM product was
25 around for many, many years and I think people

1 gravitating to it during this time was more about
2 opportunity, I think, in the context of the
3 affordability crisis.

4 But the OTS in particular, yeah, in our view
5 became kind of the regulator of last resort. That
6 institutions that were concerned about actually being
7 regulated by one of the bank regulators would go to the
8 OTS, and I guess we have seen the results.

9 At one point I could easily rattle off the list
10 of Wachovia, Washington Mutual, IndyMac, Downey Savings
11 & Loans, all these large savings and loans that failed
12 that were regulated or supposed to be regulated by the
13 OTS. We saw institutions that were OCC chartered, and
14 we are no fans of the OCC, but they would apply to move
15 to the OTS and this is in the context of this sort of
16 race to the bottom of the regulators.

17 At one point, I think the OTS had something of
18 a -- they were pretty public about wanting to have more
19 institutions that they regulated, which is a big part of
20 the problem.

21 CHAIRMAN ANGELIDES: Mr. Putnam, very quickly,
22 you may be old enough or been around the business long
23 enough to know this. We were told in Florida by Bill
24 Black, who is a former S&L regulator now professor at
25 University of Missouri Kansas City, that the industry

1 had tried to move to no doc loans on a broader basis in
2 the '80s the S&L industry had.

3 Were you in the business at that time -- and
4 that the regulators blocked it, the pervasive use of no
5 doc, minimum doc loans?

6 MR. PUTNAM: It was widely used most
7 predominantly by -- World Savings was the -- given
8 credit for I think growing the concept. They were based
9 in Oakland and used it a lot in California. And it was
10 used widely for -- originally for, you know, high credit
11 scoring, high income, big capital folks who didn't want
12 to go through the documentation process or had variable
13 income but had the reserves and such to deal with it.

14 So it was a market innovation that addressed a
15 certain small group of the buying population that I
16 think went from there expanded to lots of other
17 institutions and got diluted in the process and turned
18 out to be not such a great idea. But the idea of it if
19 you -- going back to the four Cs, if you are not going
20 to -- if you have very strong credit, you have a big
21 down payment and you have a really strong appraisal --
22 in those days World Savings did their own appraisals,
23 you couldn't go out and -- the borrow or broker didn't
24 get it. They had very strong controls on three of the
25 Cs and they opted to go more lenient on the capacity of

1 the income line.

2 And that's not a bad idea. At least you
3 have -- you know your risk. But if you start dumbing
4 down all four of them, then you start having problems.

5 CHAIRMAN ANGELIDES: So here is kind of an
6 observation -- and if someone disagrees with it I want
7 you to speak up -- but this has been very interesting
8 when I combine what I heard in Bakersfield starting with
9 Gary Crabtree, who I think, Ms. Mann, you know. It's
10 probably the reason you are here today. He recommended
11 you would be very strong in talking about this market.

12 But he is a real estate appraiser who on his
13 own began to see what he thought were phony
14 transactions, corrupt transactions, began to track and
15 identify about 241 transactions that he thought were
16 potentially fraudulent.

17 We heard in Florida about kind of the nature
18 and extent not only to which lending standards declined
19 but it became the Wild West. I mean, this is going to
20 sound odd to everyone in this audience but I've been at
21 this a year and I had an epiphany this week. The
22 epiphany was: How do we come to a point where we allow
23 such a large share of our market to be mortgages
24 extended to people without any documentation or proof or
25 verification at origination and up the chain? It's

1 quite stunning when you think about it.

2 So you take an institution like WaMu that
3 operated in Sacramento. I think they were the third
4 largest lender here along with Long Beach -- you know,
5 with their subsidiary in Long Beach in 2006 in the
6 subprime space. And it turns out, according to
7 information that was in our staff report, that 41
8 percent of their loans in the Sacramento area failed.

9 You know, you talked about how you went to WaMu
10 I think you said in the interview with the staff that
11 "It was, in my opinion, a mess." That's not my opinion
12 that's yours.

13 You also talked about how the laxity of
14 regulations drew many people in the business, the kind
15 of people that don't like regulation, and you talked
16 about how really both business standards and regulation
17 had collapsed. And then you said, "Now there is no
18 business without the government now. We ran it into the
19 ground."

20 I look at the diminution of lending standards,
21 the opening of the door wide with things like no doc
22 loans, the lack of effective regulation, and it's almost
23 as though -- we talked about mortgage fraud, it's almost
24 as though what we did here is we created a very
25 corrupted system as a whole, a system that was

1 absolutely prone to almost any kind of action.

2 And what we did is in the course of doing that,
3 we not only allowed irresponsible conduct, but we also
4 now so narrowly defined what we constitute -- what
5 constitutes fraud, that we have dramatically narrowed
6 that definition, when if you look at it, it may be that
7 the whole product and system became fraudulent in the
8 2005 to 2007 period.

9 So, I mean, I know that's a statement, but it's
10 something that I've really focused on. We focused on
11 the narrow band of fraud, but it seems as if the whole
12 system became prone to widespread corruption, however
13 you define that term.

14 If anyone disagrees, let me know.

15 MR. WAGNER: I wouldn't disagree with that.
16 Fraud -- you know, from our perspective, fraud is
17 fraud. I mean, look at federal statutes and it's the
18 same over time as a legal matter. But really, we are
19 looking at cases within a context. What did they know?
20 When did they know it? That sort of thing.

21 And the relaxation of standards that you are
22 talking about, both regulatory standards and industry
23 underwriting standards, makes it more difficult to
24 criminally prosecute because you are looking at sort of
25 the context in which they were operating.

1 And if their response is, "Hey, I'm just doing
2 what my neighbor was doing. I didn't intend anything
3 worse than everyone else in the industry," it makes it a
4 much more difficult case to bring. And that's one of
5 the things that's complicated about these cases is when
6 you focus on a transaction where there may be 20 people
7 involved on paper. There's appraisers and title
8 insurance people and real estate people and brokers, you
9 have to go to each one and figure out what did they
10 know, when did they know it, what did they intend?

11 And in this kind of Wild West atmosphere, it
12 becomes fairly difficult to separate out the true
13 criminals from just the people who are operating in the
14 Wild West.

15 MR. STEIN: I basically would agree there were
16 all these players in the process. One we didn't
17 mention, which was the rating agencies, which in a
18 similar way that had a financial incentive for -- as
19 Mr. Putnam put it, for people to become numbers on the
20 MBS spreadsheet.

21 So everyone was invested in things happening,
22 the ratings agency blessed it and said it was okay for
23 the, you know, maybe the unsuspecting investors, the
24 people who actually wound up holding everything. So
25 yes, we set ourselves up to fail and the demand came

1 from above.

2 And I always come back to that one quote from
3 Bill Dallas of Ownit Mortgage Solutions where he's
4 reported to have said "Wall Street is paying me more to
5 do stated income."

6 So to the Chair's point about the prevalence of
7 stated income, it didn't -- it started out, as
8 Mr. Putnam said, maybe there was a reason for it, but
9 somehow there was this idea that there was more money to
10 be made doing stated income.

11 It wasn't the borrowers -- the people that came
12 into the offices of our members didn't go in and say,
13 "Can I get a stated income negatively amortizing option
14 ARM loan?" These are brokers who were selling those
15 loans because they were going to make money and everyone
16 up the chain was going to make money.

17 CHAIRMAN ANGELIDES: All right. Thank you.

18 You have been excellent witnesses, participants
19 in this hearing. I thank you very much for your
20 thoughts, your answers to our questions, your written
21 and your oral testimony.

22 And with that what I would like to announce is
23 we are going to take a one-half hour lunch break. We
24 will reconvene in this room promptly at 12:45 with
25 Session No. 3, where we will take a look at how it is

1 that mortgage loans made in Sacramento travel a great
2 distance to enter the financial system.

3 And then after that we will be ending today
4 with a look at where Sacramento is today, local business
5 community, services to the community, local lending
6 institutions, the impacts of this crisis.

7 Thank you all very, very much.

8 ...

9 CHAIRMAN ANGELIDES: The meeting of the
10 Financial Crisis Inquiry Commission will come back into
11 order. We are now in Session No. 3 and we are going to
12 be discussing today how it is that mortgages that were
13 made in Sacramento were sent to Wall Street and became
14 part of a financial system.

15 And so we have three witnesses today. I would
16 like to thank you for being here. And what I would like
17 to ask each of you to do -- first of all, just for the
18 audience, I will introduce the witnesses.

19 Mr. Keith Johnson who is formerly with
20 Washington Regional and Long Beach Savings as well as
21 Clayton Holdings; Ms. Vicki Beal, who is with Clayton
22 Holdings; Dr. Kurt Eggert, who is a professor of Chapman
23 University are here. I would like to ask you three to
24 please do what we have asked all witnesses to do, which
25 is to please stand and raise your right hand and I will

1 give you the oath and ask you to acknowledge.

2 Do you solemnly swear or affirm under the
3 penalty of perjury that the testimony you are about to
4 provide the Commission will be the truth, the whole
5 truth, and nothing but the truth, to the best of your
6 knowledge?

7 (All sworn.)

8 CHAIRMAN ANGELIDES: Thank you very much.
9 Let's do this: I think we will start with you,
10 Mr. Johnson, today.

11 And thank you all three of you for your written
12 testimony which has been entered into the record. And
13 Mr. Johnson and other witnesses, we are going to ask you
14 to give up to 5 minutes of oral testimony. There is a
15 light here which you can look at and when it turns to
16 yellow, that means you have one minute so you should
17 begin to sum up. And when it gets to red, that means
18 your time is up.

19 So Mr. Johnson, let's start with you.

20 MR. JOHNSON: Thank you.

21 Chairman Angelides, Vice Chairman Thomas, and
22 members of the Commission, my name is Keith Johnson and
23 I have been in the financial services and banking
24 industry for 30 years. From 1986 to 2000, I was
25 employed by Bank United of Texas where I held a variety

1 of executive positions involving finance, capital
2 markets, loan origination, securitization and
3 servicing.

4 In 2000, Bank United was sold to Washington
5 Mutual where I became their chief operating officer of
6 WaMu's commercial segment. In mid-2003, I was asked to
7 assist the existing management of Long Beach Mortgage.
8 And in 2005, while remaining employed at WaMu, I became
9 the acting president of Long Beach for approximately
10 nine months.

11 In May of 2006, I left WaMu and became
12 President and Chief Operating Officer of Clayton
13 Holdings, the largest residential loan due diligence and
14 securitization surveillance company in United States and
15 Europe. And I left Clayton at the beginning of 2009
16 shortly after we sold it to a private real estate
17 investment fund.

18 I thank the commission for the invitation to
19 appear, and I hope that my testimony will assist in your
20 efforts to better understand the cause of the financial
21 crisis. The Commission has asked me to address several
22 topics related to loan securitization, mortgage brokers,
23 and their related impact to the Sacramento region and
24 other communities in the Central Valley.

25 In my opinion, this crisis is not the result of

1 a single cause but a combination of significant factors
2 operating at the same time and feeding each other. Low
3 interest rates, increased housing goals, creative
4 securitization, lack of assigning liability, compromised
5 warehouse lending, flawed rating industry process,
6 relaxed and abusive lending practices, rich incentives,
7 shortfalls on regulation and enforcement provided the
8 fuel to inflate home prices and excess borrowing by
9 consumers.

10 Now, in addition to the factors I previously
11 mentioned, improvements in technology, credit scoring,
12 and financial engineering transformed the traditional
13 lending platforms into financial factories. Several of
14 these factories were originating, packaging,
15 securitizing, and selling at the rate of \$1 billion a
16 day.

17 The quality control processes failed at a
18 variety of stages during the manufacturing,
19 distribution, and ongoing servicing. Traditional
20 regulatory examination procedures were not able to
21 evaluate either processing exceptions nor the resulting
22 cumulative risk.

23 The lack of accountability and failure by many
24 parties to present value the pain allowed the process to
25 continue. And lastly, the lingering impact and

1 transformation has been the starting of practical
2 solutions between borrowers facing financial hardship
3 and the investors with principal at risk.

4 Now, many will blame this crisis on growth of
5 securitization, but I believe that securitization was
6 flawed and abused but it can and will be beneficial to
7 the public as it provides a vehicle for lenders to sell
8 loans in exchange for the capital necessary to make
9 additional loans.

10 Hopefully, this crisis will lead to reform of
11 commonsense improvements to bring back a prudent, robust
12 securitization market.

13 Now, as it relates to doing business with
14 mortgage brokers, I can share with you my experience at
15 Long Beach and observations while at Clayton. Unlike
16 most mortgage companies that contain multiple
17 origination channels -- retail, telephone, refinance --
18 Long Beach was a subprime lender that relied 100 percent
19 on mortgage brokers.

20 Broker-originated loans was and can be a viable
21 loan production channel. The model serves a purpose in
22 helping those financial institutions reach out to
23 unbanked and underbanked areas; however, performance
24 data has shown us that the broker model became flawed
25 with greed, fraud, and deception.

1 Low barriers of entry, lack of regulatory
2 supervision or enforcement coupled with rich incentives
3 for production created in an environment that
4 contributed to the surge in default.

5 Now, during my period of time at Clayton, I was
6 able to observe an operation of close to 40 of the
7 largest mortgage originators and servicers in the United
8 States. Too late to be effective, it became obvious to
9 all that the only way to correct the broker model was to
10 shut it down and wait for regulatory reform and
11 enforcement.

12 Recent regulatory changes have been made to
13 improve the broker channel and I would encourage
14 additional supervision and enforcement. For me, one of
15 the underlying conflicts with the broker model is the
16 question whom does the broker work for.

17 The main problem is that counter-to-counter
18 perception, brokers do not represent the borrowers who
19 pay them for advice. Instead, they are more like
20 independent salespeople who are often paid this much by
21 the lenders in addition to the borrowers.

22 When brokers are paid commissions by both
23 parties to a loan transaction, confusion results about
24 who the broker actually worked for. In my opinion, the
25 broker should be acting as a fiduciary of the borrower

1 and have the responsibility for making sure that the
2 borrower understands and benefits from the transaction
3 by receiving fair terms.

4 My criticism of this approach is that
5 implementing it will have an adverse effect on
6 low-to-moderate income applicants, and I would suggest
7 to you that the benefits would tilt toward the consumer
8 with alternatives to encourage financial institutions to
9 invest in this low-to-moderate housing.

10 Now, as it relates to the Sacramento and the
11 other communities in the Central Valley, I have three
12 areas of concern. Special servicing: Effective loan
13 servicing, foreclosure avoidance, and loss mitigation
14 are necessary to help the families work through their
15 financial hardships.

16 Servicer incentives and the lack borrowing of
17 financial literacy and the threat of investor litigation
18 are limiting this effective action.

19 Current servicing fees provide little to no
20 economic incentive for the servicers to spend time,
21 money, and effort with the borrower to arrive at a fair
22 solution. For some servicers, the most profitable path
23 is to move the loan to foreclosure. And Special
24 Servicing should be engaged which has incentives to cure
25 defaults and avoid foreclosure.

1 My recommendation is all future securitizations
2 including Fannie, Freddie and FHA, is that once a loan
3 goes 90 days delinquent, the special servicer will
4 evaluate the collateral and borrower's financial
5 conditions and perform a low-cost solution that will
6 take into consideration loan modification, short sale,
7 deed in lieu. The special servicer would then be
8 compensated at market rates.

9 As to the financial literacy, I've worked
10 with --

11 CHAIRMAN ANGELIDES: Can you wrap up, please?

12 MR. JOHNSON: Sure.

13 CHAIRMAN ANGELIDES: I know you're almost
14 there, so if you can wrap up and make your remaining
15 points.

16 MR. JOHNSON: As to financial literacy, much
17 needs to be done to improve that. In the last year I
18 have -- relates to investors, that there is impact with
19 a structural waterfall has created a conflict, not
20 allowing investors to have the prudent thing.

21 Two other areas for this area in Sacramento is
22 foreclosed home inventories. Empty homes do not pay the
23 salaries of teachers, police officers, and fire
24 departments.

25 And this unsold inventory leads me to my third,

1 which is the availability of credit. My recommendation
2 on that is something that I found that worked in Texas
3 during the recession is the loans to facilitate the sale
4 of foreclosed homes could be an active program by those
5 banks and GSEs that are actively the investor today.

6 With that, I look forward to your questions.

7 Thank you.

8 CHAIRMAN ANGELIDES: Thank you very much.

9 Ms. Beal.

10 MS. BEAL: Thank you, Chairman Angelides and
11 members of the Commission.

12 I am Vicki Beal, senior vice president of
13 Clayton Holdings, the nation's largest provider of
14 mortgage due diligence services. We have been asked by
15 the commission to describe the due diligence process,
16 its benefits and its limitations.

17 Clayton's principle due diligence clients are
18 financial institutions, and more recently government
19 agencies, private equity firms, and hedge funds. We are
20 retained by our clients to review samples of closed loan
21 pools that they are considering for purchase.

22 Clayton is not retained by its clients to
23 provide an opinion as to whether a loan is a good loan
24 or a bad loan. Rather, our clients use Clayton's due
25 diligence to identify issues with loans, negotiate

1 better prices on pools of loans they are considering for
2 purchase, and negotiate expanded representations and
3 warranties in purchase and sale agreements from
4 sellers.

5 The type and scope of our due diligence work is
6 dictated by our clients based on their individual
7 objectives. Clients select the sample, generally 10 to
8 20 percent of the pool, and decide if the sample is to
9 be random or adverse.

10 Clayton typically reviews a sample of loans
11 against the seller or originating institution's
12 guidelines and the client's tolerance. Clayton reviews
13 for: (1) Adherence to seller credit underwriting
14 guidelines and client risk tolerances; (2) compliance
15 with federal state and local regulatory laws, and; (3)
16 the integrity of the electronic loan data provided by
17 the seller to the prospective buyer. This review is
18 commonly referred to as a "credit and compliance
19 review."

20 As part of this review, we grade each loan for
21 credit and compliance using grades of: Event 1, loans
22 that meet guidelines; Event 2, loans that do not meet
23 guidelines but have sufficient compensating factors; and
24 Event 3, loans that do not meet guidelines and have
25 insufficient compensating factors. Clayton's fees are

1 not contingent on our findings or our grades.

2 The work product produced by Clayton is
3 comprised of loan level data reports and loan exception
4 reports and is the property of our clients. An
5 important part of our due diligence services is
6 providing exception reports; that is, reports of loans
7 with deviation from seller underwriting guidelines and
8 client tolerances.

9 However, the number of reported exceptions
10 should not be viewed in isolation. Exceptions must be
11 reviewed in conjunction with the corresponding
12 underwriting guidelines and client tolerances.

13 Simply stating a Clayton grade of Event 1 does
14 not mean a loan is good or is likely to perform, nor
15 does a Clayton grade of Event 3 mean that a loan is bad
16 and is not likely to perform. Moreover, it may not be
17 possible to draw an apples-to-apples comparison of deals
18 from different clients or different sellers.

19 Exceptions to underwriting guidelines can vary
20 from being severe -- such as the valuation of a property
21 not being supported by an appraisal, stated income not
22 being reasonable for the job, or missing critical
23 documents in a file such as HUD-1, loan application, or
24 an appraisal -- to benign, such as a debt-to-income
25 ratio of less than 5 percent or loan-to-value exception

1 of 5 percent or less, or a credit score that's within an
2 acceptable tolerance; for example, 650 score is
3 required, 640 is the actual credit score.

4 It's also important to understand what Clayton
5 does not do. Clayton does not confirm the authenticity
6 of information in the file. The loan has already closed
7 and due diligence firms historically have relied on the
8 documentation within the file for the review.

9 Clayton does not know whether a loan was placed
10 into a securitization, the type of securitization, or if
11 it was held in portfolio by the client. Clayton does
12 not tell clients which loans to buy or not buy. Clayton
13 does not participate in the actual trading or pricing of
14 loans. Clayton does not participate in the structuring
15 or rating of a security.

16 There are many improvements that need to be
17 made throughout the mortgage industry which will help
18 restore investor confidence and rebuild the mortgage
19 market.

20 Clayton fully supports the American
21 Securitization Forum, ASF, and Security Industry and
22 Financial Markets Association, SIFMA, who are making
23 significant contributions to the development of asset
24 securitization markets that investors will have
25 confidence in.

1 Specifically in the area of due diligence, we
2 have seen the rating agencies adopt specific
3 improvements that relate to mortgage securitization
4 which call for: Independent third-party
5 pre-securitization review of samples of underlying
6 mortgage loans, and including disclosure to investors of
7 all exceptions; (2) Standardized post-securitization
8 forensic reviews, and; (3) Expanded loan-level data
9 reporting of initial mortgage pool and ongoing loan
10 performance.

11 I would be pleased to answer any questions you
12 may have.

13 CHAIRMAN ANGELIDES: Thank you very much,
14 Ms. Beal.

15 Mr. Eggert.

16 MR. EGGERT: Thank you. And I appreciate the
17 opportunity --

18 Is that better?

19 CHAIRMAN ANGELIDES: That's much better.

20 MR. EGGERT: I appreciate the opportunity to
21 testify and I admire all the time that you are spending
22 on this. It's an important job that you are doing.
23 Your charge is not only to explain what happened but
24 also to explain why so few of the people that caused it
25 to happen have so far suffered any significant

1 repercussions.

2 And it's important to realize this is not the
3 first time that subprime has collapsed. It collapsed
4 once in the late '90s. This is the second time. And
5 the job we have before us is how to make sure that it
6 does not collapse again. So I have three points in five
7 minutes.

8 My first point is that there is a tremendous
9 lack of transparency in the securitization of loans
10 that's one of the primary reasons that investors bought
11 those securities based by so many bad loans. Investors
12 were not given sufficient information to make the
13 decisions that they needed to make to see if they were
14 going to buy these securities.

15 They should have been given loan-level detail
16 for every pool that was -- for which securities were
17 issued. Current loan-level detail, not what was true
18 weeks ago or a month ago.

19 The underwriting that -- they were given
20 disclosures about underwriting that were vague and they
21 weren't told what I think was true about significant
22 portion of subprime underwriting, which is the main
23 underwriting that some subprime lenders did was: "Will
24 this loan be securitized? If it will be securitized, I
25 will make the loan."

1 That's how they underwrote -- or that's how
2 many firms underwrote loans and that was not disclosed
3 to investors. Instead, they were told that the lender
4 has an underwriting program and it makes some
5 exceptions. Investors should have been told not only
6 that exceptions were made, but should have been given
7 specific information for each exception in the pool that
8 they were purchasing securities for.

9 They should have been told what the exact
10 exception was, how many exceptions there were, why each
11 exception was given, and whether there were any
12 mitigating factors for those exceptions.

13 Pools -- some pools of loans had exceptions in
14 50 to 80 percent of the loans. The exceptions took over
15 or were an incredibly important part of the pool
16 information, but investors weren't given that
17 information. Instead, they got vague, boilerplate
18 language about underwriting, and that there were
19 substantial exceptions. Whatever that means.

20 They should have gotten the due diligence
21 reports that we just heard described. Those reports
22 existed. The exceptions were described and defined.
23 Why weren't investors given that information which was
24 in the hands of the people that were selling the
25 securities? Why weren't they given the underwriting

1 reports by the originators who knew what exceptions were
2 given and why?

3 Investors need that kind of information to
4 get -- to make good decisions. They also needed better
5 waterfall information. Investors often didn't know
6 exactly how the waterfall structure worked. Waterfalls
7 can be very complicated as far as which security gets
8 paid off first, and there needed to be better
9 description of that.

10 My second point is that securitization
11 encourages the bargaining down of due diligence. We
12 have seen due diligence in the kind of the reports we
13 are talking about. Why only 10 to 20 percent of the
14 loans were examined? Why that small number?

15 Earlier, before the crash, many more -- a much
16 larger sample was done. Why not 100 percent? What
17 would happen is originators would say to Wall Street,
18 "If you want to buy our loans, you need to look at fewer
19 of them. You need to do less due diligence, and we
20 don't want to buy back as many loans that you find." So
21 we saw this bargaining down of due diligence.

22 Also, we saw at each level what happened with
23 securitization is risk was pushed to its maximum. So
24 brokers told appraisers essentially, "We want you to
25 inflate your appraisal."

1 Wall Street reverse-engineered the rating
2 system so that they knew exactly what pool they needed
3 to assemble to get the rating they wanted. So they
4 assembled the riskiest possible pool that would get the
5 ratings that they needed.

6 And so at each level the riskiest loan was
7 made, brokers with yield spread premiums would push
8 borrowers to accept a higher interest rate, Wall Street
9 was pushing the credit rating agencies to give better
10 ratings to back worse pools.

11 And so at every single level, risk was pushed
12 to the maximum, and that led to a brutal structure and
13 the subprime collapse that we saw.

14 Thank you, and I look forward to your
15 questions.

16 CHAIRMAN ANGELIDES: Thank you very much. I
17 was about to ask you to wrap up and you did it.

18 Before we go to questions, I would like to make
19 an acknowledgment, and I would like to acknowledge that
20 my father, Jerry Angelides, and my mother, Helen
21 Angelides, are in the audience. Welcome, mom and dad.

22 So I will begin the questioning of the
23 witnesses. And let me start, actually, Mr. Johnson,
24 with you. You were with Washington Mutual you were sent
25 in essentially to take over and, I guess, get Long Beach

1 Savings in shape. And you made the determination that
2 it couldn't be gotten in shape is what I understand.

3 I think you talked about -- and by the way, I
4 think this is very relevant to Sacramento because, at
5 least from the information you have seen, Washington
6 Mutual is the third largest lender in this market.
7 There was an extraordinarily high failure rate on their
8 subprime loans.

9 But you talked a lot, I know, in interviews
10 with our staff, and you mentioned in your testimony
11 about this notion of the financial factory. Long Beach
12 was 100 percent dependent on mortgage brokers. I think
13 you described that system as the heroin of subprime.
14 You said the broker model became flawed with greed,
15 fraud, and deception.

16 You said that -- in your interview with our
17 staff -- you realized in hindsight that there were
18 systemic issues; in other words, the fraud and the
19 incentives were totally out of whack.

20 What could have been done in the run-up to the
21 crisis other than shut down these enterprises? What
22 could have been done, regulatory or business practices,
23 to put a halt to what you clearly saw were destructive
24 practices?

25 MR. JOHNSON: First I want to correct, I did

1 not shut Long Beach down when I was there.

2 CHAIRMAN ANGELIDES: No, you left. I meant to
3 say --

4 MR. JOHNSON: (Inaudible) -- after that.

5 CHAIRMAN ANGELIDES: No, but you made a
6 comment, I think, today that your view was the broker
7 model should have been shut down.

8 MR. JOHNSON: Once I got to Clayton and I could
9 see the broker model being used by almost 40 of the
10 largest originators, you saw the same problems. As an
11 operator, you know, we try to put in all the right risk
12 controls. We bought every third-party fraud system we
13 could find. But these were just force fields in which
14 people can walk right through and commit a fraud.

15 I think that it really gets down to the relaxed
16 underwriting guidelines probably should have never come
17 out, the stated income, the 100 percent loan-to-values;
18 however, there was a need for that based on the raw
19 materials for securitization.

20 Companies were being encouraged to provide that
21 for securitization product. I guess that could have
22 stopped if the right data was going to rating agencies
23 to perhaps change the subordination levels whereby that
24 risk would have been graded a little bit more harsh and
25 the profits would have stopped.

1 So to me, there is a variety of points in the
2 factoring of this product that we could have present
3 valued the pain. Whether it's the rating agency side,
4 whether it's in the enforcement side. When we caught
5 fraud, very little was done. Very little could be
6 pointed to to discourage brokers and brokers could
7 simply go to the next financial institution down the
8 line.

9 CHAIRMAN ANGELIDES: Very quick question for
10 you, Mr. Eggert. Clearly, there was a breakdown in the
11 system. But didn't investors let themselves down also
12 by not asking for the requisite information?

13 MR. EGGERT: Well, I think investors did ask
14 for the information and were, in essence, told, "Take it
15 or leave it."

16 CHAIRMAN ANGELIDES: They took it.

17 VICE CHAIRMAN THOMAS: They could leave it.

18 MR. EGGERT: And some did leave it. Some
19 investors relied on credit rating their ratings and they
20 shouldn't have in retrospect. But I think they weren't
21 given the information to realize how suspect many of the
22 ratings were.

23 I think some savvy investors realized there was
24 a big problem. Some were savvy enough even to go short
25 on the on the securities that were being produced. But

1 at a certain point I think what happened was Wall Street
2 realized some investors were getting turned off by what
3 they were producing and so they responded by saying, "We
4 have to find other investors who haven't figured this
5 out yet."

6 CHAIRMAN ANGELIDES: Right. I will make an
7 observation. There is a chain here and it does start
8 with borrower and it ends with investor. Just an
9 observation I will make.

10 MR. EGGERT: I think that's entirely accurate.

11 CHAIRMAN ANGELIDES: Now, let me -- so the
12 reason -- the focus really of the reason I wanted to, in
13 a sense, have this discussion was one of the questions I
14 get a lot in this community is: "How did what happened
15 here turn into a financial crisis?"

16 And I think this world of how loans were
17 originated, you know, moved from broker to originator to
18 securitizer to investor, and then of course packaged and
19 repackaged is something that's of tremendous interest to
20 people.

21 And I would like to ask you, Mr. Johnson, you,
22 Ms. Beal, some questions about the work that Clayton did
23 because I think one of the things we have been looking
24 at is the declining underwriting standards. But I think
25 one of the essential issues is also that as underwriting

1 standards declined, was there even a failure to meet
2 those underwriting standards?

3 So there are some charts I would like to ask
4 you about so I would like to enter in the record just so
5 I can talk to you about these, I think, the staff
6 provided and, actually, you provided them to us, so I
7 think you are very familiar with them. These are the
8 trending reports that talk about due diligence.

9 So I want to see if I've this right just in
10 terms of my understanding. Clayton was hired by
11 issuers, securitizers to do due diligence. My
12 understanding is you had about 20 percent of the
13 market. And from the first -- is that about right?

14 MS. BEAL: That's -- yes.

15 MR. JOHNSON: Out of all the securitizations
16 done, only 20 percent of which were done by third-party
17 issuers. So Clayton would only be working on
18 third-party issuers. We would never work on a
19 securitization, like, perhaps Bank of America would do
20 or Countrywide or Chase. And of that 20 percent, our
21 market share was probably 50 to 70 percent of that due
22 diligence.

23 CHAIRMAN ANGELIDES: All right. So my
24 understanding is from first quarter of 2006 through
25 second quarter of 2007, which is kind of the heat of the

1 subprime market, you reviewed about 911,000 loans. And
2 my understanding is the simple sizes were normally 5 to
3 10 percent or were they smaller?

4 MS. BEAL: They were running about 10 percent.

5 CHAIRMAN ANGELIDES: All right. So it's fair
6 to say if you looked at 911,000 loans, roughly it's a
7 punitive pool of about 9 million loans, correct?

8 MS. BEAL: Correct.

9 CHAIRMAN ANGELIDES: And my understanding is
10 you reviewed those loans for compliance with
11 underwriting standards; in other words, if they were
12 originated here in Sacramento by Washington Mutual or
13 Long Beach, you would look to whether or not the loans
14 conformed to that lender's underwriting standards as
15 well as any "overlay standards" that the issuer would
16 put on top?

17 MS. BEAL: That's correct.

18 CHAIRMAN ANGELIDES: And you were looking for
19 certain things or certain safeguards or standards,
20 correct?

21 MS. BEAL: That's correct.

22 CHAIRMAN ANGELIDES: All right. And then my
23 understanding is that in that period you rated about
24 54 percent 1s, meaning they met all the standards,
25 correct? And I understand your admonition that that's

1 not necessarily good bad loan bad (sic), that's whether
2 they meet the standard or not.

3 MS. BEAL: Yes, the 54 percent would have met
4 the seller's guidelines and any client tolerances or
5 overlays.

6 CHAIRMAN ANGELIDES: Correct. And another 18
7 percent might have missed something but there was a
8 compensating factor. So in my simple mind, maybe the
9 loan to value was a little high above the standard, but
10 that person had substantial cash, that kind of thing; is
11 that a fair assessment?

12 MS. BEAL: That's correct.

13 CHAIRMAN ANGELIDES: But then there were
14 another 28 percent that you initially rejected, and I
15 guess that's because they didn't meet the standards.
16 But then I guess the issuer securitizers decided to
17 "waive those back in." 39 percent on average. Why did
18 they waive them back in?

19 MS. BEAL: The 11 percent or the 39 percent of
20 the waiver rate. The 39 percent is the percentage of
21 loans initially flagged as 3s that were waived back in.
22 And the 11 percent is the overall out of the 911,000.

23 CHAIRMAN ANGELIDES: Can I ask a question?

24 MS. BEAL: Yes.

25 CHAIRMAN ANGELIDES: So originally you rated 3

1 or rejects 28 percent of them --

2 MS. BEAL: Yes.

3 CHAIRMAN ANGELIDES: -- but then that number
4 gets reduced to 11 percent by the issuers; is that --

5 MS. BEAL: Yes.

6 CHAIRMAN ANGELIDES: And that was because they
7 made a business decision? They looked at the loans
8 individually? How did that all work?

9 MS. BEAL: Yes, they look at the loans
10 individually and they make business decisions. And this
11 was also our two Ws, which meant that they coded the
12 loans as a waiver. And it was also our two Ts, which
13 were side letters, meaning they would give the seller 30
14 days to cure maybe missing documents or something they
15 could look at to see if the exception was acceptable.
16 And then they would let us know that these would be two
17 Ws or two Ts.

18 CHAIRMAN ANGELIDES: Can I ask a question? Do
19 you have any information that they would have sampled
20 the other 90 or 95 percent of the loans?

21 MS. BEAL: No, I don't have that information.

22 CHAIRMAN ANGELIDES: So would I be off if I
23 said, "Gee, they're failing initially 255,000 loans,"
24 you times that by 9 in the pool, or 9 million, you might
25 have 2.3 million loans that initially failed by your

1 standards and when that was reduced down, you still had
2 a million failures out of that 9 million. Is that my,
3 kind of, rough math?

4 MS. BEAL: Yes.

5 CHAIRMAN ANGELIDES: All right. Interesting.

6 I would like to ask a couple of questions. So
7 these trending charts were prepared for what reason?
8 Were they prepared -- did they show a decline in
9 understanding standards? What did they show during that
10 critical period of 2006 to 2007? What is happening in
11 the market as these loans are being moved up the chain?

12 MS. BEAL: What we did notice was that it was
13 declining originator guidelines. And then as the
14 guidelines were declining, we saw that our clients were
15 increasing their tolerances; in other words, they were
16 putting more credit overlays. As -- you know, there was
17 stated income, they were telling us look for
18 reasonableness of that income, things like that. They
19 were also --

20 CHAIRMAN ANGELIDES: Does that mean they -- so
21 the standards were going down, but were they then adding
22 some protections against standards going down?

23 MS. BEAL: Yes, they were raising the bar.
24 They were raising the guidelines themselves.

25 CHAIRMAN ANGELIDES: So you have two things

1 working here, you have underwriting standards going down
2 and the issuers, in a sense, mitigating some of that?

3 MS. BEAL: Yes, yes.

4 CHAIRMAN ANGELIDES: Okay. That's interesting.

5 Let me ask this question of you, Mr. Johnson.
6 My understanding is you actually went to the rating
7 agencies at one point because I think you thought you
8 had a product to sell, correct? Which is -- this goes
9 back to enlightened self-interest -- that you thought
10 this information would be interesting to them.

11 Would you talk about that a little and what
12 their reaction was?

13 MR. JOHNSON: Sure. We thought that these
14 exception-tracking mechanism, we are the only firm in
15 the country that has it and I still believe the only
16 firm that does today -- was a great product to show
17 clients how their manufacturing quality is. Good
18 managers manage exceptions and try to get that down, try
19 to get that --

20 CHAIRMAN ANGELIDES: So you thought it was a
21 management tool?

22 MR. JOHNSON: I thought it was first a
23 management tool that managers could try to get that
24 54 percent closer to 100 percent and that this would be
25 a good tool.

1 Then we went to the rating agencies and said,
2 "Wouldn't this information be great for you to have as
3 you assign tranche levels of risk?"

4 Again, if they would have accepted it, I think
5 this is one way of paying within present value because
6 they could have -- for good originators with great
7 quality had better subordination levels than middle and
8 worse originators. And therefore, the market economics
9 would have forced those people out of the equation.

10 We started meetings with -- in 2006 with S&P,
11 Fitch, and then in 2007 we met with the executive team
12 of Moodys. All of them thought this was great. All of
13 them thought this would be wonderful to have. None of
14 them would have adopted it at that time, for the most
15 part being that: A, we were only 20 percent of the
16 market third party. If any one of them would have
17 adopted it during that period of time, they would have
18 probably lost market share --

19 CHAIRMAN ANGELIDES: They would have lost
20 market share to each other?

21 MR. JOHNSON: Issuers would have gone to the
22 easier channel.

23 It should be noted in 2007 after the Attorney
24 General came into the picture all three said that
25 third-party independent due diligence is going to be

1 required going forward.

2 CHAIRMAN ANGELIDES: So when I look at some of
3 these waiver rates and I see Deutsche Bank waiving back
4 in 50 percent of the failures, is that because they are
5 tougher or because they are waiving them bank in?

6 On the other hand, Goldman looks like it has
7 one of the lower reject rates and they are waiving in
8 less. Is that because they are more stringent on the
9 review?

10 MS. BEAL: Well, there are two things.
11 Deutsche Bank was one of our clients that had very
12 strict credit overlays. They had us looking at many
13 more reasons for making a loan a 3, and then they also
14 took away during that period Clayton's ability to make
15 loans a 2 with compensating factors.

16 In a lot of cases they would say either it's a
17 1 or it's a 3. So you do see that with Deutsche Bank.
18 You see more loans being generated as 3s so that they
19 would go back to them for their review.

20 They also were pooling third-party services
21 around valuations, made use of fraud tools, occupancy
22 checks, so they were layering on other tools in addition
23 to the due diligence.

24 And the point about Goldman and some of the
25 other clients that you see, it could be that they

1 weren't quite as robust in their credit overlays. It
2 could also be a mix of the sellers that they were buying
3 loans from. So you know, there are many there.

4 And then also one other point I would like to
5 make in this is that this was a beta version of the
6 trending reports. It was raw data, this summary report,
7 it hadn't been scrubbed. It wasn't an apples-to-apples
8 comparison just as we're saying --

9 CHAIRMAN ANGELIDES: You didn't standardize it,
10 so it was reflective of each institution, right?

11 MS. BEAL: Yes, that's correct.

12 CHAIRMAN ANGELIDES: All right. So I am going
13 to just pose something then I want to turn to other
14 commissioners and then I want to come back at the end
15 because this is an area I would like to hear my
16 colleague's questions around these issues.

17 But there seems to be kind of three points here
18 as I looked at this. One is, from what I can tell, it
19 doesn't look like your information ever migrated to
20 disclosure. I know you didn't prepare it for that
21 purpose, but this wasn't disclosed. What you read in
22 the disclosure is some of these loans, a significant
23 amount, may be exceptions but there is compensating
24 factors. What's not revealed is the actual data, so it
25 appears not to have been available to investors. Is

1 that -- would that be your --

2 MR. JOHNSON: We are not aware of -- and we
3 looked at a lot of prospectuses -- of any of our
4 information --

5 CHAIRMAN ANGELIDES: -- ever popping through.

6 MR. JOHNSON: -- going through the prospectus.
7 And one of our recommendations was that a table should
8 be included in the future that simply said, you know,
9 due diligence -- independent chosen due diligence
10 achieved a 95 percent confidence level in certain
11 attributes with an error of, you know, 2 or 3 percent
12 was performed. And that way rating agencies would have
13 it and investors could acknowledge and then you could
14 grade good, bad, and ugly issuers.

15 CHAIRMAN ANGELIDES: Secondly, it appears as
16 though you did a sample of 5 to 10 percent, but it looks
17 like the other 90 percent were never faxed. So I am
18 thinking if I am a securitizer, even forgetting whether
19 it's 28 percent failed or 11 percent failed, what is
20 happening here, they got a sample of 10 percent. I know
21 11 percent of those fail. I kick those out. But as to
22 the other 90 percent, I don't do nothing?

23 MS. BEAL: Right.

24 CHAIRMAN ANGELIDES: Does the silence mean I
25 got it right?

1 MR. JOHNSON: Did you ask a question or is this
2 a statement?

3 CHAIRMAN ANGELIDES: Is that an accurate
4 statement?

5 MR. JOHNSON: That's an accurate statement.

6 CHAIRMAN ANGELIDES: All right. And the final
7 thing is I just want to note that I looked, I guess the
8 examiner for the New Century bankruptcy and a former
9 regulatory compliance person in Fremont said there was
10 also practice of even if loans were kicked out they were
11 put back in another securitization.

12 Are you familiar with that or not?

13 MR. JOHNSON: I think it goes to "three
14 strikes, you're out" rule.

15 CHAIRMAN ANGELIDES: So this was a case of --
16 okay, three strikes.

17 MR. JOHNSON: I've heard that even used. Try
18 it once, try it twice, try it three times, and if you
19 can't get it out, then put --

20 CHAIRMAN ANGELIDES: Well, the odds are pretty
21 good if you are sampling 5 to 10 percent that you'll pop
22 through. When you said the good, the bad, the ugly, the
23 ugly will pop through.

24 All right. Final question, and that is: You
25 made a comment at one point, I think it was public

1 comment about you felt like a potted plant. And not you
2 personally, but due diligence folks. In this whole
3 process you felt like you were producing information
4 and --

5 MR. JOHNSON: Right. I think it was when we
6 looked at these reports here, we saw that -- 54 percent
7 was alarming to me personally, you know, I can say this.
8 And I didn't realize what --

9 CHAIRMAN ANGELIDES: 54 percent were making the
10 initial grade?

11 MR. JOHNSON: Right. And so I don't know what
12 our role was. Back in the old days, in the '80s, due
13 diligence -- and I was a big buyer of loans -- is really
14 simple. It's good loan, bad loan. When you bought the
15 loan, I owned it, it went in my portfolio. If it went
16 delinquent in fault, I had to be personally liable and
17 answer to a guy named Lou Raneire.

18 In this case here I think the liability got
19 pushed all the way out to the investor and we got away
20 from the practice of good loan, bad loan. Just "Does it
21 meet the guideline? Does it mean meet the ugly
22 guideline? Oh, 54 percent do, okay." Again, I don't --

23 CHAIRMAN ANGELIDES: This wasn't the gold
24 standard of underwriting guidelines, correct?

25 MR. JOHNSON: Our value added really came in

1 compliance with Clayton.

2 CHAIRMAN ANGELIDES: Whether regulatory
3 compliance?

4 MR. JOHNSON: Right. Because liability can be
5 a sign to an issue if they did something wrong with
6 regulatory compliance.

7 CHAIRMAN ANGELIDES: So they paid attention to
8 that?

9 MR. JOHNSON: 100 percent attention.

10 CHAIRMAN ANGELIDES: Oh, that's an -- I hadn't
11 planned --

12 MR. JOHNSON: When liability --

13 CHAIRMAN ANGELIDES: So you are telling me that
14 the credit standards, they kind of said, "Thank you very
15 much." When it came to regulatory standards compliance,
16 I assume that's consumer regulatory, other standards,
17 because they had liability, they sat up and paid
18 attention?

19 MR. JOHNSON: Would you disagree? I think we
20 were always -- compliance issues to me, when we found a
21 problem, most of our clients would just not buy those
22 loans.

23 When there was an underwriting issue, there
24 could be some negotiation between the buyer and the
25 seller.

1 CHAIRMAN ANGELIDES: All right. Well, thank
2 you.

3 Did you want to comment on that, Ms. Beal?

4 MS. BEAL: No, I agree. And I think that over
5 time that is an area where the sellers improved as they
6 were originating loans was in regulatory compliance. So
7 I think that's, in my opinion, why some kind of
8 regulatory guidelines around credit standards may make
9 the market react that same way to credit underwriting.

10 CHAIRMAN ANGELIDES: Thank you.

11 Mr. Vice Chairman.

12 VICE CHAIRMAN THOMAS: Thank you,
13 Mr. Chairman.

14 Mr. Johnson, in your testimony on page 2
15 where -- the first major paragraph where you think there
16 isn't a monocausal aspect of this. I think based upon
17 everything that we have looked over time: (1) That
18 tends to be the answer for almost everything. As
19 someone once said, there are people who have very
20 straight, simple answers for things and they are wrong.
21 It tends to be a multitude of factors.

22 However, when we were in Bakersfield, I have a
23 friend who ace director of a bank and if you meet him on
24 the street he is kind of a cowboy farmer. Trouble is he
25 has a Harvard MBA in business. And he said, "We brought

1 in these guys who supposedly understood these securities
2 things and I asked them to explain them to me." And
3 when they were done he said, "I didn't understand what
4 they said so get rid of them."

5 So he didn't engage in those activities because
6 he couldn't understand them. And I have to tell you
7 that based upon the testimony presented as to what the
8 Clayton folk do, I am clear on what you don't do, but
9 when I go through the list of what you don't do, I am
10 trying to figure out what I get for my money.

11 And is it possible to give me a one- or a
12 two-sentence explanation of what I got for my money if I
13 hired you?

14 MR. JOHNSON: I no longer work there.

15 VICE CHAIRMAN THOMAS: Well, you mean they've
16 changed the philosophy since you were there, or do you
17 prefer to have the one who's still doing it?

18 MR. JOHNSON: No, I think there is no longer
19 securitization, so we're --

20 VICE CHAIRMAN THOMAS: Right. It's dead. But
21 I mean, at some point people were paying you a lot of
22 money for this.

23 MR. JOHNSON: I would say hindsight -- in the
24 '80s I hired Clayton to tell me if the loan is a good
25 loan or bad loan because I was securitized and I was

1 putting it on my bank's balance sheet.

2 VICE CHAIRMAN THOMAS: Notwithstanding all the
3 things you don't do, sample percentage, 5 percent,
4 et cetera? I am just curious. I guess people --

5 MR. JOHNSON: Back in the '80s sample sizes
6 were closer to 50, 100 percent.

7 VICE CHAIRMAN THOMAS: Oh, well, that's
8 entirely different.

9 MR. JOHNSON: Right. All I am saying in the
10 2000 to 2000 period, sample sizes got lower. I think we
11 were used to basically help negotiate the purchase price
12 between a buyer and a seller.

13 VICE CHAIRMAN THOMAS: So you used, a little
14 bit like the rating agencies where "Just give me the AAA
15 and I am comfortable, don't explain to me what the AAA
16 means." It was a kind of a Good Housekeeping seal of
17 approval aspect to it?

18 THE DEPONENT: Now, we were never asked to make
19 a pie, we were just simply -- we were third-party
20 contractors saying, "Look at 1,000 loans and give us a
21 grade," and then we were out of it. We didn't know what
22 got into the securities, we really didn't -- we were
23 just simply showing, "Here is our exceptions."

24 And now in hindsight, if you look at almost a
25 million loans, you know, that 54 percent to me says

1 there is a quality control issue in the factory. And it
2 took until 2007 to be able to produce this report, but
3 that's the breakdown that probably led to my quote in
4 the paper, that I didn't see much value added in our
5 approach.

6 VICE CHAIRMAN THOMAS: Yeah, okay. It just,
7 again, reinforces my belief there's a niche market for
8 almost anything and so I appreciate that.

9 Mr. Eggert, you used as a footnote an article
10 that you had in the Connecticut Law Review May 2009 of
11 "The Great Collapse: How Securitization Caused the
12 Subprime Meltdown."

13 I was always fascinated with Charles Beard's
14 "Economic Interpretation of the Constitution" because I
15 thought at the time that he wrote it in terms of the
16 market analysis it was insightful, it was very clever,
17 and a lot of the stuff I think nowadays we take for
18 granted. But what I couldn't do was get over the hump
19 of not 50 percent, not 60 percent, not 90 percent -- 100
20 percent of the Constitution was based upon economics,
21 which is, you know, basically the Marxist position.

22 The monocausal aspect always concerns me. So
23 was this a zippy title to catch attention, "How
24 Securitization Caused the Subprime Meltdown," or would
25 you qualify that and say it really wasn't necessarily

1 securitization, it was the way in which it was used and
2 there were a lot of other factors that led to the
3 meltdown? Because you say it caused it.

4 MR. EGGERT: Well, in my article -- I
5 understand your title can't say everything that your
6 article wants to say. In my article I do note that
7 there were other causes as well but that the
8 structure --

9 VICE CHAIRMAN THOMAS: But you wanted them to
10 read it to find that out so you put that out to grab
11 them; is that it?

12 MR. EGGERT: Well, I put that very early on in
13 the article, but it was -- and also, when you talked
14 about a cause, there are but-for causes which I think
15 securitization was a but-for cause of the -- of the
16 meltdown. I don't think it was the only cause. I think
17 there are other attributes, but I think it clearly was a
18 primary cause.

19 VICE CHAIRMAN THOMAS: And you focused on
20 private-label securitization?

21 MR. EGGERT: Right. And there are -- a lot of
22 things that are securitized haven't exhibited the same
23 problems we have seen in the private-label mortgage
24 market. Credit card securitization has been much more
25 stable.

1 And I want to be clear that what I was focusing
2 on was private-label mortgage securitization in that
3 article.

4 VICE CHAIRMAN THOMAS: So it's not
5 securitization as a structure or a method to multiply?
6 See, I tend to agree with Mr. Johnson's argument as to
7 securitization not being bad. Securitization has
8 created a lot of positives.

9 MR. EGGERT: But you can -- my point in the
10 article is you can structure securitization in bad ways
11 and the way that private-mortgage securitization was
12 done was structured poorly and so it was built into the
13 structure of that form of securitization.

14 And one of the things that I am hoping your
15 report will produce and the regulatory change that we
16 are seeing now will demonstrate is a better way to
17 structure this type of mortgage securitization.

18 VICE CHAIRMAN THOMAS: I think everybody agrees
19 that almost any other way would have been better. I
20 mean, you could have thrown a dart at a board and taken
21 whatever it said and put it in. So I mean, that's kind
22 of a given.

23 But you said just a minute ago in response to
24 something that these people who were doing this would
25 find other investors who haven't figured this out yet.

1 I just have to say through your whole testimony I had
2 this feeling that you really thought that it was causal;
3 that these are really a bunch of people who knew what
4 they were doing and they were motivated by clearly, for
5 want of a better term, sinister behavior.

6 When we've interviewed a lot of them, the one
7 thing that floored me the most is that the CEOs running
8 a lot of these big operations making millions of dollars
9 a year, didn't know what they were doing. One of them
10 didn't even know there had to be collateral calls
11 against the securities that they had.

12 Do you really believe these were knowledgeable
13 people who were working in the shadows structuring these
14 documents for the, I guess, the pure sake of making
15 money, or was it a lot of people didn't fully understand
16 what was going on?

17 MR. EGGERT: When you're talking about the
18 motivations, I mean, clearly, for many of the people in
19 the structure, the primary motivation was to make money.
20 They were in business to make money.

21 VICE CHAIRMAN THOMAS: Is that bad?

22 MR. EGGERT: And I am not arguing that that's
23 bad at all.

24 VICE CHAIRMAN THOMAS: You are not a Marxist,
25 good.

1 MR. EGGERT: What I am arguing, though, is you
2 have to set up the system so that people's desire to
3 make money is channeled in such a way that the result
4 isn't all these bad loans, all the foreclosures. And so
5 for me it's how do we structure the system to correct
6 the incentive problem?

7 VICE CHAIRMAN THOMAS: But it isn't necessarily
8 the securitization aspect?

9 MR. EGGERT: It's the way it was structured.

10 VICE CHAIRMAN THOMAS: Sure. Anybody can talk
11 about that. We could have done it the old-fashioned way
12 and had the loans go to community banks, then we could
13 have taken the debt of community banks and securitized
14 it. Or we could have run it through a REIT structure, a
15 real estate investment trust structure.

16 You know, there are a lot of ways to securitize
17 product. It just happened to occur this way because it
18 was fairly efficient and all of those check points along
19 the way didn't do their job. Not only the government --
20 federal government regulators, state regulators, but
21 people who were paid good money to rate them, people who
22 were paid good money to carry out various activities. I
23 think everybody agrees it just broke down.

24 So that's good because it would really be hard
25 for me -- some people say, "Gee, well, let's go back to

1 the glad days. Let's go back to the 1950s." The world
2 won't operate that way anymore and you can't take it
3 back to that. But if it's now down to saying if we are
4 going to do things, transparency is critical on
5 anything, knowledge and assistance in making decisions,
6 even requiring people to hang on to some of what it is
7 they are trying to sell.

8 I always wanted in those westerns when the guy
9 was selling snake oil, someone in the audience would
10 say, "Well, you take a big swig first and then I will
11 think about it," and then just let them put a little bit
12 of what they are selling on their selves or in
13 themselves.

14 And to try to carry this theme in a slightly
15 different way --

16 CHAIRMAN ANGELIDES: Yield some more time?
17 What do you want --

18 VICE CHAIRMAN THOMAS: Yeah, just another
19 minute or two.

20 CHAIRMAN ANGELIDES: That's fine.

21 VICE CHAIRMAN THOMAS: Mr. Johnson, when you
22 were --

23 CHAIRMAN ANGELIDES: We are on Sacramento
24 casual time.

25 VICE CHAIRMAN THOMAS: Okay. Levy time. I am

1 with you.

2 We've heard over and over again that really
3 good -- in fact, we just heard it in an earlier panel,
4 that really good intentions -- I mean, the no docs for
5 people that get aggravated to have to filling forms when
6 they got more than enough money to buy and sell the
7 institution they wanted to get a loan out of, was a
8 clever way to not have to put people who were willing to
9 take a loan through the grinder until you saw what
10 happened with them.

11 And obviously, I think you had some things to
12 say about affordable housing goals and Freddie Mac and
13 Fannie Mae in terms of what very well could have started
14 out as good intentions, and once you start structuring
15 good intentions and you have to hit a mark on good
16 intentions, it really influences behavior. And you had
17 something to say about that.

18 MR. JOHNSON: I think you may be referring to a
19 specific transaction that I was asked about in my
20 summer testimony.

21 VICE CHAIRMAN THOMAS: Yeah.

22 MR. JOHNSON: Let me talk a little bit about
23 that. In 2003, as mortgage rates had declined and the
24 refi market had exploded, it was difficult for the GSEs
25 to meet their affordability goals.

1 VICE CHAIRMAN THOMAS: Admirable as though they
2 may be.

3 MR. JOHNSON: Right. And I believe the goal is
4 a simple calculation where's it's just a number of
5 loans, low to moderate, divided by the total number of
6 loans.

7 VICE CHAIRMAN THOMAS: That was devised by
8 Congress.

9 MR. JOHNSON: Excuse me?

10 CHAIRMAN ANGELIDES: That was devised by
11 Congress, so it couldn't be too complicated.

12 MR. JOHNSON: No, it is a very simple
13 calculation. But the one unique concern that was
14 written into the regulations that small balance
15 multifamily loans would act as a multiplier to that
16 affordability credit.

17 And when I was a chief operating officer for
18 the commercial segment at Clayton -- I am sorry, at
19 WaMu, many don't realize that we were the largest
20 multifamily lender in the nation, primarily in
21 California. And it's a model that was beautiful back
22 then, I think it's still beautiful today, and it's well
23 run by Chase. Most of our multifamily was small
24 balance, 2 million and below, 35 units, it all qualified
25 under this definition.

1 So every year when the GSEs had an issue, they
2 would come to WaMu and ask for a transaction. And in
3 2003 I received a call from Freddie Mac wanting to
4 arrange a deal -- a very large deal, largest we've ever
5 done -- for \$6 billion in multifamily. Small balance.

6 And 6 billion in multifamily is about 4,000
7 loans. But the 4,000 loans if you think the average is
8 35 units in each loan, is -- then you multiply that
9 double, you can actually get 280,000 affordability units
10 would be the numerator, and 4,000 would be the
11 denominator.

12 So when GSE and you're struggling to hit your
13 affordability goals, this was a unique transaction to
14 perhaps get you over the threshold.

15 VICE CHAIRMAN THOMAS: So it was a quota
16 maker?

17 MR. JOHNSON: Yes, it was a quota maker.

18 VICE CHAIRMAN THOMAS: Driven by quota?

19 MR. JOHNSON: Exactly. And it became very
20 obvious to us at that they were very serious about
21 making that number. We had not done a lot of business
22 with Freddie Mac Freddie Mac was not a strategic partner
23 at that time with WaMu, became later. When they
24 originally asked me to do the transaction for 6 billion,
25 I think I asked for: "We will do it only if Freddie Mac

1 will sell me \$10 million of commercial mortgage-backed
2 securities, but sell it to me at a price that WaMu could
3 make a risk-adjusted return of 18 to 20 percent."

4 They came back with a "We can't do that"
5 because the price would be below where they have it on
6 the books and it would cause a mark-to-market issue and
7 they don't need another accounting issue. "What
8 else" --

9 VICE CHAIRMAN THOMAS: We find out later.

10 MR. JOHNSON: "So what else would you take,
11 Mr. Johnson?" And I asked for \$100 million in cash.
12 And the swap is nothing more than me giving paper and
13 they, in return, giving paper. There is no change of
14 ownership in terms of the loss. WaMu still received the
15 unilateral right to collapse the security after one
16 year. And as a result, those assets continued to be
17 for -- accounted on our books and records as loans.

18 Now, I want you to know that we were, at WaMu,
19 skeptical about doing the transaction for \$100 million,
20 which is the swap, so we insisted and received
21 confirmation that this transaction was reviewed and
22 approved by their board of directors, their auditors,
23 their lawyers, and disclosed in their financial
24 statements as well as disclosed in ours.

25 VICE CHAIRMAN THOMAS: So how broadly can I say

1 that that transaction was based almost totally on their
2 need to make quota?

3 MR. JOHNSON: 100 percent. There was no
4 economic incentive behind it.

5 VICE CHAIRMAN THOMAS: That's 100 percent, all
6 right. Because we have had some concern about the role
7 of GSEs driving particular aspects of the housing and
8 mortgage market at this time. I appreciate that
9 testimony.

10 CHAIRMAN ANGELIDES: I would like to ask before
11 we go to Ms. Murrin, just a quick follow-up.

12 Do you know how that portfolio performed?

13 MR. JOHNSON: That portfolio is pristine. That
14 multifamily -- small balance multifamily in California
15 was a product that I wish I could take credit for as the
16 commercial CFO. It started with Amonston and Great
17 Western and performed better than single family over a
18 45-year record.

19 And again, it's located in areas of high
20 barriers of entry, so -- for housing, so people continue
21 to rent in those and it has performed incredibly well.
22 I believe the security was collapsed and is now part of
23 ownership by Chase.

24 CHAIRMAN ANGELIDES: Again, one last thing just
25 for clarification. I want to return to something

1 Ms. Beal said.

2 So Deutsche Bank rejected more loans. So my
3 understanding is you really did your -- this is an
4 interesting phenomenon. We're talking about
5 transparency. I think the Vice Chair asked some good
6 questions about what was the transparency up the chain.
7 And we have heard about this notion of asymmetric
8 transparency, that, you know, the person who is making
9 the sale has more information.

10 Just to be clear, you did the due diligence in
11 this instance so that the issuer who is going to sell it
12 into the marketplace who is buying it from Countrywide
13 or New Century, they could use your information to
14 bargain the price, correct?

15 MS. BEAL: Correct.

16 CHAIRMAN ANGELIDES: Okay. And even though
17 they failed loans, that doesn't necessarily mean they
18 were kicked out of securitizations, correct, or you
19 don't have knowledge of that?

20 MS. BEAL: I don't have knowledge of that.

21 CHAIRMAN ANGELIDES: Do you have any direct
22 knowledge, Mr. Johnson?

23 MR. JOHNSON: I've no direct knowledge.

24 CHAIRMAN ANGELIDES: All right. Thank you.

25 Ms. Murren.

1 COMMISSIONER MURREN: Thank you, Mr. Chairman,
2 and thanks to all of you for spending time here with us
3 today. I would like to talk a little bit about
4 corporate culture. And in particular, Mr. Johnson, I
5 think you have a unique vantage point in that regard.

6 In reading through your biography, it appears
7 that you were at Arthur Anderson for a period of time.
8 Although you did leave there well before the firm
9 collapsed, I would note that the firm collapsed in part
10 because of inaction as a result of some of what its
11 clients' behaviors were.

12 And from there went on to Texas to United
13 Savings Association which ultimately itself collapsed
14 and was seized by the FDIC in part because of
15 enforcement action brought as it relates to its mortgage
16 portfolio.

17 And you mentioned earlier that Clayton holdings
18 actually did some work for you while you were there; is
19 that correct?

20 MR. JOHNSON: No. United Savings collapsed,
21 but I really spent most of my career with Bank United
22 which bought it from the Southwest Plan. And we bought
23 it about 20 billion, I think, from the RTC. We were a
24 very successful institution, went public, and then was
25 sold for, I think, \$2 billion to WaMu.

1 COMMISSIONER MURREN: And would you comment on
2 your underwriting standards when you were both at --
3 well, I guess all three places?

4 MR. JOHNSON: Well, at Bank United we looked at
5 doing subprime and we passed. We were only a prime
6 shop. We were a broker shop, too, for a while, just
7 100 percent broker channel and it did work primarily
8 here in California. I would say some of that probably
9 worked because home prices can hide -- if they increase
10 they can hide a lot of underwriting flaws. But we at
11 Bank United had hardly any credit issues during that
12 period of time from '86 to 2000.

13 COMMISSIONER MURREN: And could you comment in
14 each of those roles how your compensation was
15 determined? I know at Washington Mutual that much of
16 your compensation was based on firm performance and
17 aggregate, but can you break down the elements of firm
18 performance for me, please?

19 MR. JOHNSON: For my compensation personally?

20 COMMISSIONER MURREN: Yes, or executives
21 broadly. It's up to you.

22 MR. JOHNSON: My compensation was based
23 primarily on the overall company Washington Mutual, or
24 Bank United at the time. I was not paid any incentives
25 on volume or, you know, yield spread premiums like, you

1 know, loan officers or brokers were.

2 COMMISSIONER MURREN: Understood. But were
3 those targets based in part on expectations that the
4 company would grow, or if it stayed static would you --

5 MR. JOHNSON: It was mostly based on return on
6 equity and profit, not asset size per se or volume, my
7 personal targets weren't. That may be an incentive that
8 was done, pushed down to the loan originators in the
9 divisions that they had to grow, you know, say, Los
10 Angeles market from 50 million to 75 million. So that
11 would have been one of their metrics, not personally one
12 of mine.

13 COMMISSIONER MURREN: But profit would be a
14 dollar figure or a growth in profit?

15 MR. JOHNSON: Both. Probably mostly a dollar
16 figure, a target to hit for my division, my segment, and
17 then usually for the overall company. So my
18 compensation would have been half in cash, salary,
19 bonus, and half probably in equity.

20 COMMISSIONER MURREN: And the profit figure
21 would have been same level as the prior year?

22 MR. JOHNSON: Usually above the level have the
23 prior year.

24 COMMISSIONER MURREN: So effectively it was you
25 were paid in part on growth?

1 MR. JOHNSON: Absolutely.

2 COMMISSIONER MURREN: Did you say
3 "absolutely"?

4 MR. JOHNSON: Yes. I don't recall a year where
5 we -- well, I'll take it back. At WaMu there was
6 probably a year that we said maintaining was probably
7 growth given the market.

8 COMMISSIONER MURREN: And based on looking at
9 return on equity, would you say that leverage played a
10 role in that at all?

11 MR. JOHNSON: The entitiesthat I worked
12 at?

13 COMMISSIONER MURREN: Yes.

14 MR. JOHNSON: Leverage did play a role in our
15 growth as a bank, yes.

16 COMMISSIONER MURREN: So commenting now on your
17 experience as a variety of different firms, could you
18 talk a little bit about the accountability of executives
19 who either themselves are part of the process where we
20 end up in a situation where so many bad loans are in the
21 system, either as a participant because you are in the
22 market, or as an observer because you are evaluating the
23 loans themselves.

24 It sounds as though the reaction that all of
25 you are having -- or both of you -- is that you were

1 paid to do a job and your job was simply to determine
2 whether or not these particular loans fit the criteria
3 of the banks themselves. And I can certainly understand
4 that.

5 But to what extent -- given the history and
6 your observation of how some of these firms can fail,
7 did you feel any sense of obligation to note that there
8 was apparently a problem, that these loans were being
9 sold to firms who were then turning around and marketing
10 them as perhaps something they weren't or certainly
11 without full disclosure? You are a sophisticated guy.

12 MR. JOHNSON: I don't -- during the middle of
13 the bubble, I don't think you would come to the
14 realization at that time. You know, we did what we
15 thought was appropriate. We weren't sure exactly what
16 loans went into securitizations.

17 In 2006, when we saw the declining exceptions
18 and the 54 percent, that number came to us in 2007, we
19 took action. We went to the rating agencies. Not all
20 for the benefit of goodwill, for a profit as well as,
21 you know, building our business.

22 But I think we took the -- we also went back to
23 our clients with these reports for each one of them and
24 said, "Look, this is what you are doing and this would
25 could be a very viable tool for you to use as you manage

1 your factory going forward. And you could take this
2 tool and perhaps create broker score cards and
3 correspondence score cards, and create score cards on
4 your own loan officers to make you a better manager."
5 That's basically what we were trying to do.

6 COMMISSIONER MURREN: Did you have those
7 conversations yourselves or yourself?

8 MR. JOHNSON: We broke up the conversations. I
9 did a few. I did Goldman Sachs, Morgan Stanley, I
10 probably did a few others, but most of them were very
11 receptive on receiving this type of data and saying they
12 want to become a better, you know, issuer, a better
13 securitizer. Unfortunately, when we were able to get
14 this data, the market was sort of crashing.

15 COMMISSIONER MURREN: I see. Thank you.

16 CHAIRMAN ANGELIDES: Can I ask just one quick
17 follow-up very quickly?

18 I have a note that -- I think from you,
19 Ms. Beal, in your interview you said you did take the
20 trending reports at Deutsche Bank, but they didn't
21 really like the product because I think they were
22 concerned that if it got in the hands of the wrong
23 people, it would be misunderstood, so they were
24 concerned about what you were showing them?

25 MS. BEAL: Yes. We took the reports to

1 Deutsche Bank and their transaction management team that
2 we worked with day-to-day, they were overall very
3 positive, as were most of our -- all of our clients that
4 we spoke with. They liked that we had the capability to
5 start developing reports to use the data to show them
6 trends. They were giving feedback on how to make the
7 reports more meaningful.

8 In the instance of Deutsche Bank, one of their
9 senior managers joined the meeting and he took a look at
10 it. And understanding the process that Deutsche Bank
11 used where they had a -- grade more loans as a material
12 exception based on their client tolerances, and then
13 took away that discretion from Clayton to grade loans 2s
14 with compensating factors so that they wanted to look at
15 the loans.

16 So there again we were generating more Level 3
17 loans. They showed more loans graded than the 2-W and
18 the 2-T. And he was concerned that the reports could be
19 misunderstood, which we agree with that concern because
20 that was our beta version. We understood we needed to
21 standardized the reports, so that --

22 CHAIRMAN ANGELIDES: Of course information is
23 information. If it's properly presented, people can
24 make determinations.

25 MS. BEAL: Yes.

1 CHAIRMAN ANGELIDES: All right. Mr. Georgiou.

2 COMMISSIONER GEORGIU: Professor Eggert, I
3 would like to start with you, if I could. There is a
4 central question that we have been looking at on this
5 Commission for some time which concerns the issue of
6 securitization.

7 I think we can all stipulate that the notion of
8 securitization, qua securitization by itself is somewhat
9 neutral. That is, it was intended to and enables the
10 raising of capital from a disbursed way from investors
11 all over the world and disperses risk all over the world
12 and enables the spreading of risk and the spreading of
13 certain loans or other obligations far and wide.

14 The question, I guess, we are troubled about is
15 whether in this particular run-up of securitization and
16 the utilization of it in connection with the mortgage
17 securitization market, the extent to which that was
18 based on incentives that enabled the creation of a super
19 structure of securitizations that created part of the
20 risk and was one of the causes of the financial crisis.

21 And I guess I would like you -- if I could, I
22 would like to give you an opportunity to tell us why as
23 I read your testimony you believe that it did. And I
24 would also like you, if you could, to identify who it is
25 that you think believes the opposite.

1 That is, that who it is that we could inquire
2 from that would tell us that in their view a
3 securitization wasn't a significant factor in the run-up
4 to the crisis.

5 MR. EGGERT: Well, I think it would be hard to
6 find somebody who says that it was uninvolved; however,
7 there has been a debate between what is more important
8 in the boom and bust and whether it's securitization or
9 housing prices.

10 There is an argument out there that what we saw
11 was a boom in mortgages caused by housing prices, and
12 then when housing prices started dropping, that that's
13 what led to the mortgage bust, more than
14 securitization. I don't know that there is anyone who
15 would say securitization was uninvolved, but there is
16 the argument out there that says it wasn't
17 securitization so much as a housing price issue.

18 I don't happen to agree with that. I think it
19 was more caused by securitization and that to some
20 extent even the housing price bubble was a product of
21 securitization. That it wasn't -- that wasn't all that
22 was there, but that if you look at the markets that were
23 the most bubble markets, they were ones where
24 securitization was widely used.

25 As far as the structure of securitization,

1 while I agree that different forms of securitization can
2 be structured differently and that not all forms exhibit
3 the grave problems that we have seen, there are some
4 aspects of securitization that are kind of universal
5 that are kind of hard-coded into the whole process that
6 it's hard to figure out how to work around.

7 For example, the whole element of
8 securitization is that you take something of value and
9 you put it in a pool of securities and then you sell
10 securities to investors who weren't present at the
11 creation of whatever it was.

12 By doing that, you have almost inevitable
13 information loss. The person who makes the initial loan
14 will know more than the investor who buys the security
15 about that loan, even if they -- just because they have
16 met the borrower.

17 So when you are designing the new structure,
18 what you have to do is try to figure out how to minimize
19 that information loss, but I don't think you can
20 eliminate it. So I think by and large what we have to
21 do is recognize the structural flaws in securitization
22 and try to create a structure that minimizes those
23 flaws, recognizing that we can't completely eliminate
24 them.

25 COMMISSIONER GEORGIU: But one thing you say

1 in your testimony is that it's too facile to just
2 characterize the lack of skin in the game and the lack
3 of transparency as being the only difficulties presented
4 by the securitization of mortgages that led to the
5 problems, but that there were other aspects of it that
6 led to the diminution in underwriting standards and to
7 the creation of bad loans. And I wish you could speak
8 to that.

9 MR. EGGERT: I think that's very important
10 because if you look at people who are trying to fix it,
11 to a great extent they're focusing on those two aspects.
12 And I don't want to say those aren't important aspects.
13 I think they are. But as we have seen, you -- there are
14 other issues as well that are, I think, very important
15 and have to be addressed as well.

16 So for example, one of the things that
17 securitization did in the private mortgage label market
18 was it caused pushing to the risk of in every level of
19 the system. And for example, if you take a -- if you're
20 rating corporate securities -- I am not a securities guy
21 so I am coming to this from the mortgage market, but my
22 understanding is if you are rating corporate securities,
23 you will have securities you will create sort of bands
24 of risk and so some will be AAA some will be A. And
25 within those bands, the securities can kind of exist all

1 throughout that band. Some AA will be almost AAA, some
2 will be at the bottom, but there will be a range.

3 When you are securitizing mortgages, though,
4 the people who are arranging them could make the
5 security, the resulting securities at the bottom of
6 whatever range they were. If you have a pool of -- you
7 know, access to a lunch of loans, the question for the
8 Wall Street firm was: "What is the worst pool of loans
9 that we can assemble to get the ratings that we want?
10 And what is the lowest number of credit enhancements we
11 can add to get that level?"

12 And the effective securitization is that you
13 will have -- when you are making investment grade loans,
14 you'll make -- you know, the weakest level of investment
15 grade loans is that the credit rating agencies will
16 bless. That's part of the securitization process. And
17 I don't see anyone trying to address that issue.

18 COMMISSIONER GEORGIU: And that feeds a little
19 into what I think Ms. Beal and Mr. Johnson said, which
20 is that your analysis at Clayton was utilized frequently
21 by the securitizers to bargain down the price of the
22 pool of loans that they were purchasing from the
23 originators, but that didn't necessarily translate into
24 that information being utilized to structure the
25 ultimate pool of loans that was put into the securities

1 up the line.

2 Of course, you didn't really know what they did
3 with that; is that correct, Ms. Beal?

4 MS. BEAL: That's correct. We didn't know what
5 they did with the data we gave them and the results.

6 COMMISSIONER GEORGIU: Back to Dr. Eggert, if I
7 could.

8 This is an important point for us and I am
9 trying to get to what -- what utilization was made of
10 the originally distributed model that structurally
11 impaired the process and led to a greater degree of
12 risk. And I don't know that I have your views on that
13 very fully.

14 MR. EGGERT: Okay. Well first of all, I'm not a --
15 I don't have a doctorate, so if you could call me
16 "professor."

17 COMMISSIONER GEORGIU: All right. Got you.
18 Very well.

19 MR. EGGERT: People with a doctorate frown on
20 those of us without.

21 But as far as I would like to note, it's
22 interesting, the testimony about the use of these due
23 diligence reports and how securitization changed the
24 use. Back when people were buying to hold, due
25 diligence was something that they did so they wouldn't

1 buy bad loans.

2 Under securitization, due diligence was
3 something that they did so they could get a better price
4 on pools of loans. It wasn't a way to --

5 COMMISSIONER GEORGIU: By better price on a
6 pool of loans by identifying some of the poor loans
7 they'd have to pay less for.

8 MR. EGGERT: Right. By telling the
9 originators, "I'll still buy it, but I won't pay as much
10 because of the due diligence problems." It's a very
11 different result than "I won't buy the bad loans."

12 COMMISSIONER GEORGIU: Right. But doesn't
13 that go, to some extent, to the skin-in-the-game notion;
14 that is, if you are either originating loans or
15 purchasing loans that you actually wish to see paid
16 back, you wouldn't do it if you were holding them.

17 If you could pass them along at 100 percent at
18 full par, you would do so if you could sell them for
19 that. But if you actually had to hold them, then you
20 could run the risk that has already been disclosed to
21 you by the due diligence information that they could
22 fail. So that wouldn't make economic sense if you
23 actually had a hold -- a long hold position with regard
24 to some significant portion of those loans with those
25 securities, correct?

1 MR. EGGERT: I think that --

2 CHAIRMAN ANGELIDES: Do you want another
3 minute?

4 COMMISSIONER GEORGIU: Yes.

5 MR. EGGERT: I think that's correct. And I
6 think you see that both in the origination and also in
7 the securitization. Originators have their own issues
8 with, say, housing appraisals. It used to be when
9 originators held loans, they wanted an accurate
10 appraisal because it protected them against risk of
11 default.

12 Once there's securitizing, housing appraisals
13 are just a hurdle you have to jump over so you can
14 securitize it. So their interest was, instead of having
15 an accurate housing appraisal, was having an inflated
16 one because it made it easier to securitize loans.

17 If they are forced to retain risk, then they
18 would have a greater interest in doing real
19 underwriting, having accurate housing appraisals. And
20 so I think that's a central of element of the fix that needs to be
21 made.

22 COMMISSIONER GEORGIU: Mr. Johnson, you raised
23 your hand to make a comment.

24 MR. JOHNSON: I just want to clarify that I
25 don't know of any Wall Street issuer in my history that

1 ever wanted to find loans with exceptions to go back and
2 negotiate a lower price to profit on their
3 securitization.

4 In fact, as earlier -- like, in 2000 to 2005
5 probably the seller had more power than the Wall Street
6 issuer because the seller -- if you weren't going to buy
7 at Wall Street firm A at par or 101, I got another one
8 down the street who will pay 101 and take the loans with
9 you.

10 I do think that what happened is exceptions got
11 higher, Wall Street got smarter, and then priced those
12 loans cheaper. I don't believe that was the model. I
13 just want to go on record. No one ever came to us and
14 said, "Hey, we're funding a bunch of bad loans."

15 COMMISSIONER GEORGIU: No, I am not suggesting
16 that but they would utilize your information in part to
17 price the loans they purchased?

18 MR. JOHNSON: Sure.

19 COMMISSIONER GEORGIU: Right. Okay. Thank
20 you very much.

21 CHAIRMAN ANGELIDES: Mr. Thompson.

22 COMMISSIONER THOMPSON: Mr. Eggert, I am not a
23 doctor, either, so we can smile at one another.

24 You are not suggesting that securitization is
25 bad; you are suggesting that the process by which it was

1 executed during this bubble period was perverse; is that
2 fair or not?

3 MR. EGGERT: I am not suggesting --
4 securitization, like --

5 COMMISSIONER THOMPSON: I want to get at what
6 you think the real issue is. Is it the process that's
7 broken or is it a product that shouldn't exist? What
8 are you telling us?

9 MR. EGGERT: Securitization has flaws and it
10 has good points. And what we have to do to re-start
11 securitization is to minimize and fix the flaws as much
12 as possible, recognizing that they will still exist.
13 But as it existed from 2006, 2007, the flaws were much
14 greater than the value. We have to work on the flaws to
15 try to turn that around.

16 I think it's important to recognize that
17 lending -- mortgage lending people have sort of
18 villainized subprime lending. There is a usefulness to
19 lending to people who are not prime borrowers. Even
20 people who are prime borrowers, if they can afford a
21 house, should be able to buy that.

22 So we have to figure out how to make good loans
23 to non-prime borrowers, not the kind of loans that were
24 made and that have exploded. So that's the challenge is
25 how to set up the system in order to encourage better

1 lending to non-prime borrowers.

2 COMMISSIONER THOMPSON: So you make the point
3 that it would be good if people had current information
4 about the status of the loans that were in those
5 portfolios. So how practical, really, is that?

6 MR. EGGERT: If you look at the -- well, first
7 of all, that information exists. I mean, people are
8 keeping track of the status of loans all the time. The
9 question is how practical it is to disclose.

10 And there we are having an interesting
11 conversation between the association of mortgage
12 investors -- whatever they are called -- and the Wall
13 Street firms talking about how current the information
14 should be, what information should be provided, and I
15 think that's an important discussion. But it's clear
16 that we can have better disclosure than we had.

17 I think everybody -- I think even Wall Street
18 agrees that it can be done better and will be. But the
19 question is how we balance the cost of, you know, making
20 sure everything is completely up-to-date and versus
21 giving investors the information that they need. And
22 that's a decision that is going on right now and is an
23 important one.

24 The other thing we had to include in that
25 discussion is making sure that we don't disclose so much

1 information that borrower's privacy is violated. That's
2 another factor that has to be balanced in the equation.

3 COMMISSIONER THOMPSON: Mr. Johnson, you talked
4 about the incredible transaction that happened with
5 Freddie. Was that typical or not?

6 MR. JOHNSON: We had done several other ones in
7 earlier years but much smaller.

8 COMMISSIONER THOMPSON: So atypical.

9 MR. JOHNSON: Atypical. We did a similar
10 transaction with Fannie Mae the same year for the same
11 amount, 6 billion and charged them nothing.

12 COMMISSIONER THOMPSON: Charged them nothing?

13 MR. JOHNSON: Charged them nothing.

14 COMMISSIONER THOMPSON: The logic for that?

15 MR. JOHNSON: They were a strategic partner we
16 agreed to work better on multifamily transactions.
17 Washington Mutual wanted to buy and own adjustable rate
18 multifamily and Washington Mutual could not originate
19 fixed rate and hold them on our books, so we wanted to
20 sell that to Fannie Mae. So that was the pre quo quo.

21 Also, I would say the executives at Fannie Mae
22 were not ones that you could negotiate 100 million. The
23 executives at Freddy Mac at that time were in chaos and
24 it was --

25 COMMISSIONER THOMPSON: Management matters.

1 MR. JOHNSON: Management matters and Dan
2 Lundgren (sic) never have thought of paying us that type
3 of money.

4 COMMISSIONER THOMPSON: So that transaction
5 with Freddie was atypical?

6 MR. JOHNSON: Yes. And that's why we asked for
7 it to be disclosed, be reported to their board to make
8 sure their legal counsel signed off. We wanted that
9 done because it just didn't make economic sense to us.

10 COMMISSIONER THOMAS: But in the end, it worked
11 out for everybody -- you, Freddie, and those who were a
12 part of the process at the borrowing end?

13 MR. JOHNSON: It had no impact on our
14 borrower. It was just a swap of paper. Swap of paper.
15 There's nothing economically changed, the list stayed
16 with us, the yield stayed with us. It was, "You get the
17 affordability credits and we get 100 million."

18 COMMISSIONER THOMPSON: I wish I could have
19 been a part of that transaction.

20 MR. JOHNSON: It had no impact on my bonus.

21 COMMISSIONER THOMPSON: So can you
22 distinguish -- you talk about private-label securities
23 that's non-GSE ; is that right?

24 MR. EGGERT: Yes.

25 COMMISSIONER THOMPSON: So will you spend any

1 time with us here this afternoon on your observations
2 about the GSEs in this whole process?

3 MR. EGGERT: Well, I think -- I think the GSEs
4 played a role in the process in two regards: (1) is the
5 way that they securitized prime loans; and the other is
6 the way that they invested in subprime loans.

7 There are some who argue that Fannie and
8 Freddie were a primary cause of the subprime meltdown
9 and I don't agree with that. I think my concern about
10 them is they didn't do enough to prevent the problem
11 rather than they caused the problem.

12 COMMISSIONER THOMPSON: So what evidence do you
13 have that would suggested they didn't cause the problem?

14 MR. EGGERT: Well, part of it is their subprime
15 presence was decreasing. During the period that --

16 COMMISSIONER THOMPSON: So they were losing
17 shares?

18 MR. EGGERT: They were losing market shares
19 during the time when the problems were mounting. If
20 they were the cause, them losing shares should have
21 meant that the problem was abated, but instead it was
22 growing dramatically as they lost shares. When they
23 were more active in the subprime market in, say, 2004.
24 Things were better than they were in 2006 when you were
25 less active.

1 So I think if you track Fannie's participation,
2 it's hard for me to say they were the cause. But again,
3 I think it's unfortunate that they didn't do something
4 which they could have done if they had stayed more
5 active, which is be the cop on the beat that says these
6 subprime securities stink and this system has to be
7 reformed. And they should have been shouting that and
8 demanding change, but I didn't hear that in 2006.

9 COMMISSIONER THOMPSON: Thank you very much.

10 CHAIRMAN ANGELIDES: All right. We -- just one
11 wrap-up question because we have to move on and I just
12 have a question which is I am looking at a standard
13 disclosure and it says, "On a case-by-case basis, the
14 originator" -- you know, put in the company's name --
15 "may determine that based on compensating factors, a
16 prospective mortgagor not strictly qualified under the
17 underwriting guidelines warrants an underwriting
18 exception."

19 It goes on to say, some, a substantial a significant
20 number of mortgage loans included in the loan pool
21 represent such exceptions. Weren't investors entitled
22 to know the basic due diligence information. I mean,
23 the issuers had it. Weren't they entitled to know? Was
24 there -- wasn't that something that should have been in
25 the marketplace?

1 MR. JOHNSON: That has been our argumentative
2 for 2006 and 2007 is that we thought it should. The
3 only time I found one is -- I think I saw a European
4 securitization which did disclose due diligence was done
5 and they'd laid out the exceptions to LTV, et cetera.

6 So I believe the market is going toward that
7 now, and that is the boilerplate we looked at and said,
8 you know, exceptions could be material. Well, is
9 material 4 percent or is material, you know,
10 60 percent?

11 CHAIRMAN ANGELIDES: If I know that 10 percent
12 had been sampled and X percent failed, I would at least
13 think that was a big enough sample to give me a
14 magnitude of challenge.

15 MR. JOHNSON: In my opinion as a businessman,
16 not wearing the Clayton hat or the Long Beach hat or
17 anything, I think the exceptions were an indicator. I
18 was very proud of this report that we did come up with.
19 And that, to me, this is one of the areas is that if we
20 worked with better we could have helped present value
21 the pain and stopped the factory from producing.

22 CHAIRMAN ANGELIDES: Well, thank you very, very
23 much. As I said, one of the big questions I always get
24 in this community is: "How did it come -- go from here
25 to there?" You've at least given us something to think

1 about for people to hear and understand about how these
2 simple mortgages that people used to buy or refinance
3 their homes, migrated on their way to Wall Street and
4 around the world. Thank you very much.

5 We are going to take literally -- everyone in
6 the audience, we're going to take a 2-minute break while
7 this next panel is assembled. We're going to catch up
8 some time. Two minutes.

9 ...

10 CHAIRMAN ANGELIDES: Welcome back to the final
11 session of today's hearing of the Financial Crisis
12 Inquiry Commission. This final panel is on the Impact to
13 the Financial Crisis on Sacramento Neighborhoods and
14 Families. And I might add, given the people at table of
15 Sacramento, families, neighborhoods, and businesses. I
16 want to thank you all for taking the time to be here.

17 And I would like to start this off by doing
18 what we customarily do for all our witnesses as we have
19 done in all 19 days of hearings across this country and
20 ask that you all stand and raise your right hand so you
21 can be sworn in.

22 Do you solemnly swear or affirm under penalty
23 of perjury that the testimony you are about to provide
24 the Commission will be the truth, the whole truth, and
25 nothing but the truth to the best of your knowledge?

1 (All sworn.)

2 CHAIRMAN ANGELIDES: Thank you very much.

3 I think that's the last time I am going to say
4 this as Commission Chairman, unless I say it in our
5 Commission meetings.

6 Let's do this: I think for this panel -- I
7 think we are going to start and we are going to go from
8 my left to right. So Ms. Canada -- Canada, correct?

9 MS. CANADA: That's right, yes.

10 CHAIRMAN ANGELIDES: We are going to start with
11 you and go across and end up with Mr. Wirz. So if you
12 would begin your testimony, it would be terrific. As
13 I've indicated earlier, there is a light here. It turns
14 to yellow -- you have five minutes up to five minutes to
15 provide your oral testimony. At one minute to go, the
16 yellow light will come in. When your time is expired,
17 the red light will go on. So if you will please
18 commence.

19 MS. CANADA: Thank you. My name is Pam
20 Canada. I'm the CEO of NeighborWorks Sacramento.
21 NeighborWorks is a premier member of the NeighborWorks
22 network for non-profit organizations chartered by
23 NeighborWorks America. And we carry out a mission to
24 provide stable, sustainable home ownership through a
25 comprehensive process that includes pre-purchase home

1 buyer education, responsible lending, and post purchase
2 counseling.

3 In 2006, we started to feel a bit of an up-tick
4 in the number of people coming in for foreclosure
5 prevention information and counseling. Almost not a
6 measurable number, it was significant in that it was
7 measurable and previous to this we had helped maybe half
8 a dozen people a year that would come in with severe
9 credit issues that were in need of some kind of
10 assistance.

11 Beginning then in first quarter of 2007, the
12 foreclosure crisis for us had begun to show its full
13 force. With hundreds of existing homeowners seeking
14 help and advice, it would give them an understanding of
15 the situation they were in and what they could do to
16 preserve their home ownership.

17 NeighborWorks Sacramento joined with various
18 other private non-profits, public sector agencies, and
19 officials to begin offering informational workshops
20 around the region. The workshops drew thousands of
21 people everywhere we went.

22 To further begin to build our response to this
23 growing number of client requests, we reorganized our
24 work flows, added capacity, hired and trained more
25 housing counselors, and built some internal

1 efficiencies.

2 People came into our office beginning in '07
3 and through '08 and '09, and particularly with boxes,
4 armloads of papers, personal financial records, anything
5 they felt that would help them tell their story and help
6 us figure out a solution for them. They were begging
7 for an appointment immediately so NeighborWorks could
8 help them save their family home.

9 It was a daily tragedy in process and taking
10 place right in our own community, in our own
11 neighborhoods, and playing out in our office lobby every
12 single day.

13 It was, and is to this day, an overwhelming
14 experience that cannot be adequately expressed in
15 words. These people who were coming for help were from
16 all walks of life, across all socioeconomic and
17 demographic levels with their own stories of confusion
18 and fear.

19 Typical stories we would hear every day were
20 about the single mom with three boys who lost her job,
21 was desperate to stay in the home where her boys knew
22 the neighborhood and knew their way to school, and how
23 could she stay in this home in this safe neighborhood
24 now?

25 The elderly couple that had refinanced a couple

1 of years ago using a cash-out refi to pay the
2 extraordinary costs of care for their daughter who had a
3 health-related emergency and now their loan payment was
4 adjusting, would almost double. They had a fixed
5 income, no savings, and limited retirement. What should
6 they do now?

7 The man who had gotten an inheritance when his
8 father passed away, used that as a large down payment on
9 a modest home with a reasonable loan product but his
10 small business was suffering and so he put money into
11 his small business and wasn't able now to make his loan
12 payments that had just adjusted. The bank was
13 foreclosing. He would lose his home and his greatest
14 concern was the dishonor on his father for losing the
15 inheritance money his father had worked so hard to
16 build.

17 The majority of people who came in for mortgage
18 problems had not previously had credit problems. They
19 paid their debts on time and were willing but no longer
20 capable of making that house payment. At every client
21 appointment for housing counselor, we were routinely
22 asked for basic information about foreclosure process.

23 And some people actually expected, when they
24 got a late notice from their lender that -- this was the
25 first time they had ever gotten a letter to that extent

1 with that severity -- they thought the sheriff was going
2 to come and throw them on the streets the very next day
3 and they were humiliated and scared.

4 We needed to dramatically increase our internal
5 capacity. We added a foreclosure workshop every week.
6 And we had people come into the foreclosure workshop
7 that would tell them in 90 minutes what the basic --
8 what their letters meant, what's the basic process of
9 foreclosure, what are the timelines, what are the legal
10 steps to follow, and what should they expect next,
11 because people just had no idea what to do or how to
12 respond.

13 From that, we offered that weekly seminar in
14 Spanish, Russian, and English. We had an average of 30
15 people every week for 50 weeks a year come to that class
16 for three years. Following the class they would have an
17 individual counseling time with our trained counselors.

18 In addition to the scores of homeowners with
19 mortgage payment issues, we began having a significant
20 number of people who believed they had been victims of
21 mortgage fraud or some form of misrepresentation, and
22 some were weighing the decision of filing bankruptcy or
23 walking away from their home or other similar decisions.
24 So we forged an innovative arrangement with the
25 University Pacific McGeorge School of Law that allowed

1 us to bring in legal expertise to advise people of what
2 the consequences would be for that.

3 In 2010 now, we have hundreds of open cases.
4 Loan modifications are taking nine months to a year,
5 minimal to no response from lenders and servicers on
6 these issues, trial modifications extending beyond --
7 well beyond the 90-day time frame that they were
8 intended to. And even then, some of the trial
9 modifications are being denied and loan modifications
10 are nonexistent.

11 People more and more with home values drawing
12 down are looking at what is called "strategic default"
13 or walking away, and that's become now a very common and
14 almost accepted conversation with our counselors as a
15 solution that people are taking.

16 CHAIRMAN ANGELIDES: Can you please wrap up?
17 If you want to just make a closing comment.

18 MS. CANADA: I think the closing comment is not
19 only the families, it's the neighborhoods.
20 NeighborWorks, as many non-profits across the nation, do
21 a lot of community development and community engagement
22 work in the neighborhoods. And block after block of
23 empty houses has deteriorated a lot of the work and
24 investment that we and many others have made. And it's
25 disheartening, to say the least.

1 CHAIRMAN ANGELIDES: Thank you very much.

2 Ms. Tawatao. Did I pronounce that correctly?

3 MS. TAWATAO: Yes.

4 CHAIRMAN ANGELIDES: Could you also pull the
5 microphone towards you. Thank you. Thank you very
6 much.

7 MS. TAWATAO: Thank you, Mr. Chairman, Vice
8 Chairman, and Commissioners. My name is Mona Tawatao.
9 I am regional counsel with Legal Services of Northern
10 California, a legal aid organization based here in
11 Sacramento and also serving 22 additional Northern
12 California counties.

13 I greatly thank the commission for the
14 opportunity to testify this afternoon. The main message
15 I want to convey is that this crisis has had a
16 devastating impact on this area and on lower and middle
17 income people, our clients, and that there needs to be a
18 systemic fundamental change to fix what has happened and
19 to prevent this from happening again.

20 I understand that the Commission chose to come
21 to Sacramento and the Stockton area recognizing it as an
22 epicenter of this crisis, so I won't spend time talking
23 about those statistics.

24 I would only ask that the Commission look
25 carefully at the subprime -- the high rate of subprime

1 and apparently securitized mortgages that have come to
2 people in this area and what impact that has had.

3 Regarding the impact on our organization's
4 practice and what we are seeing, our foreclosure
5 homeowner caseload literally increased by tenfold from
6 2005 to now.

7 So in 2005, we saw 47 cases involving
8 homeowners in foreclosure. This year we have seen
9 almost 500 and it's only September. And that is just
10 homeowners that doesn't count the hundreds and hundreds
11 of tenants we are seeing in foreclosure.

12 And that isn't the entire story even still
13 because what the housing bust has meant was loss of
14 jobs, including -- especially construction jobs which,
15 in turn, has meant loss of revenue for state and local
16 governments. And thus, there are fewer essential
17 services at a time when they are needed the most.

18 We help people with unemployment claims. We
19 help people fight county cuts so they can get
20 life-or-death medical care. So what I am saying is
21 people are hurting like never before. Our waiting rooms
22 and waiting lists are always -- always have more people
23 than we can assist and it is, as Ms. Canada said,
24 difficult to describe what it's like to see a good case
25 and say, "I am sorry, we can't help you."

1 Now, for those that we can assist on the
2 foreclosure side, we see lots of kinds of cases but
3 primarily three. Of course, predatory lending and
4 subprime lending, people who got steered or defrauded
5 into entering option ARMS with teaser rates or
6 pick-a-pay loans forcing them to pay into -- pay loans
7 that they could never pay off.

8 Prevalent among these clients are seniors,
9 people of color, people with disabilities, and limited
10 English speakers and seniors who are African-American
11 and Latino. Second type of thing, mortgage-rescue scams
12 are the double whammy.

13 So you have gotten tricked, defrauded into
14 entering into a bad loan, you are trying to keep up with
15 the payments and be a good person, and someone comes
16 along and says, "I will help you fix everything. I will
17 take care of the dealing with the servicer and lender,
18 stop making your payments but pay me some money."

19 And often our clients -- we have seen clients
20 pay their very last dollar with the hope that their home
21 could be saved only to have that money taken and find
22 themselves in foreclosure and then facing eviction.

23 I hope Lovey Hollis, who I mention in my
24 written submission who is 79 will be here later this
25 afternoon to tell you her story because this happened to

1 her.

2 Then there is HAMP and those cases with loan
3 modifications, which I know Ms. Canada also talked
4 about, rife with problems. Counselors and advocates
5 spending 30 minutes just getting a servicer to actually
6 believe them that they are authorized to talk to them.
7 So 30 minutes later, you know, you finally get to the
8 problem.

9 Paperwork needing to be submitted over and over
10 again, people getting approved -- worst of all, people
11 getting approved for a tempering modification, making
12 all the payments, hearing nothing from the service rep
13 except "Keep sending us your checks. Keep sending your
14 money," and then being foreclosed on and now facing
15 eviction.

16 Our clients Nia Lavulo and Bernard Mose are
17 here today, and I ask that they be given some time to
18 testify.

19 So what to do as a lawyer and advocate, you
20 might expect my response would be "We need more
21 resources." And that certainly is true, but I am going
22 to say that, you know, honestly, throwing more lawyers
23 at this is not -- it is a piece of the puzzle because my
24 clients have been helped by my colleagues and good
25 tremendous members in the private bar who have helped

1 them -- literally helped some of them save their homes,
2 but there really needs to be a real change that takes
3 consumers and people like our clients into account.
4 More than lip service, more than programs that don't
5 work.

6 So in closing, I would say the paradigm needs
7 to be shifted to take into these sorts of problems and
8 the effect that all these complex phenomenon that we
9 have been hearing about today, the effect they have
10 often real people and that's really where it matters.

11 I would just ask that -- there are three
12 witnesses, clients who are scheduled to be here, and I
13 would ask that they be given some time after we are
14 done.

15 CHAIRMAN ANGELIDES: After this session I will
16 cede my time -- the balance of my time so we can get
17 very brief statements from the folks who can tell us
18 very directly what they face.

19 MS. TAWATAO: Thank you very much,
20 Mr. Chairman.

21 CHAIRMAN ANGELIDES: Mr. Wagstaff.

22 MR. WAGSTAFF: Chairman Angelides, Vice Chair
23 Thomas, and members of the Commission. I am Bruce
24 Wagstaff, administrator of Sacramento County's
25 Countywide Services Agency.

1 I would like to welcome you to Sacramento and
2 thank you for your work to examine the cause of our
3 country's financial crisis and for conducting this
4 hearing today to explore the impact on our community.

5 My agency includes our county's programs to
6 provide financial assistance, indigent health care,
7 mental health and homeless services, food assistance,
8 child family welfare, and a number of other services to
9 those who are most in need.

10 There is no question that the financial crisis
11 has had impact statewide as well as locally on
12 individuals and families with children, many of whom are
13 already living on the edge.

14 Statewide and locally, caseloads and human
15 services programs have surged since the onset of the
16 recession in 2007. One in every three Sacramento County
17 residents is now served in some fashion by our
18 Department of Human Assistance.

19 Since January of 2008, our economic decline and
20 high unemployment rate have resulted in a significant
21 increase in our version of a national TANF program which
22 in California is called "calWORKs."

23 This occurred following a period of significant
24 caseload decline after the implementation of welfare
25 reform in the late '90s. The number of individuals

1 receiving calWORKs in January 2008 was about 77,000.
2 The number is now nearly 90,000, a 17 percent increase.
3 And I have to say this includes over 65,000 children age
4 18 and under.

5 The number of people receiving food stamps has
6 climbed from over 129,000 to about 188,000, a
7 substantial increase of over 40 percent.

8 The number of MediCal recipients has risen from
9 127,000 to 145,000, a 15 percent increase. And our
10 general assistance program, which is targeted for single
11 adults who do not qualify for other programs, has
12 suffered an increase of about 20 percent.

13 The increase in applications and caseload has
14 been both rapid and dramatic and shows no signs of
15 slowing. We see those needing our services lining up at
16 our doors hours before our office is open, and demands
17 on our workers being at an all-time high.

18 Our community providers have also seen
19 increased demands for emergency food, clothing,
20 parenting supplies, and other essentials.

21 For example, the Sacramento Food Bank assists
22 about 1,000 clients each day reporting a 30 percent
23 increase since 2007. It's been clear that not only are
24 higher demands for services occurring, but that the
25 characteristics of the person seeking our help are

1 changing dramatically.

2 We have seen a significant increase in seeking
3 aid for the first time, those who have recent work
4 history but have lost their jobs, and those who for the
5 first time are at risk or who have become homeless.

6 The increased level of stress and tension is
7 felt every day. Those who initially are found to be
8 ineligible for aid because of available assets, for
9 example, are frequently returning a few months later
10 when those assets have been used up and are then
11 approved for assistance.

12 Shane and Jennifer Taylor who have three
13 children are an example of this new face of public
14 assistance. When Jennifer, the primary breadwinner, was
15 laid off from her banking job of 15 years in June of
16 2009, the family was faced with becoming homeless. They
17 never expected to have to apply for calWORKs, cash
18 assistance, food assistance and MediCal.

19 Jennifer found temporary employment working for
20 the U.S. Census, but that ended in June of 2010. She
21 now participates in Community Work Experience to fulfill
22 her family's Welfare-to-Work requirement, a condition of
23 receiving calWORKs. She is hopeful to find a job that
24 pays enough to support her family without the help from
25 public assistance.

1 A critical aspect of our situation in
2 Sacramento and the situation throughout the state is
3 that these increased demands for services are occurring
4 at a time that resources available to provide those
5 services are being dramatically reduced. This is the
6 result of reductions in state and federal funding as
7 well as local revenues due to declining properties and
8 sales tax.

9 In Sacramento County, more than 3,000 positions
10 have been eliminated countywide over the last three
11 years. That's why we refer to our current situation as
12 "The Perfect Storm."

13 I should note that we have effectively utilized
14 available federal stimulus funding to help address our
15 situation. This includes TANF emergency contingency
16 fund, of which we have used 2.7 million as of June 30th
17 and anticipate expenditures to go to 3.3 million by
18 October 1st.

19 Using this funding, we have placed 450 adults
20 and 392 youths in subsidized employment positions in our
21 community. Of the adults placed, 216 have resulted in
22 permanent employment so far. Unfortunately, this
23 funding expires at the end of this month, unless there
24 is some last-minute action to extend it.

25 Sacramento's Homeless Prevention and Rapid

1 Rehousing Program has aligned a total of 9 million in
2 one-time funding through September of 2011 to find
3 housing or prevent homelessness for a targeted
4 number of 1,800 families and individuals. To date, over
5 1,320 households have received assistance to leave
6 homelessness or to stabilize their housing situation.

7 CHAIRMAN ANGELIDES: If you could wrap up,
8 Mr. Wagstaff.

9 MR. WAGSTAFF: I will do that. I will wrap
10 up.

11 Our experience dramatically shows that the situation the
12 country has been dealing with is not just a financial
13 crisis affecting financial institutions; it's absolutely
14 a human crisis as well. And while some economic
15 organizations have indicated that the recession has
16 ended, I can tell you that it has not ended for the
17 hundreds of families and individuals that we see every
18 day who continue to need our help.

19 So your Commission certainly has a huge
20 challenge in looking for the causes of our current
21 situation. I want to thank you again for taking on this
22 important task. My hope is that you are successful and
23 are able to provide key information that could prevent
24 future collapses and save future generations from facing
25 the struggles that so many are facing today. Thank you.

1 CHAIRMAN ANGELIDES: Thank you very much,
2 Mr. Wagstaff.

3 Mr. Williams.

4 MR. WILLIAMS: Good afternoon, Mr. Chairman and
5 Commissioners. My name is Clarence Williams.
6 California Capital Financial Development Corporation, a
7 non-profit organization that provides business
8 development and financing programs for small businesses
9 throughout Northern California.

10 Thank you for allowing me to offer testimony
11 related to the financial crisis that has so
12 unforgivingly devastated many businesses, individuals,
13 and families.

14 The testimony I offer today relate to the
15 effect this financial crisis has had on Sacramento
16 County families and neighborhoods is through the eyes of
17 California Capital and the stories of our clients.
18 California Capital was founded in 1982 and over the past
19 22 years I've had the privilege to serve as president.
20 I can say without hesitation that this has been the most
21 difficult challenging two years we have ever
22 experienced.

23 Historically, Sacramento's small businesses
24 have played a vital role in the strong economy and
25 employment; however, the critical role that small

1 businesses have played in supporting Sacramento's
2 economy has gravely diminished as a result of drastic
3 cuts to small business loans.

4 A look at the statistics of the biggest banks
5 in the Sacramento region provides evidence that the
6 struggles many of our clients have faced are not
7 isolated incidents, but instead reflect a larger
8 negative trend in the local economic climate.

9 According to the FFEIC, among the largest banks
10 in Sacramento, including Bank of America, Citibank,
11 U.S. Bank, and Wells Fargo, small business lending has
12 dramatically decreased from 2007 to 2009. The total
13 number of small business loans in Sacramento County
14 decreased from 32,280 in 2007 to 9,790 in 2009, or an
15 almost 70 percent decrease.

16 The decrease in small business lending has
17 greatly impacted businesses in low-moderate income
18 communities.

19 For example, Bank of America provided 2,957
20 loans to small businesses in low-mod income communities
21 in 2007 compared to 161 loans to the same population in
22 2009; in other words, in 2007, 60.5 percent of Bank of
23 America's small business loans were directed towards
24 businesses in low-mod income communities, while in 2009,
25 only 25.9 percent of the total small business loans were

1 provided in the LMI communities.

2 California Capital has been guaranteeing for
3 the past -- guaranteeing business loans for the past 27
4 years serving as an intermediary between banks and
5 borrowers, making it possible for small business owners
6 to secure financing.

7 Between 2006 and 2009, we guaranteed an average
8 of 230 loans per year creating and retaining over 1,800
9 jobs. The loans we have guaranteed have ranged in size
10 from \$5,000 to \$1.7 million for small businesses ranging
11 from 1 to 300 employees.

12 The types of businesses we finance range from
13 retail, contracting, and professionals -- including
14 doctors, dentists, attorneys -- including many minority-
15 and woman-owned businesses; however, in the past year
16 our ability to infuse wealth into the community has
17 decreased as a result of financial crisis and ensuing
18 budget cuts.

19 A quick look at our loan-guarantee data paints
20 a bleak picture of the detrimental effects of the
21 financial crisis. In 2007/2008 fiscal year, California
22 Capital guaranteed a total of 250 loans, of which 73
23 were new loan guarantees, and there were a total of 2
24 default payments on those guarantees.

25 In 2008/2009 fiscal year, California Capital

1 guaranteed 217 loans, of which 22 were new loan
2 guarantees, a 13 percent decrease from the previous
3 year.

4 In 2009/2010 fiscal year, California Capital
5 guaranteed a total of 115 loans, a 47 percent decrease
6 from the previous year and 54 percent decrease from two
7 years earlier. Of these loans, only three were new loan
8 guarantees. In addition, in the 2009/2010 fiscal year,
9 there were 25 default payments on the guarantees a 1,250
10 percent increase from 2007.

11 You've asked me to explain how small businesses
12 in Sacramento have been affected by the financial
13 crisis. I can tell you from my experience that the
14 impact has been devastating.

15 In conclusion, the impact on the Sacramento
16 area has been overwhelming and reaches far beyond the
17 realm of business.

18 Those on Main Street and throughout the
19 community have been negatively affected in countless
20 ways. You invited me to speak on the impact of
21 financial crisis on Sacramento, and I trust that I have
22 conveyed the severity of the situation.

23 Thank you for your time and interest in our
24 community.

25 CHAIRMAN ANGELIDES: Thank you very much,

1 Mr. Williams.

2 Mr. Wirz.

3 MR. WIRZ: Thank you, Chairman Angelides, Vice
4 Chairman Thomas, and Commissioners. Thank you for
5 allowing me to present the challenges experienced by
6 SAFE Credit Union, our members, during this financial
7 crisis. As background, I have been CEO at SAFE Credit
8 Union since 1984.

9 SAFE has more than 1.7 million in assets and
10 about 150,000 members from every level of society. We
11 have 21 branches. We serve 12 counties surrounding
12 Sacramento. SAFE serves 3,000 small businesses and is
13 ranked No. 2 by the SBA in the number of SBA loans in
14 our area.

15 SAFE has a \$1 billion loan portfolio.
16 33 percent of that is in autos, 46 percent is in
17 mortgages, 11 percent in business loans, 10 percent in
18 credit cards.

19 I am proud to say SAFE has always been a
20 prudent lender. We never qualified members for
21 long-term mortgage loans using a teaser rate. We never
22 offered pick-a-pay loans. Both practices are contrary
23 to our mission of helping to improve our members'
24 financial well-being.

25 The financial crisis had a big impact on the

1 Sacramento region and on SAFE. During the crisis,
2 unemployment increased from 4 1/2 percent in 2006 to
3 13.1 percent today. At SAFE, we believe future layoffs
4 of public employees will increase unemployment in our
5 area. We are not at the bottom yet.

6 We have seen home prices decline in Sacramento
7 County by 48 percent since December 2006. SAFE's
8 mortgage loans made at an 80 percent loan-to-value ratio
9 are now under water by \$39 million, declining home
10 values have eroded member equity.

11 The economic crisis and loss of jobs have
12 reduced our members' credit scores, increasing the calls
13 to SAFE. The total dollars in delinquent SAFE loans
14 increased from \$6 million in 2006 to \$32 million in
15 2009. SAFE's loan losses increased from \$4 million in
16 2006 to over \$33 million in 2009. At the same time,
17 SAFE's loan production decreased by about 20 percent
18 from 2006 to 2009. The financial crisis has resulted in
19 fewer qualified borrowers.

20 SAFE has done everything possible to help our
21 members get through this crisis. SAFE has modified more
22 than \$41 million of member loans. The default rate on
23 these loans is about 16 percent, evidence of our
24 well-thought-out modifications and lower than the
25 national average of about 50 percent.

1 Modifications allow our members the opportunity
2 to stay in their homes, retain their vehicles, and most
3 important, maintain their peace of mind.

4 I would like to pass on some lessons that we
5 have learned in this crisis. High-risk lenders who
6 offered loan programs such as pick-a-pay hurt borrowers
7 and gained market share from prudent lenders like SAFE.
8 Risky lending drives out prudent lending. I would
9 encourage more oversight of risky lenders is essential.

10 Government policies make a difference. State
11 and federal tax -- state and federal tax rules no longer
12 assess income taxes when mortgage debt is forgiven.
13 This policy has increased the number of members who have
14 the ability and the means to repay their loan to
15 strategically walk away from their mortgage loans.

16 Mortgage loans are now a no-lose wager for
17 consumers. When home prices rise, the borrower profits;
18 when home prices decline, they walk away. This behavior
19 will result in higher-priced mortgage loans in the
20 future.

21 SAFE actively teaches financial literacy to
22 high school students so that the next generation does
23 not repeat our mistakes. It should be a national policy
24 to teach financial literacy in high school. Financial
25 education may prevent the next crisis.

1 At SAFE, we identify members of default and
2 proactively contact them. Other lenders require them to
3 be delinquent before they consider a workout, which
4 lowers that member's credit scores. Any new policy
5 should address this issue.

6 The best time to help is before the problem is
7 out of hand. The best way to prevent a future crisis is
8 with proactive oversight and an informed public.
9 Examination results in all regulatory action by
10 regulators should be made public. Transparency will
11 make regulators better regulators and will make the
12 public part of the solution. Thank you.

13 CHAIRMAN ANGELIDES: Thank you, Mr. Wirz. I
14 appreciate your testimony.

15 Thank you to all of you for your testimony. It
16 was excellent, it was illuminating, and for those of us
17 who have been on this journey for a year, these are
18 things we know and feel, but to be reminded in the
19 course of our inquiry is fundamentally important.

20 I am going to be the clean-up hitter in this
21 last hearing in this last session, so I am going to
22 start this round of questioning with the vice chairman.

23 Mr. Vice chairman.

24 VICE CHAIRMAN THOMAS: Are there any media or
25 press in the room? Show of hands.

1 Oh, all right. I want to make note of the fact
2 this has happened repeatedly. It happened down in
3 Bakersfield, it happened in Las Vegas, in Miami, that
4 what you are hearing are people who bought into the
5 American Dream. They wanted to own their own home.

6 I am not talking about all the fraudulent
7 activity; I am talking about people who accepted a
8 commitment, they understood the commitment, and they are
9 trying to honor the commitment.

10 Many of them, because of the economic
11 situation, still want to honor their commitment, and all
12 it takes is a modification of a loan. Modification, if
13 they can't pull that off, at least try to find someone
14 in a short sale, foreclosure, causes all those community
15 problems.

16 And what we have heard over and over again is
17 people tried to work it out, they talked to machines or
18 people on the phone, they submit papers, they are
19 promised a timeline, it isn't honored, they go back and
20 try to get the papers, they submit them again.

21 The quickest way to handle this panel is to
22 say: "Do any of you working with those kinds of
23 individuals have any success stories to talk about?"
24 And the answer is virtually none.

25 Ms. Canada.

1 MS. CANADA: We are able to get successful loan
2 modifications on approximately one out of every five
3 people that come through.

4 VICE CHAIRMAN THOMAS: Well, that's not bad.

5 MS. CANADA: So we consider that the best
6 success we are likely to achieve.

7 VICE CHAIRMAN THOMAS: That's 20 percent,
8 yeah.

9 MS. CANADA: It's reasonable.

10 VICE CHAIRMAN THOMAS: 80 percent --

11 MS. CANADA: 80 percent aren't, yes.

12 VICE CHAIRMAN THOMAS: Okay. One in five
13 sounds better than 80 percent failure.

14 MS. CANADA: That's why we say it that way,
15 yes.

16 VICE CHAIRMAN THOMAS: Ms. Tawatao.

17 MS. TAWATAO: Yes, in my survey of the
18 counselors at -- well, the counselors that I talk to,
19 it's about 1 in 10. And in the small program that I
20 spoke to up in our rural area of Lake County, the one
21 that succeeded was because of the local congressman
22 intervened. The other nine people weren't quite as
23 fortunate.

24 VICE CHAIRMAN THOMAS: Well, I tell you, if
25 that were made public as well, the other nine might have

1 an opportunity for relief because publicity is one of
2 the -- transparency, sunshine is one of the best things
3 you can do because many of these financial institutions
4 are currently running ads in newspapers and on
5 television touting how sympathetic they are and how much
6 they want to help, and yet the reality is they aren't
7 responding in the way that they should.

8 The only way you can really get some of them --
9 I'm sorry to say -- is to embarrass them. And so my
10 goal here is to try to embarrass them. Some folks
11 mentioned some names of companies. If anybody wants to
12 mention the companies that seem to be -- for want of a
13 better term -- the most deadbeat companies, I invite you
14 to let us know.

15 No, you don't want to? You know who they are.

16 MS. CANADA: It would probably be easier to
17 say, you know, there are one or two that are reasonably
18 responsive. But really, the majority of lenders that we
19 talk to, it's difficult. It's, as you say, fairly
20 non-responsive.

21 VICE CHAIRMAN THOMAS: Okay. If we aren't
22 willing to name names and point fingers, our chances of
23 getting a response out of those folks is not very high
24 because they have dodged the bullet, the bullet is
25 exposure. And I am looking at the journalist, these

1 people are willing to talk to you and be quoted as
2 others might.

3 I don't know of any other solution at this
4 point but frank public embarrassment, threatening
5 additional ability to serve the community if they don't
6 respond at this time. I am not asking for charity; I am
7 asking for a reasonable timeline for modifications of
8 loans that can be modified. And you have seen a lot of
9 them and you are just not getting any results. I think
10 that's the best way to spend my time, Mr. Chairman. And
11 I yield back.

12 CHAIRMAN ANGELIDES: Let me actually follow-up
13 on Mr. Thomas's question. Are there particular lenders
14 who have been responsive, aggressive in the best way?
15 Have there been lenders who have been particularly
16 non-responsive in this region?

17 MS. TAWATAO: I would like to name names of the
18 ones that have not been responsive. CitiMortgage --

19 VICE CHAIRMAN THOMAS: That would take more
20 time, but I'm certainly willing to make sure that we
21 cover it.

22 MS. TAWATAO: Well, the ones that we've seen,
23 CitiMortgage, Aurora Loan Services, Bank of America,
24 Wells Fargo.

25 VICE CHAIRMAN THOMAS: Should I get the phone

1 book so you can just go down the list?

2 CHAIRMAN ANGELIDES: Have there been any that
3 have been particularly responsive?

4 MS. CANADA: It has really been more about the
5 consumer situation as much or more than -- you know, I
6 can't think of a one that I would name that has been
7 particularly responsive. I wish I could. I would like
8 to point them out, but I cannot honestly think of one
9 that has been reliably responsive on a timely basis.

10 We have gotten some through, obviously, but it
11 has been more on the persistence of the counselor, the
12 persistence and determination of the customer to fulfill
13 every -- you know, cross every "t" and dot every "i" and
14 be there every day and harass, basically, the lender
15 until there is no other way other than to give an
16 answer.

17 And so I hesitate to say, you know, point out
18 some five-star lender. It has really been the
19 counseling and the customer that have made it positive.

20 CHAIRMAN ANGELIDES: I see Mr. Wirz. His
21 finger wants to go to that mike.

22 Mr. Wirz, do you want to comment? This issue
23 is also what your practice is as a local lender.

24 MR. WIRZ: I would just like to remind the
25 committee it's our testimony that we proactively contact

1 our members. We look for members who have negative
2 equity. We look for members who have distressed credit
3 scores. We call them. We contact them. We say, "We're
4 here to help," and we put the onus on the member. If
5 they want to work with us, we will work with them. I
6 think that makes a critical difference.

7 I think our experience has been, as I said in
8 my testimony, that when we talk to members who have a
9 second with us and first with someone else, they are
10 being told they need to be delinquent before the
11 financial institution will work with them. We don't
12 believe that's the right time to work with a member.
13 The right time to work with a member is when they are in
14 trouble.

15 VICE CHAIRMAN THOMAS: Mr. Wirz, now, let's be
16 frank is this because you are a tax-exempt institution
17 and you want to stay that way, or do you think that when
18 people pool their money together and create a co-op loan
19 arrangement, it has a slightly different attitude in
20 terms of those who run the shop and those who receive
21 the help?

22 MR. WIRZ: I don't think it has anything to do
23 with our tax-exempt status.

24 VICE CHAIRMAN THOMAS: So you don't need to
25 worry about maintaining it?

1 MR. WIRZ: No. Mr. Thomas, I think that there
2 are a number of credit unions that would find the grass
3 much greener on the taxation side. If it weren't for
4 the onerous conditions that the regulators put on us in
5 terms of converting, I think you would see more credit
6 unions convert.

7 VICE CHAIRMAN THOMAS: All right. I will keep
8 that in mind. You may lose the poll, though.

9 Thank you, Mr. Chairman.

10 CHAIRMAN ANGELIDES: Again, on your time since
11 you asked the question, what is your record on
12 modifications? How many borrowers do you have? How
13 many come in the door? Where do you sit in that
14 process, Mr. Wirz?

15 MR. WIRZ: Can you repeat the question,
16 please?

17 CHAIRMAN ANGELIDES: The question is: In your
18 portfolio of borrowers, how many are in a modification
19 process? Kind of what's the --

20 MR. WIRZ: Well, if you take the 41 million
21 that we have modified so far, that represents about
22 4 percent of our portfolio. I think we're modifying the
23 loans as quickly as they come into our view as being
24 distressed.

25 It -- I think all of the other panelists will

1 tell you it really requires the borrower to be willing
2 to be foursquare with the lender and tell us what their
3 problems are. We won't modify a borrower unless they
4 can afford to continue the payments.

5 And I can send you the details, but I believe
6 the threshold is we try to get the borrowers so that the
7 mortgage payments is about 30 percent of their income.
8 If we can't get them there, then we feel it's probably
9 not feasible to modify them. Our modifications are
10 designed to keep the member in the home, and if they
11 can't stay in the home, it isn't a feasible transaction.

12 CHAIRMAN ANGELIDES: All right.

13 I think Mr. Georgiou.

14 COMMISSIONER GEORGIU: Mr. Wirz, you have a
15 different model. You hold all your loans, don't you? I
16 mean, they are on your portfolio?

17 MR. WIRZ: We try to hold them. There is one
18 criteria. We model our interest rate risk using a
19 stress test of an instantaneous increase in interest
20 rates. And if our interest rate risk exceeds a certain
21 threshold, we will begin selling the mortgage loans.

22 As you may know in the last year or two because
23 of interest rate risk we have sold more loans than we
24 have in the past, but it is our policy to keep the loan
25 if we can. We believe mortgage loans are a great asset.

1 COMMISSIONER GEORGIOU: And the interest rate
2 risk, is it since rates are down you are concerned that
3 people will, what, refinance out of them?

4 MR. WIRZ: We believe that interest rates may
5 rise, which would reduce the cash-flows from our real
6 estate loans and put us in a position of having a
7 liquidity problem.

8 COMMISSIONER GEORGIOU: I understand. Okay. I
9 guess I want to ask all the panelists, if I can, we have
10 had prior testimony elsewhere, and I think in the
11 written testimony of Professor Eggert, that entities
12 that are servicers -- that are exclusively services --
13 servicers have a skewed incentive structure that may
14 lead them more likely to recommend and to proceed with
15 foreclosure than a modification in the circumstances
16 where loans have been securitized and these subprime
17 loans are now being serviced, as opposed to what a
18 direct holder of a loan might do.

19 Can anybody speak to that question or has
20 anybody had any experience with having to deal with
21 servicers rather than the current holder of the actual
22 mortgage?

23 Ms. Tawatao.

24 MS. TAWATAO: Yes, we have had to deal with
25 servicers rather than the holder. And, you know, I

1 don't know -- I can only base my response on the conduct
2 of those servicers and what they seem interested in
3 doing and not, and it certainly doesn't seem like they
4 are motivated to work with our clients to make it -- I
5 mean, honestly, it seems like they make it as difficult
6 as possible to have a permanent modification outcome.
7 At least that's what it seems like.

8 And it really takes -- in our trainings, what
9 we say is, "You just have to really be on top of it with
10 each case where, you know, that we take on to that
11 assistance level and just keep submitting the papers and
12 go after them and after them and go up the food chain in
13 the entity."

14 And sometimes that works but our experience has
15 been -- there is -- you know, again, I'm just -- I'm
16 basing this on the behavior of the servicer staff that
17 we encounter.

18 COMMISSIONER GEORGIU: Mr. Wirz, you had your
19 hand up.

20 MR. WIRZ: Yes. We at first were against doing
21 principal reductions in our mortgage loans. What we
22 found was when we weren't doing those, the loan
23 typically went to a short sale and we ended up losing
24 money on the loan and the loan ended up in a transaction
25 where the ownership of the property changed.

1 And we've made a judgment now that it's
2 probably better to work with the borrower, keep the
3 homeowner in the property, take the loss which we would
4 have taken anyway, and retain our member, retain the
5 person in the property. And I think that's a
6 fundamental issue for someone that holds a loan, whereas
7 a servicer might not be inclined to do the same thing.

8 COMMISSIONER GEORGIOU: Right. That's what we
9 have heard and at a couple of hearings now, that part of
10 the difficulty that people have had in retaining
11 modifications that there's really a financial
12 disincentive for the servicers to -- to engage in the
13 capital in the principal reduction.

14 Whereas a portfolio holder of the loan might
15 make the judgment that they are better off keeping
16 people in the home at the end of the day, even if they
17 have to take some kind of a modification hit.

18 Can I ask you, when you do a principal
19 modification, does that ever lead you to re-rate or to
20 downgrade, take losses on other loans in your portfolio
21 that are similarly situated?

22 MR. WIRZ: Our -- in terms of setting a reserve
23 and calculating the allowance for loans for loan losses, yes.

24 COMMISSIONER GEORGIOU: Exactly.

25 MR. WIRZ: Yes, it does.

1 COMMISSIONER GEORGIU: You do. So that really
2 has a magnifying consequence, does it not, for your
3 institution when you start doing capital principal
4 reductions?

5 MR. WIRZ: It really is an inevitable
6 consequence of the financial crisis. I think whether we
7 did the principal reduction or not, it's a reality of
8 what is out there in the marketplace. As I said, we
9 face two choices. We either allow the property to go to
10 a short sale where someone other than the member who is
11 in the property ends up with a benefit of the short sale
12 or we can do a principal reduction and pass that benefit
13 to the member and keep the member in the property. It's
14 an equivalent transaction either way.

15 COMMISSIONER GEORGIU: Right.

16 Ms. Canada, do you have a difference in your --
17 in the clients that you have been able to serve with
18 respect to dealing with servicers or entities that
19 actually hold the loan?

20 THE DEPONENT: We have primarily dealt with
21 servicers. Most of the servicers that we have talked to
22 directly, there was one based here in Sacramento for
23 quite some time, Home Ec, that was recently sold and is
24 now -- I think they laid off about 800 people here in
25 Sacramento. And we visited their shop several times and

1 knew their local executives and talked to them quite a
2 bit about what is their rationale, how are they handling
3 these, can we work together on some sort of formula
4 process?

5 And they were very open with us about the fact
6 that they have contracts and they are essentially a
7 servicer, if you will. They are not the holder. They
8 are not in control. They go by what the contract is
9 with their investors on that particular loan or, you
10 know, group of loans. And most investors, according to
11 them, were not willing or able to even consider
12 principal reduction. It was not in the contract for
13 them to allow.

14 So they would service the loan and consider
15 modification or any sort of -- any level of
16 modification, not just principal reduction issues.
17 Although I know that's what you are dealing with here in
18 your question. Even interest rate reductions, payment
19 extensions, terms, anything that wasn't already within
20 the contract and allowed by the investor for them to
21 consider was just off the table.

22 So, you know, it was it was hard to get to.
23 And then the investor, of course, was not -- we wouldn't
24 be able to get any contact with the investor. It was
25 always the servicer.

1 COMMISSIONER GEORGIOU: For the record, it
2 appears to us from what we have heard from others that
3 this is a continuing problem, and I think we have asked
4 our staff to look into some of the structural
5 difficulties associated with servicers. And that being
6 one of the consequences, I think, of the securitization
7 process --

8 MS. CANADA: Yes.

9 COMMISSIONER GEORGIOU: -- that led to the sale
10 of a lot of these loans is a failure to really even have
11 accountability in the late stages of the loans when they
12 are being downgraded, and an ability to act with
13 dispatch to preserve the highest level of recovery for
14 the lender and also the highest level of safety, really,
15 for the borrowers.

16 Thank you for your courtesy and thank you for
17 joining us today.

18 CHAIRMAN ANGELIDES: Mr. Thompson -- before I
19 actually go to Mr. Thompson, let me just make an
20 observation. When we were appointed last year, as I
21 said in my opening statement today, many people
22 predicted that the financial crisis would be past tense,
23 a distant memory, the country will have moved on. And
24 as we race towards our report on December 15th, we'll be
25 reminded every time we come out to the field, every time

1 we do our work, we are reminded that the financial
2 crisis is very much still us and will be until the day
3 we issue this report and beyond.

4 Mr. Thompson.

5 COMMISSIONER THOMPSON: Thank you,
6 Mr. Chairman. I am reminded by one of our presenters
7 earlier today, Dr. Fleming, where he said that the
8 solution to the housing challenge or crisis is, in fact,
9 in getting people working again. Yet when I hear the
10 statistics from Mr. Williams about small business
11 lending, recognizing that small businesses employ more
12 people than probably this economy in our global economy
13 than almost anything else, I am shattered to think that
14 that recovery and therefore the problem in housing is
15 going to get solved any time soon.

16 So, Mr. Williams, can you talk a little bit
17 about the downstream consequences of small business
18 lending volume reduction on employment or unemployment
19 and what you think has happened in that regard in the
20 economy directly by the organizations or institutions
21 you serve?

22 MR. WILLIAMS: I think it's some of the
23 testimony that I presented it was pointed out.
24 Sacramento area is somewhat -- I won't say "unique," but
25 what is unique about the Sacramento area is that we are

1 not a headquartered type of town.

2 A lot of Sacramento's economy is driven by real
3 estate, driven by development. As the housing industry
4 goes, so goes our economy and this is especially so as
5 we have seen a downturn in terms of government and
6 several years ago the closure of several military
7 bases.

8 Unless we begin to turn around demand, unless
9 we begin to turn around the business situation, the
10 employment is not going to increase here in the
11 Sacramento area, and housing is critical to it. It is a
12 vicious circle. We talk about it in many press accounts
13 in terms of it being cyclical, of it being
14 self-fulfilling.

15 I am somewhat optimistic. I am
16 optimistic as recently as last week in the passage of
17 the HR5297 in terms of the small bank financing and some
18 of the components therein, that we may begin to see some
19 small banks begin to increase their lending.

20 From my testimony you can see the drop off in
21 terms of small business lending has been catastrophic.
22 The jobs have fallen with them. It's the horse or
23 the cart sort of situation.

24 The banks are saying, "We're not lending
25 because of two things: (1) There is not demand; (2) If

1 we make some of these loans, the regulators are going to
2 classify them. We go to the regulators and they say
3 that's not so.

4 The businesses -- the banks will also say that
5 they are not lending because the demand is not there.
6 The demand is not there because people are afraid, they
7 are not necessarily comfortable in terms of their
8 employment situation.

9 So how do we break this vicious cycle I think
10 is the key, and the most optimistic thing I've seen in
11 the last week, as I said, is the likelihood that the
12 HR5297 will be signed by the President as early as next
13 week.

14 COMMISSIONER THOMPSON: Mr. Wirz.

15 MR. WIRZ: One of the things that I would
16 suggest is that at SAFE -- we are the No. 2 SBA lender
17 in the area -- we are seeing a lot of demand from the
18 really small businesses, \$100,000 and less. In
19 Sacramento, credit unions hold 25 percent of the deposit
20 base.

21 Congress has put a cap on what we can do in
22 terms of business lending. I think that cap ought to be
23 removed. We could add a lot of business lending to
24 small businesses in areas where banks aren't
25 particularly active in the \$100,000-and-less category.

1 And I would urge the Commissioners to look into that as
2 one thing that they could recommend.

3 COMMISSIONER THOMPSON: Unfortunately, our
4 statute doesn't ask us to make recommendations, just to
5 point to where the problems are. But your point is well
6 made.

7 MR. WAGSTAFF: I was going to just beef up
8 the -- my colleagues here because I see the effects of
9 the folks -- when small businesses fail and when our
10 caseworkers speak to the folks coming through our door,
11 it has been a major contributing factor to those
12 increased caseloads that I mentioned.

13 So I was going to urge the Commission to look
14 for whatever it could do to make recommendations,
15 although you just mentioned you don't make
16 recommendations.

17 But in any event, whatever can be done to
18 strengthen small businesses in this area is a key to
19 turning things around here, I think.

20 COMMISSIONER THOMPSON: When we were in Las
21 Vegas, there was a great deal of discussion about the
22 need to diversify their economy away from construction
23 or home building and, quite frankly, the hotel
24 industry.

25 Is there any discussion going on within the

1 community leadership here in Sacramento about the need
2 to diversify the workforce or the economy here in
3 Sacramento?

4 MR. WILLIAMS: I think one of the most
5 optimistic things going on in Sacramento, is Sacramento
6 is fast becoming a very green and energy efficient hub.
7 We see that as the fastest-growing sector in terms of
8 the economy going forward. And Sacramento has staked a
9 claim in that area and we have seen growth that has
10 exceeded the rest of California.

11 In addition to that, given the fact that UC
12 Davis is actually right here in Sacramento for all
13 practical purposes, biosciences is another area that we
14 are looking at expanding in this area outside of just
15 the regular real estate.

16 COMMISSIONER THOMPSON: Sure.

17 Final question, Ms. Canada -- Canada?

18 MS. CANADA: Canada.

19 COMMISSIONER THOMPSON: Canada. Of the four
20 that fail, in your opinion, should they truly pass or
21 are there problems with them that would suggest that you
22 really won't ever get to 100 percent?

23 MS. CANADA: It's not likely we would ever get
24 to 100 percent. I would give you that. Certainly, some
25 people don't want to stay in their homes. I mean, there

1 are some people who come to us to find a pathway out of
2 their situation and not to preserve home ownership.

3 So, you know, each of these are very dynamic
4 situations and very personal and emotional. Some people
5 have lost their employment as they were just talking
6 about. Jobs -- you know, there is job loss nationally
7 and certainly in the Sacramento region, and they may
8 have been able to afford the home they purchased under
9 the terms and the income they had at the time they
10 purchased but they can't anymore. One spouse or both
11 may have lost income and reduced income.

12 I mean, our own state, we have a lot of state
13 workers that come to us and the furloughs have cut into
14 their income, so, you know, even though they are still
15 employed they have reduced income.

16 A lot of people in those situations, really,
17 it's not likely that they will get a successful
18 modification. Many of the modifications, trials and
19 others, aren't at current market rates. So they are
20 higher than market rates, their homes are valued --
21 basically they are under water.

22 So there is a lot of dynamics going on with
23 these and I think you do have to look at the big picture
24 and understand all the things at play in the deal, if
25 you will. And our efforts from the counseling

1 standpoint is to try to do just that, to be as pragmatic
2 as possible and look at the current circumstances of the
3 borrower, the homeowner, the motivation they have to
4 stay in their home, and the likelihood that that is
5 going to come to some kind of positive outcome and work
6 with them to find that solution.

7 COMMISSIONER THOMPSON: So if 100 percent is
8 unlikely --

9 MS. CANADA: Yes.

10 COMMISSIONER THOMPSON: -- and 20 percent is
11 unreasonable, what is the right point?

12 MS. CANADA: Well, when we started this, we
13 were thinking 50 to 60 percent was, you know, our
14 target. We have certainly vacillated from that goal
15 because we found that it just wasn't a realistic goal.
16 But based on what we see and based on the people that
17 come to us, you know, on paper that could fit and that
18 appear to qualify for the modification, we don't -- we
19 don't ask the servicer to modify a deal that doesn't
20 make any sense. That puts our credibility at risk as
21 well. And it's just not fair to the homeowner to say,
22 "Let's just go for this 0 percent, you know, 50-year
23 loan term," and see if they will go for it. That's not
24 reasonable.

25 We understand what reasonable is and we -- our

1 counselors are trained to understand and put a package
2 together and come up with a scenario that makes sense.
3 It's hopefully a win-win. And that is what's
4 submitted. When we submit those, we expect to get a
5 positive response. It's a reasonable presentation 50 to
6 60 percent of those ought to get approved.

7 COMMISSIONER THOMPSON: Thank you.

8 CHAIRMAN ANGELIDES: Ms. Murren.

9 COMMISSIONER MURREN: Thank you, Mr. Chairman.
10 Thanks to all of you for being here. I've a question
11 that I was hoping each of you could respond to briefly,
12 and that is: If you look, based on your experience now
13 in the trenches at the impacts of the financial crisis,
14 and also those within the broader community, whether
15 it's the public sector or the private sector, at the
16 different enterprises and individuals who have been able
17 to find ways to reach creative solutions -- and I mean
18 that in the positive sense of "creative" -- in terms of
19 flexibility either in offering people different
20 employment or offering people different terms for the
21 provision of health care or housing or credit -- in
22 other words, what I am looking for is: Are there some
23 success stories in all of this? Meaning that there have
24 been ways that people have found to work within the
25 community to help advance it? And if so, could you

1 share some of those with us so that we might have an
2 idea of what kinds of solutions might be present, not
3 only here but perhaps could be applicable in other
4 places?

5 For example, you mentioned the right -- you
6 know, being able to get to a point where you have done
7 analysis that suggests that it might be better to keep
8 someone in their home and not allow it to go through in
9 a short sale, even if that means bringing down --
10 modifying the principal amount, those kinds of things
11 but in different settings.

12 Ms. Canada, if you could start.

13 MS. CANADA: Well, we have been trying to work
14 out a lease-purchase option and have talked to a few of
15 the lenders and servicers about if they won't reduce the
16 principal -- which seems to be a pretty significant
17 obstacle, to get principal reduction -- would they
18 consider essentially short-selling, if you will, to us,
19 to the non-profit.

20 And we have an investor who will do lease
21 purchase, so it is possible for us to come up with a
22 significant amount of capital, do a lease purchase with
23 the present homeowner under essentially modified
24 circumstances, a short sale, if you will, to the same
25 homeowner. And we have been repeatedly denied that as

1 an option because the lenders -- the holder of the note
2 will not sell to or benefit the existing homeowner.

3 They would rather, apparently, go through a
4 short sale or some other -- just basically strip the
5 home away from -- go through the foreclosure or go
6 through a short sale, strip the home away from the
7 homeowner.

8 And then essentially time after time, that
9 homeowner watches as the home that they lived in for 4,
10 5, 6, 10 years just sold for a price that they could
11 have afforded had they been able to get a modification
12 or a lease purchase or some other form of creativity, as
13 you say.

14 So we are trying -- there are vehicles, there
15 are tools that can be put in place even on a pilot
16 process to try, but we have not been successful in
17 getting that accomplished as yet.

18 COMMISSIONER MURREN: Would you be willing to
19 submit to us just a brief summary of what you've
20 attempted to do?

21 MS. CANADA: Certainly.

22 COMMISSIONER MURREN: That would be helpful,
23 thank you.

24 Ms. Tawatao.

25 MS. TAWATAO: Yes, I have to confess I am

1 struggling a little bit to respond to your question,
2 probably because of the nature of what we do. But I
3 guess on the homeowner's side, it has really been a
4 matter of when we are -- when we do chose that case to
5 pursue and take all the weight on behalf of a very -- on
6 behalf of a family that's in a very difficult and dire
7 situation, it has been gratifying to work with people in
8 the private bar who have stepped forward and helped us.
9 And, frankly, in litigation strategies because sometimes
10 that's what it takes to, you know, make things right on
11 behalf of the homeowner.

12 I will say on the tenants' side because that's
13 a lot of what we do. The HPRP, Homeless Prevention
14 Rapid Rehousing, has been a very useful tool in -- sort
15 of in situations where we can prevent homelessness on
16 the part of the renter who is -- that has been affected
17 by the downturn and can get that extra bit of cash to be
18 able to move into or stay in a place.

19 Still takes people to intervene and make sure
20 that it works well, but that has been pretty good.
21 Also, Protecting Tenants in Foreclosure Act, really a
22 very, very useful tool not adhered to as much as it
23 should be, but it has been useful to us in ensuring that
24 tenants who are often called the innocent victims of
25 this crisis are taken care of and given time to move or

1 are able to stay until their lives are stabilized.

2 So I think all those things have been relative
3 positives in our work. Thank you.

4 COMMISSIONER MURREN: And the Protecting
5 Tenants in Foreclosure Act -- I'm guessing, perhaps I'm
6 wrong, you can correct me -- but that was likely
7 advanced by the people that are involved in that process
8 in your community, whether it be the constables or the
9 people that are sort of directly involved with having to
10 go to the places and evict people as they are, in fact,
11 tenants. At least that's what happened to Nevada when
12 we changed our laws.

13 Would you say that it takes people coming
14 forward in a variety of different walks to be able to
15 move forward legislation, regulatory change to effect
16 those things?

17 MS. TAWATAO: Yes, absolutely. That would be
18 correct.

19 COMMISSIONER MURREN: Thank you.

20 MR. WAGSTAFF: In terms of your general
21 question of different ways peoples are navigated
22 successfully through this crisis, what I've seen in the
23 human services area is a community-wide response, quite
24 frankly, to develop different ways of doing business to
25 meet the need.

1 Because as I said earlier, the need has gone
2 up, the resources have gone down. So we really have had
3 to re-invent the way we do business.

4 Larger role for non-profit community,
5 oftentimes by partnering amongst themselves; larger role
6 for the private sector in terms of raising matching
7 funds and things like that for our Homeless Prevention
8 Program, which was just mentioned; and a larger role
9 from a faith-based community as well, I think, in
10 providing services, providing time, providing housing.
11 So it has been a community-wide response, I would say.

12 And to that extent, it really has been
13 inspiring to see the way the community has responded and
14 see previous barriers of resistance kind of breaking
15 down and responding to the crisis.

16 COMMISSIONER MURREN: Thank you.

17 MR. WILLIAMS: That's a great question. And
18 I've two examples. Two banks here in Sacramento, one a
19 smaller local bank, Bank of Sacramento and another
20 example from a larger bank, U.S. Bank, both have the
21 same thing, I think, in common and that is certain
22 leadership, important decision-making is based in this
23 area.

24 In the case of the Bank of Sacramento, I have a
25 guarantee on a loan with a business that is an

1 association. A lot of the clients have been in the real
2 estate. Now, for all practical purposes, this loan
3 should have been buried. It would have been. But
4 because the client did not walk away, could have very
5 easily brought in the keys of the businesses, they
6 persevered, they worked with the bank, the bank itself
7 agreed to restructure this loan, work it out, along with
8 having our guarantee and worked -- the transaction costs
9 in terms of the time they put in on this loan has been
10 above and beyond the call of duty. And the fact that
11 the character of the people who are running this
12 business has been such that they have been informative,
13 they have been close to the bank, they have kept the
14 bank apprised, the bank has bent over backwards to keep
15 this business in business.

16 The other case is I have several loans with
17 U.S. Bank, but because the executive vice president in
18 terms of small business is located here in the area
19 understands the nature of the program that we have been
20 working with, we have seen a tremendous effort on their
21 behalf in terms of working with individual clients on
22 lines of credit to keep those lines in effect, although
23 those lines, for all practical purposes, have been
24 stressed, payments are being made but is a very
25 challenging environment.

1 I would say in both of these cases, if you
2 would look at them as just numbers or code names on a
3 book, a lot of these loans would have been called or
4 would have been foreclosed. Those businesses would have
5 been shut down. But in these two instances, both the
6 Bank of Sacramento and U.S. Bank, I think they have gone
7 above and beyond the call of duty in terms of seeing
8 that these businesses stay in business by working with
9 us, with the loan guarantee, and working directly with
10 the borrowers.

11 COMMISSIONER MURREN: Thank you.

12 MR. WIRZ: SAFE is a state-chartered credit
13 union. Our regulator is a the Department of Financial
14 Institutions. Our priority when we work with a member
15 is, first and foremost, if they are in distress, is to
16 keep them in their home. And one of the anomalies is we
17 use a program that's very similar to the HAMP program,
18 the Federal Housing Assistance Program, and the
19 Department of Financial Institutions criticized our
20 modification process because our modification process
21 assumes that the first priority is to keep the member in
22 the house.

23 And what the Department of Financial
24 Institutions has criticized us for is that we base our
25 analysis on what it's going to take for that member to

1 be able to afford the housing payment and we are making
2 an assumption that the credit cards, the auto loans, and
3 whatever else is superfluous to that decision.

4 And they came in and wrote us up this last year
5 saying that our modification programs weren't acceptable
6 to them because we weren't calculating enough money in
7 the plan to pay credit cards or auto loans or other
8 loans beyond the home loan.

9 Our point is we want to keep that person in
10 their home. Let the other loans go, maybe that has to
11 be part of the solution, but the solution should be to
12 keep them in their home. And I think the Commissioners
13 ought to look at that. I think it doesn't make sense.
14 Something has got to go. Something has to be forgone.
15 These people don't have the income to cover everything.

16 COMMISSIONER MURREN: Do you hold the credit
17 card or the auto loans?

18 MR. WIRZ: In some cases we do; in some cases
19 we don't. But our priority is keep the member in the
20 home.

21 Look, the basis of a sound family of -- of
22 preserving lifestyle is to keep that member in the
23 home. We think that's the most important thing. That
24 ought to be the first priority. And it doesn't make
25 sense to us to have an analysis that requires us to

1 build in money for those other loans. It ought to be
2 first and foremost the home.

3 COMMISSIONER MURREN: Thank you.

4 Thanks to all of you. There is reason for
5 optimism, I guess, out there. Thanks.

6 CHAIRMAN ANGELIDES: Thank you, Ms. Murren.

7 What I would like to do now very quickly is ask
8 Mr. Wagstaff, Mr. Williams, Mr. Wirz, if you would
9 retire to those three seats right there, but stay here.
10 I said that I would cede my time because we wanted to
11 hear directly from a couple of folks who have been
12 affected in this process.

13 I am going to ask, because we are running late,
14 that we could ask people to make two-minute statements,
15 very quick statements, so we can get it on the record.

16 Ms. Tawatao.

17 MS. TAWATAO: Thank you very much.

18 CHAIRMAN ANGELIDES: Could you ask your clients
19 or colleagues to please come forward?

20 And while your colleagues come forward, let me
21 say something to everyone here -- who's here in the
22 audience. We invite the public to participate in our
23 inquiry by submitting written testimony about how the
24 financial crisis has affected you to the Commission, and
25 that testimony may become part of our final record and

1 report.

2 To do that, please go to FCIC.gov where you
3 will find instructions on how to provide a written
4 submission to this hearing under the "Contact us" tab or
5 send us your stories to personalstory@FCIC.gov. So one
6 more time, the web site is FCIC.gov and the e-mail
7 address is personalstory@FCIC.gov.

8 And I do want to say we have received a number
9 of submissions. In fact, they have been distributed to
10 Commissioners. I had the chance to review some of them
11 last night and I appreciate anyone who has done that and
12 would encourage others to do so.

13 If you would each quickly introduce yourselves
14 I am going to ask you to limit your remarks to two
15 minutes if possible. But please why don't we start
16 here. If you would please pull the microphone towards
17 you, make sure it's on, and give us your name and
18 identify yourself and please tell us what is going on
19 with you.

20 THE DEPONENT: My name is Nia Lavulo and this
21 is my partner Bernard Mose.

22 Chairman Angelides, Vice Chairman Thomas, and
23 members of the Commission, I live in the city of
24 Sacramento with my partner Bernard Mose who is here with
25 me today, my son, and five nieces and nephews, who

1 also -- I take care of and live with us also.

2 Bernard and I are here today to tell you about
3 how we may lose our home at any minute despite trying to
4 do everything the right way. We have been living in my
5 childhood home which I've lived in the last 28 years.

6 In the spring of 2008, Bernard bought the home
7 after my sister lost the home. Since this was our
8 family home and where we have lived for many years, it
9 was important to us to keep it in our family.

10 We've saved every penny we could for the down
11 payment deposit. We also put -- we put 15,000 down and
12 financed the remaining 135,000 with a fixed-rate 30-year
13 loan. Our loan payments included property taxes and
14 insurance which came to a total of \$1,412.95 a month.

15 Both Bernard and I were employed when we bought
16 the house and the payments were affordable to us.
17 Unfortunately, Bernard was laid off about a year after
18 we bought the house. Even with Bernard collecting
19 unemployment insurance and doing odd jobs on the side,
20 we could no longer afford our mortgage payments.

21 By June 2009, we were behind in payments.
22 After getting behind in our payments we contacted
23 CitiMortgage about getting a loan modification. In
24 January of 2010 we entered into a HAMP trial period
25 plan. Under that trial period plan, we had to make

1 mortgage payments of \$1,126.66 for four months.

2 If we made these payments, our trial period
3 plan agreement said we would receive a permanent
4 modification. We made the four payments, four months of
5 payments.

6 At the end of the four months, we contacted
7 CitiMortgage to find out about the status of our
8 permanent modification. We were told it was being
9 reviewed and that we would make -- that we would have to
10 make a fifth payment. We made the fifth payment and
11 kept calling CitiMortgage about the status of the
12 permanent modification. We were told over and over
13 again that was under review. We were also told by
14 CitiMortgage that we need not to worry about our home
15 being sold in foreclosure sale because this was put on
16 hold until the modification review was final.

17 We never received any written notices from
18 CitiMortgage about the status of our modification. We
19 only received written receipts about -- with our monthly
20 payments that we were making. Then we were shocked when
21 we received the notice on our door on July 29, 2010,
22 that told us that our home was now owned by Fannie Mae.

23 Without our knowledge, our home was sold --
24 been sold at a foreclosure sale on July 26 which -- to
25 Fannie Mae which had owned our mortgage. About a week

1 later, we received the permanent modification agreement
2 from CitiMortgage. The servicer informed us that we
3 were approved for the permanent modification.

4 Unfortunately, we no longer owned a home at this time.

5 On August 20th Fannie Mae filed an eviction
6 case against us and we were currently trying to contact
7 and see if they're willing to stop the eviction and work
8 with us to get the title of our home back and
9 permanently modify our mortgage; however, at any moment,
10 Fannie Mae can go ahead and evict us and we can be on
11 the streets. We hope our story sheds some lights on the
12 changes needs to the modification process.

13 We tried to do everything right from the
14 beginning. We saved money for the down payment. We
15 also fixed had a fixed-rate affordable loan. It was
16 only after Bernard was laid off that we fell behind. We
17 then made all the trial period payments and ultimately
18 were approved for a permanent modification; however,
19 because of a mistake or I don't know what happened by
20 our loan servicer, we and our son and nieces and nephews
21 may lose our home and financial investment.

22 Thank you for taking your time today to hear
23 our story.

24 CHAIRMAN ANGELIDES: Thank you very much.

25 I just want to note I was asked by a reporter

1 earlier today whether we learned anything at these field
2 hearings and, unfortunately, we do every time.

3 VICE CHAIRMAN THOMAS: Mr. Chairman.

4 CHAIRMAN ANGELIDES: Mr. Vice Chairman.

5 VICE CHAIRMAN THOMAS: We have talked a lot
6 about what our statutory power isn't. We're dealing
7 with an aspect of the federal government. And I think
8 we ought to think about composing a letter outlining
9 what happened and at least require Fannie Mae to tell us
10 what the process was that had these two ships passing in
11 the night and these people doing the right thing,
12 obviously getting the wrong response.

13 That's a federal agency that we have an
14 affiliation with -- not a federal agency -- but I would
15 think of all people Fannie Mae or Freddie Mac ought to
16 think about being responsive at this time. I just think
17 that's an extra step and I think we ought to take it.

18 CHAIRMAN ANGELIDES: I would say without
19 objection --

20 COMMISSIONER GEORGIU: Yes.

21 CHAIRMAN ANGELIDES: Yes. Absolutely. Done.
22 Thank you.

23 Ma'am. Next. Can you pull the microphone
24 towards you, ma'am?

25 MS. HOLLIS: Okay. Thank you.

1 CHAIRMAN ANGELIDES: And maybe pull it down a
2 little.

3 MS. HOLLIS: All right.

4 CHAIRMAN ANGELIDES: And you're good to go.

5 MS. HOLLIS: All right. My name is Lovey
6 Hollis born in Sulligent, Alabama, September 7th, 1931,
7 moved to Sacramento 50 years ago. We bought our first
8 home and raised five daughters. We both worked and we
9 paid off our mortgage.

10 In 2006, my husband, Grafton, was in a
11 wheelchair and could not get up the steps in the home
12 that we had bought, so we bought a bigger home and paid
13 50 percent down which was \$155,000, payment was 400 -- I
14 meant to say \$546 a month. It went up a little bit at
15 the time over three years, which at this time the
16 payment would be \$1,421.

17 My husband, Grafton, died May 2008. My income
18 went down to \$1,599. I answered an ad for a
19 modification. Tom answered my ad and came to my door.
20 He offered to get the loan amount payment reduced to
21 4,000 -- I meant to say if I paid him \$4,000.

22 I signed an agreement to pay him \$4,000. It
23 was called "Economic Survival Home Retention Program
24 Contract."

25 I gave him \$1,000, the only cash I had. He

1 brought over his friend Dorothy. They said they would
2 take my Mercury Grand Marquis to cover the other
3 \$3,000. Dorothy signed an agreement to pay \$6,500 Blue
4 Book price.

5 They took the car. That was over a year ago.
6 They never paid me anything. Tom told me I did not have
7 to make any payments while he was working on the
8 modification. I do not know if Tom did anything, but he
9 did not get my loan modification.

10 The bank foreclosed and my home was sold at an
11 auction. The bank sued and evicted me. That's where we
12 are now. The Senior Legal Hotline got the eviction
13 dropped while they worked on getting my home back. I
14 guess I am bankrupt. The hotline lawyer showed me
15 bankruptcy case filed in the Federal Court in
16 Sacramento. Dorothy signed the paper as a petition
17 preparer. Somebody signed my name.

18 CHAIRMAN ANGELIDES: May I ask, Ms. Tawatao,
19 has -- I assume this matter has been turned over to the
20 U.S. Attorney or the D.A.?

21 MS. TAWATAO: Yes, it has.

22 VICE CHAIRMAN THOMAS: When?

23 MS. TAWATAO: A couple of weeks ago.

24 CHAIRMAN ANGELIDES: Thank you very much,
25 ma'am.

1 Sir.

2 MR. CARPENTER: Chairman Angelides, Vice
3 Chairman Thomas, and members of the Commission. My name
4 is Allen Carpenter I used to work as a general
5 contractor but now I am retired.

6 My wife and I live on my Social Security check
7 and her income from her retail job. My wife and I
8 bought a home in Pleasant Grove in 2001 and owned it for
9 nine years. Our loan was with Washington Mutual. It
10 was a 30-year fixed loan at 7 percent rate. GMAC was
11 the servicer.

12 As the housing market began to slow and my
13 income was dropping, we had to refinance three times in
14 order to make ends meet. The last time we refinanced
15 was in 2000 (sic), right before the housing market
16 crashed and construction completely dried up.

17 During the times we refinanced, I was ignorant,
18 to my chagrin, about all the risks involved in taking an
19 option ARM, an interest-only loan based on stated
20 income.

21 My wife and I wanted to do the right thing and
22 pay all our bills even as the mortgage payment adjusted
23 to a very high rate. We cashed in our 401(k) plan which
24 we had \$200,000 in -- that was all of our retirement
25 savings -- just trying to keep our heads above water,

1 but eventually we simply could not keep up.

2 We ended up having to file for bankruptcy in
3 2008 -- I'm sorry, 2009. I wanted to try to hang on to
4 our home so my bankruptcy attorney suggested that I try
5 to get a loan modification and I contacted GMAC for that
6 purpose.

7 Trying to work things out through GMAC was a
8 nightmare. They would rarely return my calls. And when
9 I could get through they denied that I had ever called
10 them before.

11 I also tried to get modifications from other
12 companies but got the same runaround. Even though I
13 understand from consulting with someone at the Senior
14 Legal Hotline in Sacramento that I was a good candidate
15 for a modification under the HAMP program, if you
16 plugged in your financial information into the HAMP
17 formula.

18 During the whole time that we were attempting
19 to do a loan modification, I was sweating bullets and
20 felt stressed day and night. We ended up having to
21 declare bankruptcy and lost our home in a foreclosure
22 sale this year.

23 Though I am very unhappy about losing our home
24 and angry about the ordeal we went through, I am at
25 peace with our situation. At least the headaches are

1 gone. Still, I feel the federal government and the
2 banks are not doing nearly enough to protect consumers
3 like my wife and me and others.

4 Wells Fargo and other big banks got bailed out
5 even though they were a big reason for the financial
6 mess we are all in because they knew and still know that
7 there is an option ARM or an interest-only loan they are
8 dealing with a situation where income has not been
9 verified and probably isn't enough to make the payments
10 once the rate adjusts.

11 It seems that the government is more interested
12 in supporting banks, servicers, Fannie Mae, Freddie Mac,
13 than homeowners and consumers. This needs to change.
14 Thank you.

15 CHAIRMAN ANGELIDES: Thank you, Mr. Carpenter.

16 Thank you all for having the courage and taking
17 the time to come down here today. And as I listen to
18 you, I'm struck by the fact that two years ago when the
19 banks came calling the taxpayers returned the call and
20 stepped up. I'm sorry that that hasn't happened for
21 each of you.

22 Thank you very much for coming here today. I
23 want to thank each of the witnesses. I do want to ask
24 the members of the panel if they have any more questions
25 for the folks who are here with us today or the previous

1 panelists.

2 The testimony has been very powerful. I would
3 like to know if any members have any questions or would
4 like to make a comment.

5 All right. Well, thank you.

6 And let me just say this: It has been one year
7 of hearings, 19 hearings across the country. I think
8 for us it has been powerful and revelatory. I want to
9 make some thank yous before we close today.

10 First of all, I want to thank all the witnesses
11 and all the citizens who came here today and watched us
12 by live streaming.

13 The Commission is very grateful to each of
14 you. I would like to thank all the members of the
15 public and the people of my hometown and people across
16 the country who have watched us on our journey, and hope
17 you wish us well as we do our report by December 15th
18 and try to do our best job for the country.

19 As I said earlier, people can participate by
20 submitting written testimony at FCIC.gov or going to
21 personalstory@FCIC.gov.

22 I would like to also thank, as we close here
23 today, Superintendent of Public Instruction Jack
24 O'Connell, as I did earlier, for his generosity in
25 hosting the Commission.

1 And I want to let the superintendent know, who
2 leaves office at the end of this year to return to
3 private life after many years of good public service,
4 that he has an outstanding staff and they have been
5 wonderful. Hillary McClain, Jacqueline Krooks and her
6 staff.

7 And finally, a huge thank you to our staff and
8 ground coordinators for helping on the logistics of this
9 field hearing. That includes Courtney Mayo, Gretchen
10 Newsom, Rob Bachmann, Scott Ganz, and I want to thank all
11 our staff, and Mike Roth and Nikki Pashcal and Tony
12 Ingoglia who helped coordinate this at the ground level.

13 And finally, a heartfelt thank you to my fellow
14 Commissioners. Good people who care about their
15 country, trying to do the best they can with the mandate
16 we have been given. We are privileged to have the honor
17 to do this work and we hope that we can make a
18 difference.

19 Thank you each and every one of you and God
20 speed.

21 This meeting of the Financial Crisis Inquiry
22 Commission is adjourned.

23 (Meeting adjourned at 3:51 p.m.)
24
25