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Official FCIC Hearing Transcript on The Financial Crisis at the Community Level – Sacramento, CA

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Hearing on

"The Financial Crisis at the Community Level – Sacramento, CA"

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California Department of Education

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PROCEEDINGS

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

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

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

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

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

There are 26 million Americans who are out of work, can't find full-time work, or who have given up looking for work. 2 million families have lost their homes to foreclosure and another 4 1/2 million have slipped into the foreclosure process or are seriously behind in their mortgage payments.

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

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

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

Over the past year, the commission has held 19 days of hearings -- in New York; Washington; in Bakersfield, the hometown of our vice chairman; in Las Vegas, the hometown of Ms. Murren, Mr. Georgiou; in Miami, where we were joined by Senator Bob Graham; and now here in my hometown.

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

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

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

We've observed government leaders -- including at the Federal Reserve -- who failed to contain the crisis amid warning signs of risk-taking and subprime lending that was spinning out of control.

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

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

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

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

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

Mr. Thomas, welcome to Sacramento.

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

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

And unfortunately, one of the things they share in common is that between Bakersfield and Sacramento, this area has been -- the San Joaquin Valley and moving into the Sacramento Valley -- the fastest-growing area in California, which meant the building and construction industry was significant in this area and therefore significant damage has been done. So I'm anxious to hear what we have to say at the hometown hearing of the chairman.

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

Thank you, Mr. Chairman.

CHAIRMAN ANGELIDES: Thank you.

COMMISSIONER THOMAS: Push the button down.

CHAIRMAN ANGELIDES: Thank you, Mr. Vice Chairman, for A, telling me how to get my mike on and for those comments. And yes, I wanted to make sure the room was full here today. So we are now going to start our hearing, and today we are going to start off with testimony from Dr. Mark Fleming who is with CoreLogic, which was originally a Sacramento-based company and still employs a significant number of people in this marketplace. Mr. Fleming is going to give us an overall view of what happened here in the run-up to the crisis and the effects in the wake of the financial crisis.

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

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

DR. FLEMING: I do.

CHAIRMAN ANGELIDES: Thank you very much.

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

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

DR. FLEMING: Chairman Angelides and Vice

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

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

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

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

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

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

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

In January of 2000 Alt-A and subprime loans made up only 2 percent of the total unpaid principal balance of Sacramento mortgages, comparable to the shares in California and nationally at the time. By May of 2007 the share of Alt-A and subprime in Sacramento was 30 percent compared to 31 in California and 21 percent nationally. At the time the Alt-A share was 18 percent, significantly higher than the national level and the subprime share was 12 percent, only slightly higher than the national level.

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

Here in California in the first half of the decade, we experienced below-average serious delinquency rates. In large part benefiting from the significant house price appreciation that was occurring. But as price appreciation turned into depreciation in the second half of 2006, the delinquency rate among all active loans rose quickly and exceeded the national level by mid-2007. The national, state, and Sacramento serious delinquency trends all reached their peak at the beginning of 2010.

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

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

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

My third point is that home prices are stimulated by excess demand and depressed by distressed supply. One can immediately see the unprecedented increase in price levels in the 2001 to 2007 period followed by the decline until 2010 nationally and more dramatically in Sacramento.

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

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

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

The fourth point is that we must remember the enduring problem of negative equity. One of the most persistent and troubling effects of the financial crisis is the high level of negative equity many communities now face. Nationally, as of the end of the second quarter of this year, the share of mortgaged homes with negative equity was 23 percent. In California, the share of under water properties was 33 percent and in Sacramento 43 percent -- almost every other mortgaged home.

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

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

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

Today Alt-A and subprime loans are a much smaller share of the overall mortgage market. Moreover, we do not expect a re-emergence of affordability products given the more restrictive underwriting environment. What is happening now is that we have seen foreclosure rates on prime loans increase as economic conditions have deteriorated.

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

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

In conclusion, let me summarize all of this. Declining mortgage rates in the earlier part of the decade were a factor that allowed borrowers to leverage their incomes and afford more expensive homes. House prices responded to this increased leverage by rising in response to the increased demand. Loan products that allowed borrowers to leverage incomes further added to the upward price pressure.

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

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

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

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

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

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

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

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

Let me start here, Dr. Fleming. I want to talk about Figure 1, Underwriting Tightness. And as I look at your information, it seems to suggest -- and I want you to explain a little bit about the chart, but it seems to suggest that from a relatively tight set of underwriting standards in 2002 to the third quarter of 2006, there was a precipitous drop in underwriting standards. At least that is how I look at this chart.

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

DR. FLEMING: Sure.

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

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

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

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

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

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

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

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

CHAIRMAN ANGELIDES: So for every --

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

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

DR. FLEMING: Possibly. Absolutely.

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

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

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

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

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

DR. FLEMING: Absolutely, yes.

CHAIRMAN ANGELIDES: All right. Thank you.

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

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

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

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

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

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

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

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

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

DR. FLEMING: Yes, later than 2006 certainly.

CHAIRMAN ANGELIDES: Right.

DR. FLEMING: Yeah.

CHAIRMAN ANGELIDES: Right. So go ahead.

DR. FLEMING: So --

CHAIRMAN ANGELIDES: So it wouldn't be

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

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

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

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

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

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

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

CHAIRMAN ANGELIDES: But not at this scale, correct?

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

CHAIRMAN ANGELIDES: All right. Do you have any views on or data on the following, particularly again with respect to Sacramento and perhaps national, by which we can infer some impact on this community? And that is the extent to which foreclosures may have been propelled early on by the fact that in this crisis for the first time and to the extent, as never before, loans had been securitized, sliced, diced so you now had many folks holding these, the extent to which foreclosures may have been propelled early on by the fact that given that loans had been sliced up, securitized, in a sense, when there was a default it went to an automatic trigger so it may have triggered an early rush of foreclosures versus, perhaps, a situation where loans that, at least proportionally, were more held by lenders or at least by folks who held the full loan in the securitization process?

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

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

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

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

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

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

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

And as you mentioned in your opening remarks --

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

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

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

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

And clearly, as we have tried to analyze why the bubble and crash happened in certain locales, some things make sense, obviously, population pressures, demand, what also may make census price differentials, that this market was partly fed, obviously, by the price differential from the Bay Area markets. And I suspect Bakersfield was fed, in certain respects, by overflow from the Los Angeles market.

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

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

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

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

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

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

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

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

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

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

CHAIRMAN ANGELIDES: All right. Thank you very much.

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

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

DR. FLEMING: We do have some spare --

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

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

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

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

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

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

CHAIRMAN ANGELIDES: That is the hope.

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

On page 6 on your testimony, Dr. Fleming, you indicated that -- it's the second to the last paragraph "...and mortgage servicers bring to resolution the supply of distressed assets through modification, short sale, or foreclosure."

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

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

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

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

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

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

VICE CHAIRMAN THOMAS: Right.

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

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

In terms of modification data, I actually read the quarterly reports that come out from the organization -- the government organization that produces that data where they give a fair amount of information on the success of the mods, the types of mods, and the types of structures that are being given.

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

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

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

I think over the last couple of years the seasonality -- and so economists like myself, we actually build models to correct for the seasonality and give you sort of seasonally adjusted numbers. And those models and those adjustments are actually not working very well at the moment because there's all these other kind of forces that play.

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

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

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

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

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

VICE CHAIRMAN THOMAS: So all kinds of

mortgage?

DR. FLEMING: All kinds, yes.

VICE CHAIRMAN THOMAS: Okay.

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

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

DR. FLEMING: Sure.

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

DR. FLEMING: Right. Yeah, so to give you the crib sheet, the bottommost one, or the one that's exhibited the least change in foreclosure rates is home equity loan and HELOC as a category so second basically junior liens.

CHAIRMAN ANGELIDES: Explain "HELOC."

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

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

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

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

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

DR. FLEMING: Right, running right along the bottom of the axis.

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

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

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

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

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

VICE CHAIRMAN THOMAS: Yes.

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

VICE CHAIRMAN THOMAS: Screen purchasers on income and assets showing that it's just a larger mortgage but very similar to the old-fashioned prime mortgage?

DR. FLEMING: Exactly.

CHAIRMAN ANGELIDES: Mr. Vice Chairman, I --

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

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

VICE CHAIRMAN THOMAS: Just two more lines.

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

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

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

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

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

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

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

DR. FLEMING: Yes.

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

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

And there are a lot of people who have

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

Thank you, Mr. Chairman.

CHAIRMAN ANGELIDES: Thank you Mr. Vice Chairman.

Ms. Murren.

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

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

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

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

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

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

I think we have been monitoring house prices as sort of that clearing number that identifies the disequilibrium between supply and demand for a number of years. And it was apparent that, you know, house prices were significantly deviating from what would be fundamentally supported. And economists built models design to measure what the fundamental level of house prices should be usually in some way heavily correlated to income -- incomes and income growth because, after all, that's how we usually pay our mortgage obligations, and the relationship with the interest rate to create affordability. And so it was clear that there were big deviations.

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

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

Some of the testimony we have heard suggests that some of the activities that actually led to the crisis are perhaps having a resurgence, whether it's fraud relating to refinancing or mortgages being written that perhaps aren't as scrutinized as they should be, is there -- and that's just one example, but is there a data set that you think would be useful as we look at things today to determine where we stand and perhaps where we should go and should be collected by a national body?

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

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

COMMISSIONER MURREN: I see. And you had mentioned the terms of modifications that would be useful if we were able to get more transparency and visibility into that.

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

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

COMMISSIONER MURREN: I see.

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

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

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

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

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

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

COMMISSIONER MURREN: But I would guess that, as a result of the complexity associated with that, perhaps then it actually extends the time period where that could be beneficial; in other words, we may not see the benefits of it for a period of time as that's resolved.

DR. FLEMING: Yes.

COMMISSIONER MURREN: Thank you.

CHAIRMAN ANGELIDES: Thank you, Ms. Murren.

Mr. Georgiou.

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

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

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

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

DR. FLEMING: Yeah. So 7 out of every 10 is certainly a significant issue. And I think it really belies -- it's not -- again, the focus on this idea of there's two triggers. Negative equity in and of itself is necessary but not a sufficient condition for foreclosure or distress, some sort of modification.

COMMISSIONER GEORGIOU: If you combine that with the highest unemployment rate of any state in the nation?

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

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

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

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

COMMISSIONER GEORGIOU: Go ahead.

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

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

VICE CHAIRMAN THOMAS: Thank you.

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

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

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

COMMISSIONER GEORGIOU: I would like to go to

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

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

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

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

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

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

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

COMMISSIONER GEORGIOU: I think that's all I have for now.

Thank you, Mr. Chairman.

CHAIRMAN ANGELIDES: Mr. Thompson.

COMMISSIONER THOMPSON: Thank you, Mr. Chairman.

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

Do you agree with that?

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

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

COMMISSIONER THOMPSON: So let's dissect it for a moment. If you believe, as I do, that perhaps the catalyst to this economic collapse was a housing bubble that burst, could we and should we have forecasted a bubble building and the inevitable collapse?

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

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

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

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

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

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

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

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

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

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

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

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

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

COMMISSIONER THOMPSON: Okay. Thank you very much.

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

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

What would have led anyone to believe in 2004, 2005, 2006 in this community that underlying economic conditions had changed so as to support 10 and 11 and 12 and 15 percent price increases or 20 percent in a year?

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

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

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

These are all -- as economists we look and say, "Why do people want to move to these places? What drives the demographic shifts in those marketplaces?" And Sacramento had a number of positive benefits going for it at the time.

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

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

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

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

DR. FLEMING: I can't really speculate on what information decision makers had --

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

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

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

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

DR. FLEMING: Thank you.

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

Thank you. Five minutes.

…

CHAIRMAN ANGELIDES: The meeting of the

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

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

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

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

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

(All sworn.)

CHAIRMAN ANGELIDES: Thank you very much.

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

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

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

THE DEPONENT: That would be great.

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

MS. MANN: Thank you.

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

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

First of all, let me touch briefly on my experience. In the lasted 30 years I have appraised 18,000 residential appraisal reports. I have reviewed within my firm 45,000 appraisals. I have appraised over 800 church properties, plus another 4- or 5,000 commercial properties.

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

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

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

So what I'm telling you -- what I'm sharing with you is based on my personal observations for the last 30 years. By 2004 I was already experiencing stomachaches anticipating the down drop that we were going to experience.

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

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

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

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

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

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

The use of BPOs, brokers' opinions of value, further denigrated the valuation process. Thanks to HVCC, my client base of mortgage brokers, bankers, and other people that I've worked with over the last 25, 30 years, I can no longer really do business with them one-on-one. So that was a lot of frustrated work.

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

That's it, right?

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

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

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

I've served in the public sector as an analyst with the legislature as a member of the California Housing Finance Agency doing affordable housing. And I've also spent the last 20-years-plus in the private sector working for a variety of mortgage banking companies.

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

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

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

The second piece was the make-up of that population increase. Traditionally, it has been from organic growths, the births, and people who already lived in the Sacramento Valley. But we saw a different make-up coming into Sacramento due to the great disparities between house prices -- the median house prices that were in Sacramento at the time, and primarily the Bay Area counties, but some from Southern California.

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

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

The fourth factor that I think is important, too, is along with that there was governmental efforts to expand home ownership. There was great interest in serving underserved ethnic groups, in serving underserved income groups. And I think that led to some changes in underwriting, changes in marketing that affected the Sacramento market.

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

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

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

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

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

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

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

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

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

CHAIRMAN ANGELIDES: Thank you.

Mr. Stein.

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

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

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

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

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

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

Nowhere was this dynamic more clearly on display than in the summer of 2006 when the Federal Reserve convened HOEPA hearings in San Francisco. At the hearing, consumers testified to being sold option ARM loans in their primary non-English language, only to be pressured to sign English-only documents with significantly worse terms. Some consumers testified to being unable to make even their initial payments because they had been lied to so completely by their brokers.

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

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

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

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

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

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

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

Last week, RealtyTrac confirmed that seven California metro areas were again among the top ten communities most impacted by foreclosure in the nation. The list included Sacramento at No. 10 and communities in neighboring and nearby counties including Modesto, Stockton, Merced, and Vallejo-Fairfield.

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

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

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

On this last point, we feel it underscores the critical need --

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

MR. STEIN: Sure.

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

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

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

Thank you for this opportunity.

CHAIRMAN ANGELIDES: Thank you, Mr. Stein.

Mr. Wagner.

MR. WAGNER: Thank you, Chairmen and thank you, Commissioners. Good morning and thank you for the invitation to speak before you today about what we as prosecutors in the U.S. Department of Justice have seen in the Eastern District of California concerning mortgage fraud and what we've done to combat it.

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

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

The mortgage fraud schemes we have seen in this district take a number of forms. We are prosecuting mortgage industry professionals like mortgage brokers and lenders who lied and created false documents to increase their already-generous commissions; real estate agents who inflated undisclosed payments to themselves; buyers and sellers of homes who lied to extract equity from homes or simply to strip cash out of the transactions; real estate investors who lied to finance property-flipping schemes; home builders who lied and used straw buyers to get properties off their books in a downturning market; organized crime associates who have used fraudulently obtained financing to buy homes for use as indoor marijuana farms; and even a policeman who is charged with submitting false information to obtain two different mortgage loans.

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

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

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

It's important to note that although the extent of the mortgage schemes that occurred during the 2004 to 2006 period is clear as we sit here today, it took the drop off in the housing markets to bring specific criminal cases to light.

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

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

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

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

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

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

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

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

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

Next week, my office and the Financial Fraud

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

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

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

Much of what we have heard, in fact, apropos of Mr. Thompson's questions were that many people particularly policy makers and people on Wall Street said they never saw it coming. I want to get a sense of what people saw and felt at the ground level.

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

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

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

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

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

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

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

MR. PUTNAM: Well, from my perspective it was in 2002. I had been employed with a mortgage banking company that was primarily involved with agency Freddie Mac, and FHA loans, and we were purchased by Washington Mutual in January of 2002. And I worked with Washington Mutual for five months and that was my first experience with a portfolio under a very aggressive lender who was very active in the subprime, Alt-A product.

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

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

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

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

I think the natural break was that when 85 or so percent of the market was agency- and government-related lending that those tended to be more competitive and it was more difficult to sell more spreads. So it was -- it kind of -- the market disciplines kind of --

CHAIRMAN ANGELIDES: There was a much more narrow spread.

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

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

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

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

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

So one of the issues that had been raised is that the triggers need to be lowered and I think The Fed actually did lower the triggers at one point. But the general idea is that through that process and many others, community groups had tried to communicate to the fed and others that there was a lot of bad lending as the other panelists have noted. The underwriting seemed to have gotten worse, people were getting abused, and that more needed to be done, that the legislation and regulations that were in place were not sufficient.

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

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

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

And as you mentioned, the Long Beach Mortgage, one of our issues was looking at the larger bank holding companies where you have -- you have different lending entities owned by the larger financial institutions, and many of them own subprime lenders like Long Beach Mortgage.

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

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

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

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

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

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

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

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

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

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

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

So we're are looking at lenders, at brokers, at real estate agents, that they're -- it really was -- I agree with your assessment that there was kind of a Wild West atmosphere going on in the middle part of the decade that involved a lot of people, some of them at lenders.

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

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

In my particular district, relatively few of the banks and lenders have headquarters in this district. And so there is a lot of activity and so we are pursuing a lot of the employees who are active in this district. But in terms of the larger entities and their policies and so forth, those are generally cases that would be venued in districts where those banks are located, if I understand your question correctly.

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

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

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

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

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

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

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

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

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

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

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

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

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

CHAIRMAN ANGELIDES: So very quickly, then, I just wanted to ask you, and I'm running short on my time, probably over my time, but let me quickly ask Mr. Putnam and Ms. Mann, I know you probably don't have data, but what were you seeing in terms of what you thought might be fraudulent transactions in '04, 05, '06, '07 time period very quickly? Ms. Mann?

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

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

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

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

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

MR. PUTNAM: I think we -- "fraud" is defined as somebody breaking the rules. And I think rather it was a combination of fraud it was also a combination we were changing the rules. And so a lot of the low doc, no doc, the credit, we quit looking at things and so we defined a fair amount of the fraud away. And so by the time it hit the mortgage system, unless there was a clear misstatement of something, it wasn't fraud it was --

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

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

CHAIRMAN ANGELIDES: Very interesting perspective.

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

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

MR. WAGNER: We get a lot of --

CHAIRMAN ANGELIDES: You get the SARs?

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

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

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

CHAIRMAN ANGELIDES: Because one of the things that was said to us in Florida by former S&L regulators is the regulators have to be the sherpas to law enforcement. You can't expect law enforcement to find it, you got to expect the people who refer what they see as problems.

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

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

CHAIRMAN ANGELIDES: Thank you very much.

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

Thank you for being here, Assemblywoman.

ASSEMBLYWOMAN YAMADA: Thank you.

VICE CHAIRMAN THOMAS: Thank you, Mr. Chairman. Based upon earlier statements that some of you made, I just think we need to put it on the record that the Financial Crisis Inquiry Commission's statute responsibility is to examine and explain the financial crisis, not in the statute to make recommendations as to what should be done.

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

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

I think when you look at medicine and the role that drugs have played increasingly in medicine, we have focused on pharmacists in terms of, one, their knowledge -- their pharmacological knowledge, but as people are more and more taking multiple drugs, their reaction between them and the rest. I always thought of appraisers in a similar role in housing, because whenever you think about buying or selling a house, the first thing you ask is, "What's it worth?" And if you can't get a grounding in a kind of a professional way, then you just out to sea.

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

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

And what we heard, especially in Las Vegas and to a certain extent Miami, is that there would be this eventual foreclosure, then a very quick one-day, two-day resale at a significantly higher price, which I assume, based upon that kind of a behavior pattern, your argument that the problem was easy money may, in fact, carry over to this business of not modifications, not short sales, but foreclosures because of the money.

Any reaction?

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

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

VICE CHAIRMAN THOMAS: Thank you.

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

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

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

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

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

You had Fairfield, Vacaville, Dixon corridor coming up where people could still commute to Walnut Creek and job centers there. Elk Grove got a little of both. You could sort of get to the East Bay pretty well from South Sacramento, and you got tremendous growth in those areas.

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

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

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

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

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

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

Also, I mean, the role of the broker, too, just by its very nature, consumers reasonably believe that the broker is looking out for their interest. You go to a broker because a broker has access to various loan products and not to one particular lender who offers that particular lender's products.

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

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

I think the one last thing to say about it is also I think for some -- and we found this when we actually interviewed borrowers in 2000-2001 -- that many borrowers felt that they -- that the mainstream financial institutions were not available to them. For whatever reason, rightly or wrongly, they -- most of the borrowers who had subprime loans we contacted just because we bought lists of subprime borrowers. They didn't go to a mainstream financial institution because they didn't think that that institution was there for them. Maybe it wasn't in their community, maybe they had prior bad experience.

So yes, in answer to the question, yes.

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

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

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

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

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

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

VICE CHAIRMAN THOMAS: Thank you very much.

Thank you, Mr. Chairman.

CHAIRMAN ANGELIDES: Mr. Thompson.

COMMISSIONER THOMPSON: Thank you, Mr. Chairman.

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

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

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

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

So -- I was suggesting there were weaknesses in HOEPA, so states tried to kind of fix it and get it right at least within their states. And the OCC, the Office of the Comptroller of the Currency, in particular was protective in essence of the national banks who now make up such a vast majority of the presence of financial institutions in our communities in saying that, for example, the state of Georgia should not be able to pass a law that would affect the obligations of national banks operating in the state of Georgia.

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

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

So we would be, in essence, creating a competitive disadvantage for state licensees, for lenders that are not federally chartered. So it was -- in a way, the preemption created a race to the bottom and the argument of the control of the currency's office at that time is we don't want national bank disfavored, disadvantaged by these state and local policies. But what they wound up doing was bringing everybody down as a result.

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

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

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

COMMISSIONER THOMPSON: So to stay with the analogy of first responders for a moment if I might, what level of local visibility and on-the-ground coverage did those federal agencies have to have a sense of what was going on in the local market?

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

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

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

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

COMMISSIONER THOMPSON: Thank you.

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

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

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

So there was that theme. I think it's a matter of balance. What came out of that was changes to underwriting that, I think, at the time attempted to address the different, maybe, cultural and ethnic differences that were obstacles to home ownership.

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

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

So I think those things contributed. They were admirable at the time. I think they -- and you have to also say that it greatly expanded credit opportunities for millions of people in America it's just over time as we race to the bottom, I think it just got out of balance and there weren't market disciplines.

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

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

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

MR. PUTNAM: Well, the -- in the subprime and Alt-A, I think the greed would weigh. And they were they came from 10 percent of the market to 50 percent of the market by 2000 -- you know, 2005. The agencies were --

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

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

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

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

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

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

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

CHAIRMAN ANGELIDES: Absolutely.

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

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

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

COMMISSIONER THOMPSON: Corruption.

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

Mr. Georgiou.

COMMISSIONER GEORGIOU: Thank you, Mr. Chairman.

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

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

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

On the next page you summarized -- in my view, fairly accurately -- several points. Loan officers were often paid on overages, collecting additional fees for selling the consumer a higher interest rate or additional lender-beneficial terms leading to the tendency of some loan officers to maximize commission and expensive consumer interest.

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

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

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

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

MR. PUTNAM: I think your first assumption is the one that's flawed. And that is that the lender wasn't always concerned with the performance of the loan. Partly -- I think primarily to the rise and the sophistication of the securitization process, there was much more emphasis on the production of the loan, on doing the loan that would meet the criteria of the next party you were selling it to, and then that party would take the loan and do what it was going to do with it.

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

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

COMMISSIONER GEORGIOU: I guess you make that point in your -- really in your third point, increasing the distance between lender and borrower, which really you say here, "Lenders increasingly saw borrowers as data points in a MBS prospectus," rather than as individuals who could be relied upon to pay the loan back.

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

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

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

COMMISSIONER GEORGIOU: All right. And, of course, overinflated appraisals ultimately assisted in moving the bubble, expanding the bubble over time.

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

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

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

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

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

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

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

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

And I guess I would just encourage you to, you know, encourage your colleagues to take a look at that because I think that some of the experts that we heard from Tuesday seemed to think that that was a difficult problem; that had the purchasers at all the levels along the chain exercised a greater degree of diligence in purchasing fraud-free products there would have been obviously less economic incentive at the bottom to --

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

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

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

There may well be cases where there are affirmative false statements, as I mentioned, we are interested in pursuing those, but it's a little bit different than going up, say, an organized crime or narcotics chain where the person at the top knows that they're part of an organization which is deliberately violating criminal law.

COMMISSIONER GEORGIOU: Right. Understood.

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

CHAIRMAN ANGELIDES: Absolutely. I yield two minutes.

COMMISSIONER GEORGIOU: Thank you.

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

Could you elaborate on that briefly?

MR. PUTNAM: Well, I think the tremendous growth in the mortgage market, partly driven by the demand of consumers, partly by the consumers, partly by the participants that were profiting from it led to innovative new ways of lending.

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

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

COMMISSIONER GEORGIOU: You know, I remember about a year, almost a year ago now, when we did our first introductory hearing and my introductory remarks alluding back to the "It's a Wonderful Life" film that we all harken to at Christmastime.

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

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

Thank you very much for your courtesy.

CHAIRMAN ANGELIDES: Thank you, Mr. Georgiou.

Ms. Murren.

COMMISSIONER MURREN: Thank you, Mr. Chairman. Thanks to all of you for spending time with us today. I would like to talk a little bit about a subject that I have been spending a lot of time pondering, and that is what is considered by some to be this, sort of, notion of a deregulatory environment that we were in.

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

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

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

MS. MANN: Thank you. The appraisal organizations, the Appraisal Institute, the American Society of Appraisers, and the other organizations, a part of The Appraisal Foundation voiced concern to Washington D.C. In fact, I was on a panel. We went to our legislators to voice our concern in 1994, 1993, about the dangers of raising the di minimus to $250,000.

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

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

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

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

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

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

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

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

MS. MANN: On the appraisal point of view side, there was a bigger fear cast among appraisers knowing that somebody this the federal government could be overseeing and would be overseeing your work. Or as, if you know, that there is nobody on the state level to really go after you, guess what, it's a free reign. It's Wild Wild West. And that's and the attitude was "Well, who is going to come and get us? I guess, well, let's just go ahead and have a play day."

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

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

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

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

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

COMMISSIONER MURREN: Thank you.

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

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

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

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

But the facts are that the early and worst abusers of subprime were almost all state-licensed entities. The New Century, the Long Beach Mortgage, Fremont, even the early Countrywide were state licensed, and they came out of this period of innovation that at the time the banking regulators were not as interested in.

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

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

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

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

MR. PUTNAM: The mortgage standards. For the agency stuff it was fairly centralized and it was a fairly public process and so there were changes announced and debated and you could follow those pretty well, and to the extent they were 80 percent of the market or 50 percent of the market, keep a pretty good handle.

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

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

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

MR. PUTNAM: Yeah. Yes.

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

MR. PUTNAM: Well, at the local level you were supposed to turn in loan documentation to your company that you were certifying was the best of your knowledge. So there was a little bit of check at that point.

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

However, that gave lots of room for how you approached the question on a no doc loan, for instance, you know, how you phrase the question. "What is your documented monthly income?" is different from "What was your best month that you have had in the last year?" or "What was your income last month including salary, bonus and overtime," which may or may not continue versus -- so in my experience, there was very little fraud. It's -- I go back to the definition, it's got sort of --

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

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

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

Could I have two more minutes?

CHAIRMAN ANGELIDES: Yes.

COMMISSIONER MURREN: Thank you.

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

MS. MANN: The customer may not know.

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

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

COMMISSIONER MURREN: That would be terrific.

One final question. The unintended consequences of the recent regulations that have passed about appraisals, could you talk about what opportunity the appraisal industry or individuals have had in actually crafting those rules? Because you mentioned that it didn't work out the way everybody had hoped, at least not so far, and perhaps you could refresh us on what rules recently went into effect with regard to changes in the appraisal system or processes.

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

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

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

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

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

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

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

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

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

CHAIRMAN ANGELIDES: Mr. Thompson.

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

MS. MANN: On the appraisal industry?

COMMISSIONER THOMPSON: Yeah.

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

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

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

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

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

MS. MANN: Obviously. And the appraiser --

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

MS. MANN: Yes and no. Yes, we were looking out for ourselves, but we were also looking out for the public. And we realized that, okay, appraisers are not going to do this work. Who is going to do the work? Is it going to be drive-bys? Is it going to be broker opinions?

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

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

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

COMMISSIONER THOMPSON: Got it. Thank you.

CHAIRMAN ANGELIDES: Mr. Vice Chairman.

VICE CHAIRMAN THOMAS: Follow-on to that, I do want to underscore the date and the amount when you were back in 1993, 1994 at $250,000, significant number of homes below 250. I mean, even in San Francisco Marina and a few other areas, Nob Hill, that's a significant number on the quantitative aspect of the homes that dropped out of the appraisal process.

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

Thank you very much, Mr. Chairman.

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

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

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

MR. STEIN: Well, the option ARM product was around for many, many years and I think people gravitating to it during this time was more about opportunity, I think, in the context of the affordability crisis.

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

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

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

CHAIRMAN ANGELIDES: Mr. Putnam, very quickly, you may be old enough or been around the business long enough to know this. We were told in Florida by Bill Black, who is a former S&L regulator now professor at University of Missouri Kansas City, that the industry had tried to move to no doc loans on a broader basis in the '80s the S&L industry had.

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

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

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

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

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

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

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

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

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

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

I look at the diminution of lending standards, the opening of the door wide with things like no doc loans, the lack of effective regulation, and it's almost as though -- we talked about mortgage fraud, it's almost as though what we did here is we created a very corrupted system as a whole, a system that was absolutely prone to almost any kind of action.

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

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

If anyone disagrees, let me know.

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

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

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

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

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

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

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

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

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

CHAIRMAN ANGELIDES: All right. Thank you.

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

And with that what I would like to announce is we are going to take a one-half hour lunch break. We will reconvene in this room promptly at 12:45 with Session No. 3, where we will take a look at how it is that mortgage loans made in Sacramento travel a great distance to enter the financial system.

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

Thank you all very, very much.

…

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

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

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

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

(All sworn.)

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

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

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

MR. JOHNSON: Thank you.

Chairman Angelides, Vice Chairman Thomas, and members of the Commission, my name is Keith Johnson and I have been in the financial services and banking industry for 30 years. From 1986 to 2000, I was employed by Bank United of Texas where I held a variety of executive positions involving finance, capital markets, loan origination, securitization and servicing.

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

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

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

In my opinion, this crisis is not the result of a single cause but a combination of significant factors operating at the same time and feeding each other. Low interest rates, increased housing goals, creative securitization, lack of assigning liability, compromised warehouse lending, flawed rating industry process, relaxed and abusive lending practices, rich incentives, shortfalls on regulation and enforcement provided the fuel to inflate home prices and excess borrowing by consumers.

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

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

The lack of accountability and failure by many parties to present value the pain allowed the process to continue. And lastly, the lingering impact and transformation has been the starting of practical solutions between borrowers facing financial hardship and the investors with principal at risk.

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

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

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

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

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

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

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

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

When brokers are paid commissions by both parties to a loan transaction, confusion results about who the broker actually worked for. In my opinion, the broker should be acting as a fiduciary of the borrower and have the responsibility for making sure that the borrower understands and benefits from the transaction by receiving fair terms.

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

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

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

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

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

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

CHAIRMAN ANGELIDES: Can you wrap up, please?

MR. JOHNSON: Sure.

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

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

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

And this unsold inventory leads me to my third, which is the availability of credit. My recommendation on that is something that I found that worked in Texas during the recession is the loans to facilitate the sale of foreclosed homes could be an active program by those banks and GSEs that are actively the investor today.

With that, I look forward to your questions. Thank you.

CHAIRMAN ANGELIDES: Thank you very much.

Ms. Beal.

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

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

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

Clayton is not retained by its clients to provide an opinion as to whether a loan is a good loan or a bad loan. Rather, our clients use Clayton's due diligence to identify issues with loans, negotiate better prices on pools of loans they are considering for purchase, and negotiate expanded representations and warranties in purchase and sale agreements from sellers.

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

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

As part of this review, we grade each loan for credit and compliance using grades of: Event 1, loans that meet guidelines; Event 2, loans that do not meet guidelines but have sufficient compensating factors; and Event 3, loans that do not meet guidelines and have insufficient compensating factors. Clayton's fees are not contingent on our findings or our grades.

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

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

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

Exceptions to underwriting guidelines can vary from being severe -- such as the valuation of a property not being supported by an appraisal, stated income not being reasonable for the job, or missing critical documents in a file such as HUD-1, loan application, or an appraisal -- to benign, such as a debt-to-income ratio of less than 5 percent or loan-to-value exception of 5 percent or less, or a credit score that's within an acceptable tolerance; for example, 650 score is required, 640 is the actual credit score.

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

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

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

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

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

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

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

Mr. Eggert.

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

Is that better?

CHAIRMAN ANGELIDES: That's much better.

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

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

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

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

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

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

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

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

They should have gotten the due diligence reports that we just heard described. Those reports existed. The exceptions were described and defined. Why weren't investors given that information which was in the hands of the people that were selling the securities? Why weren't they given the underwriting reports by the originators who knew what exceptions were given and why?

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

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

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

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

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

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

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

Thank you, and I look forward to your questions.

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

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

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

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

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

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

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

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

MR. JOHNSON: First I want to correct, I did not shut Long Beach down when I was there.

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

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

CHAIRMAN ANGELIDES: No, but you made a comment, I think, today that your view was the broker model should have been shut down.

MR. JOHNSON: Once I got to Clayton and I could see the broker model being used by almost 40 of the largest originators, you saw the same problems. As an operator, you know, we try to put in all the right risk controls. We bought every third-party fraud system we could find. But these were just force fields in which people can walk right through and commit a fraud.

I think that it really gets down to the relaxed underwriting guidelines probably should have never come out, the stated income, the 100 percent loan-to-values; however, there was a need for that based on the raw materials for securitization.

Companies were being encouraged to provide that for securitization product. I guess that could have stopped if the right data was going to rating agencies to perhaps change the subordination levels whereby that risk would have been graded a little bit more harsh and the profits would have stopped.

So to me, there is a variety of points in the factoring of this product that we could have present valued the pain. Whether it's the rating agency side, whether it's in the enforcement side. When we caught fraud, very little was done. Very little could be pointed to to discourage brokers and brokers could simply go to the next financial institution down the line.

CHAIRMAN ANGELIDES: Very quick question for you, Mr. Eggert. Clearly, there was a breakdown in the system. But didn't investors let themselves down also by not asking for the requisite information?

MR. EGGERT: Well, I think investors did ask for the information and were, in essence, told, "Take it or leave it."

CHAIRMAN ANGELIDES: They took it.

VICE CHAIRMAN THOMAS: They could leave it.

MR. EGGERT: And some did leave it. Some investors relied on credit rating their ratings and they shouldn't have in retrospect. But I think they weren't given the information to realize how suspect many of the ratings were.

I think some savvy investors realized there was a big problem. Some were savvy enough even to go short on the on the securities that were being produced. But at a certain point I think what happened was Wall Street realized some investors were getting turned off by what they were producing and so they responded by saying, "We have to find other investors who haven't figured this out yet."

CHAIRMAN ANGELIDES: Right. I will make an observation. There is a chain here and it does start with borrower and it ends with investor. Just an observation I will make.

MR. EGGERT: I think that's entirely accurate.

CHAIRMAN ANGELIDES: Now, let me -- so the reason -- the focus really of the reason I wanted to, in a sense, have this discussion was one of the questions I get a lot in this community is: "How did what happened here turn into a financial crisis?"

And I think this world of how loans were originated, you know, moved from broker to originator to securitizer to investor, and then of course packaged and repackaged is something that's of tremendous interest to people.

And I would like to ask you, Mr. Johnson, you, Ms. Beal, some questions about the work that Clayton did because I think one of the things we have been looking at is the declining underwriting standards. But I think one of the essential issues is also that as underwriting standards declined, was there even a failure to meet those underwriting standards?

So there are some charts I would like to ask you about so I would like to enter in the record just so I can talk to you about these, I think, the staff provided and, actually, you provided them to us, so I think you are very familiar with them. These are the trending reports that talk about due diligence.

So I want to see if I've this right just in terms of my understanding. Clayton was hired by issuers, securitizers to do due diligence. My understanding is you had about 20 percent of the market. And from the first -- is that about right?

MS. BEAL: That's -- yes.

MR. JOHNSON: Out of all the securitizations done, only 20 percent of which were done by third-party issuers. So Clayton would only be working on third-party issuers. We would never work on a securitization, like, perhaps Bank of America would do or Countrywide or Chase. And of that 20 percent, our market share was probably 50 to 70 percent of that due diligence.

CHAIRMAN ANGELIDES: All right. So my understanding is from first quarter of 2006 through second quarter of 2007, which is kind of the heat of the subprime market, you reviewed about 911,000 loans. And my understanding is the simple sizes were normally 5 to 10 percent or were they smaller?

MS. BEAL: They were running about 10 percent.

CHAIRMAN ANGELIDES: All right. So it's fair to say if you looked at 911,000 loans, roughly it's a punitive pool of about 9 million loans, correct?

MS. BEAL: Correct.

CHAIRMAN ANGELIDES: And my understanding is you reviewed those loans for compliance with underwriting standards; in other words, if they were originated here in Sacramento by Washington Mutual or Long Beach, you would look to whether or not the loans conformed to that lender's underwriting standards as well as any "overlay standards" that the issuer would put on top?

MS. BEAL: That's correct.

CHAIRMAN ANGELIDES: And you were looking for certain things or certain safeguards or standards, correct?

MS. BEAL: That's correct.

CHAIRMAN ANGELIDES: All right. And then my understanding is that in that period you rated about 54 percent 1s, meaning they met all the standards, correct? And I understand your admonition that that's not necessarily good bad loan bad (sic), that's whether they meet the standard or not.

MS. BEAL: Yes, the 54 percent would have met the seller's guidelines and any client tolerances or overlays.

CHAIRMAN ANGELIDES: Correct. And another 18 percent might have missed something but there was a compensating factor. So in my simple mind, maybe the loan to value was a little high above the standard, but that person had substantial cash, that kind of thing; is that a fair assessment?

MS. BEAL: That's correct.

CHAIRMAN ANGELIDES: But then there were another 28 percent that you initially rejected, and I guess that's because they didn't meet the standards. But then I guess the issuer securitizers decided to "waive those back in." 39 percent on average. Why did they waive them back in?

MS. BEAL: The 11 percent or the 39 percent of the waiver rate. The 39 percent is the percentage of loans initially flagged as 3s that were waived back in. And the 11 percent is the overall out of the 911,000.

CHAIRMAN ANGELIDES: Can I ask a question?

MS. BEAL: Yes.

CHAIRMAN ANGELIDES: So originally you rated 3 or rejects 28 percent of them --

MS. BEAL: Yes.

CHAIRMAN ANGELIDES: -- but then that number gets reduced to 11 percent by the issuers; is that --

MS. BEAL: Yes.

CHAIRMAN ANGELIDES: And that was because they made a business decision? They looked at the loans individually? How did that all work?

MS. BEAL: Yes, they look at the loans individually and they make business decisions. And this was also our two Ws, which meant that they coded the loans as a waiver. And it was also our two Ts, which were side letters, meaning they would give the seller 30 days to cure maybe missing documents or something they could look at to see if the exception was acceptable. And then they would let us know that these would be two Ws or two Ts.

CHAIRMAN ANGELIDES: Can I ask a question? Do you have any information that they would have sampled the other 90 or 95 percent of the loans?

MS. BEAL: No, I don't have that information.

CHAIRMAN ANGELIDES: So would I be off if I said, "Gee, they're failing initially 255,000 loans," you times that by 9 in the pool, or 9 million, you might have 2.3 million loans that initially failed by your standards and when that was reduced down, you still had a million failures out of that 9 million. Is that my, kind of, rough math?

MS. BEAL: Yes.

CHAIRMAN ANGELIDES: All right. Interesting.

I would like to ask a couple of questions. So these trending charts were prepared for what reason? Were they prepared -- did they show a decline in understanding standards? What did they show during that critical period of 2006 to 2007? What is happening in the market as these loans are being moved up the chain?

MS. BEAL: What we did notice was that it was declining originator guidelines. And then as the guidelines were declining, we saw that our clients were increasing their tolerances; in other words, they were putting more credit overlays. As -- you know, there was stated income, they were telling us look for reasonableness of that income, things like that. They were also --

CHAIRMAN ANGELIDES: Does that mean they -- so the standards were going down, but were they then adding some protections against standards going down?

MS. BEAL: Yes, they were raising the bar. They were raising the guidelines themselves.

CHAIRMAN ANGELIDES: So you have two things working here, you have underwriting standards going down and the issuers, in a sense, mitigating some of that?

MS. BEAL: Yes, yes.

CHAIRMAN ANGELIDES: Okay. That's interesting.

Let me ask this question of you, Mr. Johnson. My understanding is you actually went to the rating agencies at one point because I think you thought you had a product to sell, correct? Which is -- this goes back to enlightened self-interest -- that you thought this information would be interesting to them.

Would you talk about that a little and what their reaction was?

MR. JOHNSON: Sure. We thought that these exception-tracking mechanism, we are the only firm in the country that has it and I still believe the only firm that does today -- was a great product to show clients how their manufacturing quality is. Good managers manage exceptions and try to get that down, try to get that --

CHAIRMAN ANGELIDES: So you thought it was a management tool?

MR. JOHNSON: I thought it was first a management tool that managers could try to get that 54 percent closer to 100 percent and that this would be a good tool.

Then we went to the rating agencies and said, "Wouldn't this information be great for you to have as you assign tranche levels of risk?"

Again, if they would have accepted it, I think this is one way of paying within present value because they could have -- for good originators with great quality had better subordination levels than middle and worse originators. And therefore, the market economics would have forced those people out of the equation.

We started meetings with -- in 2006 with S&P, Fitch, and then in 2007 we met with the executive team of Moodys. All of them thought this was great. All of them thought this would be wonderful to have. None of them would have adopted it at that time, for the most part being that: A, we were only 20 percent of the market third party. If any one of them would have adopted it during that period of time, they would have probably lost market share --

CHAIRMAN ANGELIDES: They would have lost market share to each other?

MR. JOHNSON: Issuers would have gone to the easier channel.

It should be noted in 2007 after the Attorney General came into the picture all three said that third-party independent due diligence is going to be required going forward.

CHAIRMAN ANGELIDES: So when I look at some of these waiver rates and I see Deutsche Bank waiving back in 50 percent of the failures, is that because they are tougher or because they are waiving them bank in?

On the other hand, Goldman looks like it has one of the lower reject rates and they are waiving in less. Is that because they are more stringent on the review?

MS. BEAL: Well, there are two things. Deutsche Bank was one of our clients that had very strict credit overlays. They had us looking at many more reasons for making a loan a 3, and then they also took away during that period Clayton's ability to make loans a 2 with compensating factors.

In a lot of cases they would say either it's a 1 or it's a 3. So you do see that with Deutsche Bank. You see more loans being generated as 3s so that they would go back to them for their review.

They also were pooling third-party services around valuations, made use of fraud tools, occupancy checks, so they were layering on other tools in addition to the due diligence.

And the point about Goldman and some of the other clients that you see, it could be that they weren't quite as robust in their credit overlays. It could also be a mix of the sellers that they were buying loans from. So you know, there are many there.

And then also one other point I would like to make in this is that this was a beta version of the trending reports. It was raw data, this summary report, it hadn't been scrubbed. It wasn't an apples-to-apples comparison just as we're saying --

CHAIRMAN ANGELIDES: You didn't standardize it, so it was reflective of each institution, right?

MS. BEAL: Yes, that's correct.

CHAIRMAN ANGELIDES: All right. So I am going to just pose something then I want to turn to other commissioners and then I want to come back at the end because this is an area I would like to hear my colleague's questions around these issues.

But there seems to be kind of three points here as I looked at this. One is, from what I can tell, it doesn't look like your information ever migrated to disclosure. I know you didn't prepare it for that purpose, but this wasn't disclosed. What you read in the disclosure is some of these loans, a significant amount, may be exceptions but there is compensating factors. What's not revealed is the actual data, so it appears not to have been available to investors. Is that -- would that be your --

MR. JOHNSON: We are not aware of -- and we looked at a loft prospectuses -- of any of our information --

CHAIRMAN ANGELIDES: -- ever popping through.

MR. JOHNSON: -- going through the prospectus. And one of our recommendations was that a table should be included in the future that simply said, you know, due diligence -- independent chosen due diligence achieved a 95 percent confidence level in certain attributes with an error of, you know, 2 or 3 percent was performed. And that way rating agencies would have it and investors could acknowledge and then you could grade good, bad, and ugly issuers.

CHAIRMAN ANGELIDES: Secondly, it appears as though you did a sample of 5 to 10 percent, but it looks like the other 90 percent were never faxed. So I am thinking if I am a securitizer, even forgetting whether it's 28 percent failed or 11 percent failed, what is happening here, they got a sample of 10 percent. I know 11 percent of those fail. I kick those out. But as to the other 90 percent, I don't do nothing?

MS. BEAL: Right.

CHAIRMAN ANGELIDES: Does the silence mean I got it right?

MR. JOHNSON: Did you ask a question or is this a statement?

CHAIRMAN ANGELIDES: Is that an accurate statement?

MR. JOHNSON: That's an accurate statement.

CHAIRMAN ANGELIDES: All right. And the final thing is I just want to note that I looked, I guess the examiner for the New Century bankruptcy and a former regulatory compliance person in Fremont said there was also practice of even if loans were kicked out they were put back in another securitization.

Are you familiar with that or not?

MR. JOHNSON: I think it goes to "three strikes, you're out" rule.

CHAIRMAN ANGELIDES: So this was a case of -- okay, three strikes.

MR. JOHNSON: I've heard that even used. Try it once, try it twice, try it three times, and if you can't get it out, then put --

CHAIRMAN ANGELIDES: Well, the odds are pretty good if you are sampling 5 to 10 percent that you'll pop through. When you said the good, the bad, the ugly, the ugly will pop through.

All right. Final question, and that is: You made a comment at one point, I think it was public comment about you felt like a potted plant. And not you personally, but due diligence folks. In this whole process you felt like you were producing information and --

MR. JOHNSON: Right. I think it was when we looked at these reports here, we saw that -- 54 percent was alarming to me personally, you know, I can say this. And I didn't realize what --

CHAIRMAN ANGELIDES: 54 percent were making the initial grade?

MR. JOHNSON: Right. And so I don't know what our role was. Back in the old days, in the '80s, due diligence -- and I was a big buyer of loans -- is really simple. It's good loan, bad loan. When you bought the loan, I owned it, it went in my portfolio. If it went delinquent in fault, I had to be personally liable and answer to a guy named Lou Raneire.

In this case here I think the liability got pushed all the way out to the investor and we got away from the practice of good loan, bad loan. Just "Does it meet the guideline? Does it mean meet the ugly guideline? Oh, 54 percent do, okay." Again, I don't --

CHAIRMAN ANGELIDES: This wasn't the gold standard of underwriting guidelines, correct?

MR. JOHNSON: Our value added really came in compliance with Clayton.

CHAIRMAN ANGELIDES: Whether regulatory compliance?

MR. JOHNSON: Right. Because liability can be a sign to an issue if they did something wrong with regulatory compliance.

CHAIRMAN ANGELIDES: So they paid attention to that?

MR. JOHNSON: 100 percent attention.

CHAIRMAN ANGELIDES: Oh, that's an -- I hadn't planned --

MR. JOHNSON: When liability --

CHAIRMAN ANGELIDES: So you are telling me that the credit standards, they kind of said, "Thank you very much." When it came to regulatory standards compliance, I assume that's consumer regulatory, other standards, because they had liability, they sat up and paid attention?

MR. JOHNSON: Would you disagree? I think we were always -- compliance issues to me, when we found a problem, most of our clients would just not buy those loans.

When there was an underwriting issue, there could be some negotiation between the buyer and the seller.

CHAIRMAN ANGELIDES: All right. Well, thank you.

Did you want to comment on that, Ms. Beal?

MS. BEAL: No, I agree. And I think that over time that is an area where the sellers improved as they were originating loans was in regulatory compliance. So I think that's, in my opinion, why some kind of regulatory guidelines around credit standards may make the market react that same way to credit underwriting.

CHAIRMAN ANGELIDES: Thank you.

Mr. Vice Chairman.

VICE CHAIRMAN THOMAS: Thank you, Mr. Chairman.

Mr. Johnson, in your testimony on page 2 where -- the first major paragraph where you think there isn't a monocausal aspect of this. I think based upon everything that we have looked over time: (1) That tends to be the answer for almost everything. As someone once said, there are people who have very straight, simple answers for things and they are wrong. It tends to be a multitude of factors.

However, when we were in Bakersfield, I have a friend who ace director of a bank and if you meet him on the street he is kind of a cowboy farmer. Trouble is he has a Harvard MBA in business. And he said, "We brought in these guys who supposedly understood these securities things and I asked them to explain them to me." And when they were done he said, "I didn't understand what they said so get rid of them."

So he didn't engage in those activities because he couldn't understand them. And I have to tell you that based upon the testimony presented as to what the Clayton folk do, I am clear on what you don't do, but when I go through the list of what you don't do, I am trying to figure out what I get for my money.

And is it possible to give me a one- or a two-sentence explanation of what I got for my money if I hired you?

MR. JOHNSON: I no longer work there.

VICE CHAIRMAN THOMAS: Well, you mean they've changed the philosophy since you were there, or do you prefer to have the one who's still doing it?

MR. JOHNSON: No, I think there is no longer securitization, so we're --

VICE CHAIRMAN THOMAS: Right. It's dead. But I mean, at some point people were paying you a lot of money for this.

MR. JOHNSON: I would say hindsight -- in the '80s I hired Clayton to tell me if the loan is a good loan or bad loan because I was securitized and I was putting it on my bank's balance sheet.

VICE CHAIRMAN THOMAS: Notwithstanding all the things you don't do, sample percentage, 5 percent, et cetera? I am just curious. I guess people --

MR. JOHNSON: Back in the '80s sample sizes were closer to 50, 100 percent.

VICE CHAIRMAN THOMAS: Oh, well, that's entirely different.

MR. JOHNSON: Right. All I am saying in the 2000 to 2000 period, sample sizes got lower. I think we were used to basically help negotiate the purchase price between a buyer and a seller.

VICE CHAIRMAN THOMAS: So you used, a little bit like the rating agencies where "Just give me the AAA and I am comfortable, don't explain to me what the AAA means." It was a kind of a Good Housekeeping seal of approval aspect to it?

THE DEPONENT: Now, we were never asked to make a pie, we were just simply -- we were third-party contractors saying, "Look at 1,000 loans and give us a grade," and then we were out of it. We didn't know what got into the securities, we really didn't -- we were just simply showing, "Here is our exceptions."

And now in hindsight, if you look at almost a million loans, you know, that 54 percent to me says there is a quality control issue in the factory. And it took until 2007 to be able to produce this report, but that's the breakdown that probably led to my quote in the paper, that I didn't see much value added in our approach.

VICE CHAIRMAN THOMAS: Yeah, okay. It just, again, reinforces my belief there's a niche market for almost anything and so I appreciate that.

Mr. Eggert, you used as a footnote an article that you had in the Connecticut Law Review May 2009 of "The Great Collapse: How Securitization Caused the Subprime Meltdown."

I was always fascinated with Charles Beard's "Economic Interpretation of the Constitution" because I thought at the time that he wrote it in terms of the market analysis it was insightful, it was very clever, and a lot of the stuff I think nowadays we take for granted. But what I couldn't do was get over the hump of not 50 percent, not 60 percent, not 90 percent -- 100 percent of the Constitution was based upon economics, which is, you know, basically the Marxist position.

The monocausal aspect always concerns me. So was this a zippy title to catch attention, "How Securitization Caused the Subprime Meltdown," or would you qualify that and say it really wasn't necessarily securitization, it was the way in which it was used and there were a lot of other factors that led to the meltdown? Because you say it caused it.

MR. EGGERT: Well, in my article -- I understand your title can't say everything that your article wants to say. In my article I do note that there were other causes as well but that the structure --

VICE CHAIRMAN THOMAS: But you wanted them to read it to find that out so you put that out to grab them; is that it?

MR. EGGERT: Well, I put that very early on in the article, but it was -- and also, when you talked about a cause, there are but-for causes which I think securitization was a but-for cause of the -- of the meltdown. I don't think it was the only cause. I think there are other attributes, but I think it clearly was a primary cause.

VICE CHAIRMAN THOMAS: And you focused on private-label securitization?

MR. EGGERT: Right. And there are -- a lot of things that are securitized haven't exhibited the same problems we have seen in the private-label mortgage market. Credit card securitization has been much more stable.

And I want to be clear that what I was focusing on was private-label mortgage securitization in that article.

VICE CHAIRMAN THOMAS: So it's not securitization as a structure or a method to multiply? See, I tend to agree with Mr. Johnson's argument as to securitization not being bad. Securitization has created a lot of positives.

MR. EGGERT: But you can -- my point in the article is you can structure securitization in bad ways and the way that private-mortgage securitization was done was structured poorly and so it was built into the structure of that form of securitization.

And one of the things that I am hoping your report will produce and the regulatory change that we are seeing now will demonstrate is a better way to structure this type of mortgage securitization.

VICE CHAIRMAN THOMAS: I think everybody agrees that almost any other way would have been better. I mean, you could have thrown a dart at a board and taken whatever it said and put it in. So I mean, that's kind of a given.

But you said just a minute ago in response to something that these people who were doing this would find other investors who haven't figured this out yet.

I just have to say through your whole testimony I had this feeling that you really thought that it was causal; that these are really a bunch of people who knew what they were doing and they were motivated by clearly, for want of a better term, sinister behavior.

When we've interviewed a lot of them, the one thing that floored me the most is that the CEOs running a lot of these big operations making millions of dollars a year, didn't know what they were doing. One of them didn't even know there had to be collateral calls against the securities that they had.

Do you really believe these were knowledgeable people who were working in the shadows structuring these documents for the, I guess, the pure sake of making money, or was it a lot of people didn't fully understand what was going on?

MR. EGGERT: When you're talking about the motivations, I mean, clearly, for many of the people in the structure, the primary motivation was to make money. They were in business to make money.

VICE CHAIRMAN THOMAS: Is that bad?

MR. EGGERT: And I am not arguing that that's bad at all.

VICE CHAIRMAN THOMAS: You are not a Marxist, good.

MR. EGGERT: What I am arguing, though, is you have to set up the system so that people's desire to make money is channeled in such a way that the result isn't all these bad loans, all the foreclosures. And so for me it's how do we structure the system to correct the incentive problem?

VICE CHAIRMAN THOMAS: But it isn't necessarily the securitization aspect?

MR. EGGERT: It's the way it was structured.

VICE CHAIRMAN THOMAS: Sure. Anybody can talk about that. We could have done it the old-fashioned way and had the loans go to community banks, then we could have taken the debt of community banks and securitized it. Or we could have run it through a REIT structure, a real estate investment trust structure.

You know, there are a lot of ways to securitize product. It just happened to occur this way because it was fairly efficient and all of those check points along the way didn't do their job. Not only the government -- federal government regulators, state regulators, but people who were paid good money to rate them, people who were paid good money to carry out various activities. I think everybody agrees it just broke down.

So that's good because it would really be hard for me -- some people say, "Gee, well, let's go back to the glad days. Let's go back to the 1950s." The world won't operate that way anymore and you can't take it back to that. But if it's now down to saying if we are going to do things, transparency is critical on anything, knowledge and assistance in making decisions, even requiring people to hang on to some of what it is they are trying to sell.

I always wanted in those westerns when the guy was selling snake oil, someone in the audience would say, "Well, you take a big swig first and then I will think about it," and then just let them put a little bit of what they are selling on their selves or in themselves.

And to try to carry this theme in a slightly different way --

CHAIRMAN ANGELIDES: Yield some more time? What do you want --

VICE CHAIRMAN THOMAS: Yeah, just another minute or two.

CHAIRMAN ANGELIDES: That's fine.

VICE CHAIRMAN THOMAS: Mr. Johnson, when you were --

CHAIRMAN ANGELIDES: We are on Sacramento casual time.

VICE CHAIRMAN THOMAS: Okay. Levy time. I am with you.

We've heard over and over again that really good -- in fact, we just heard it in an earlier panel, that really good intentions -- I mean, the no docs for people that get aggravated to have to filling forms when they got more than enough money to buy and sell the institution they wanted to get a loan out of, was a clever way to not have to put people who were willing to take a loan through the grinder until you saw what happened with them.

And obviously, I think you had some things to say about affordable housing goals and Freddie Mac and Fannie Mae in terms of what very well could have started out as good intentions, and once you start structuring good intentions and you have to hit a mark on good intentions, it really influences behavior. And you had something to say about that.

MR. JOHNSON: I think you may be referring to a specific transaction that I was asked about in my summer testimony.

VICE CHAIRMAN THOMAS: Yeah.

MR. JOHNSON: Let me talk a little bit about that. In 2003, as mortgage rates had declined and the refi market had exploded, it was difficult for the GSEs to meet their affordability goals.

VICE CHAIRMAN THOMAS: Admirable as though they may be.

MR. JOHNSON: Right. And I believe the goal is a simple calculation where's it's just a number of loans, low to moderate, divided by the total number of loans.

VICE CHAIRMAN THOMAS: That was devised by Congress.

MR. JOHNSON: Excuse me?

CHAIRMAN ANGELIDES: That was devised by Congress, so it couldn't be too complicated.

MR. JOHNSON: No, it is a very simple calculation. But the one unique concern that was written into the regulations that small balance multifamily loans would act as a multiplier to that affordability credit.

And when I was a chief operating officer for the commercial segment at Clayton -- I am sorry, at WaMu, many don't realize that we were the largest multifamily lender in the nation, primarily in California. And it's a model that was beautiful back then, I think it's still beautiful today, and it's well run by Chase. Most of our multifamily was small balance, 2 million and below, 35 units, it all qualified under this definition.

So every year when the GSEs had an issue, they would come to WaMu and ask for a transaction. And in 2003 I received a call from Freddie Mac wanting to arrange a deal -- a very large deal, largest we've ever done -- for $6 billion in multifamily. Small balance.

And 6 billion in multifamily is about 4,000 loans. But the 4,000 loans if you think the average is 35 units in each loan, is -- then you multiply that double, you can actually get 280,000 affordability units would be the numerator, and 4,000 would be the denominator.

So when GSE and you're struggling to hit your affordability goals, this was a unique transaction to perhaps get you over the threshold.

VICE CHAIRMAN THOMAS: So it was a quota maker?

MR. JOHNSON: Yes, it was a quota maker.

VICE CHAIRMAN THOMAS: Driven by quota?

MR. JOHNSON: Exactly. And it became very obvious to us at that they were very serious about making that number. We had not done a lot of business with Freddie Mac Freddie Mac was not a strategic partner at that time with WaMu, became later. When they originally asked me to do the transaction for 6 billion, I think I asked for: "We will do it only if Freddie Mac will sell me $10 million of commercial mortgage-backed securities, but sell it to me at a price that WaMu could make a risk-adjusted return of 18 to 20 percent."

They came back with a "We can't do that" because the price would be below where they have it on the books and it would cause a mark-to-market issue and they don't need another accounting issue. "What else" --

VICE CHAIRMAN THOMAS: We find out later.

MR. JOHNSON: "So what else would you take, Mr. Johnson?" And I asked for $100 million in cash. And the swap is nothing more than me giving paper and they, in return, giving paper. There is no change of ownership in terms of the loss. WaMu still received the unilateral right to collapse the security after one year. And as a result, those assets continued to be for -- accounted on our books and records as loans.

Now, I want you to know that we were, at WaMu, skeptical about doing the transaction for $100 million, which is the swap, so we insisted and received confirmation that this transaction was reviewed and approved by their board of directors, their auditors, their lawyers, and disclosed in their financial statements as well as disclosed in ours.

VICE CHAIRMAN THOMAS: So how broadly can I say that that transaction was based almost totally on their need to make quota?

MR. JOHNSON: 100 percent. There was no economic incentive behind it.

VICE CHAIRMAN THOMAS: That's 100 percent, all right. Because we have had some concern about the role of GSEs driving particular aspects of the housing and mortgage market at this time. I appreciate that testimony.

CHAIRMAN ANGELIDES: I would like to ask before we go to Ms. Murrin, just a quick follow-up.

Do you know how that portfolio performed?

MR. JOHNSON: That portfolio is pristine. That multifamily -- small balance multifamily in California was a product that I wish I could take credit for as the commercial CFO. It started with Amonston and Great Western and performed better than single family over a 45-year record.

And again, it's located in areas of high barriers of entry, so -- for housing, so people continue to rent in those and it has performed incredibly well. I believe the security was collapsed and is now part of ownership by Chase.

CHAIRMAN ANGELIDES: Again, one last thing just for clarification. I want to return to something

Ms. Beal said.

So Deutsche Bank rejected more loans. So my understanding is you really did your -- this is an interesting phenomenon. We're talking about transparency. I think the Vice Chair asked some good questions about what was the transparency up the chain. And we have heard about this notion of asymmetric transparency, that, you know, the person who is making the sale has more information.

Just to be clear, you did the due diligence in this instance so that the issuer who is going to sell it into the marketplace who is buying it from Countrywide or New Century, they could use your information to bargain the price, correct?

MS. BEAL: Correct.

CHAIRMAN ANGELIDES: Okay. And even though they failed loans, that doesn't necessarily mean they were kicked out of securitizations, correct, or you don't have knowledge of that?

MS. BEAL: I don't have knowledge of that.

CHAIRMAN ANGELIDES: Do you have any direct knowledge, Mr. Johnson?

MR. JOHNSON: I've no direct knowledge.

CHAIRMAN ANGELIDES: All right. Thank you.

Ms. Murren.

COMMISSIONER MURREN: Thank you, Mr. Chairman, and thanks to all of you for spending time here with us today. I would like to talk a little bit about corporate culture. And in particular, Mr. Johnson, I think you have a unique vantage point in that regard.

In reading through your biography, it appears that you were at Arthur Anderson for a period of time. Although you did leave there well before the firm collapsed, I would note that the firm collapsed in part because of inaction as a result of some of what its clients' behaviors were.

And from there went on to Texas to United Savings Association which ultimately itself collapsed and was seized by the FDIC in part because of enforcement action brought as it relates to its mortgage portfolio.

And you mentioned earlier that Clayton holdings actually did some work for you while you were there; is that correct?

MR. JOHNSON: No. United Savings collapsed, but I really spent most of my career with Bank United which bought it from the Southwest Plan. And we bought it about 20 billion, I think, from the RTC. We were a very successful institution, went public, and then was sold for, I think, $2 billion to WaMu.

COMMISSIONER MURREN: And would you comment on your underwriting standards when you were both at -- well, I guess all three places?

MR. JOHNSON: Well, at Bank United we looked at doing subprime and we passed. We were only a prime shop. We were a broker shop, too, for a while, just 100 percent broker channel and it did work primarily here in California. I would say some of that probably worked because home prices can hide -- if they increase they can hide a lot of underwriting flaws. But we at Bank United had hardly any credit issues during that period of time from '86 to 2000.

COMMISSIONER MURREN: And could you comment in each of those roles how your compensation was determined? I know at Washington Mutual that much of your compensation was based on firm performance and aggregate, but can you break down the elements of firm performance for me, please?

MR. JOHNSON: For my compensation personally?

COMMISSIONER MURREN: Yes, or executives broadly. It's up to you.

MR. JOHNSON: My compensation was based primarily on the overall company Washington Mutual, or Bank United at the time. I was not paid any incentives on volume or, you know, yield spread premiums like, you know, loan officers or brokers were.

COMMISSIONER MURREN: Understood. But were those targets based in part on expectations that the company would grow, or if it stayed static would you --

MR. JOHNSON: It was mostly based on return on equity and profit, not asset size per se or volume, my personal targets weren't. That may be an incentive that was done, pushed down to the loan originators in the divisions that they had to grow, you know, say, Los Angeles market from 50 million to 75 million. So that would have been one of their metrics, not personally one of mine.

COMMISSIONER MURREN: But profit would be a dollar figure or a growth in profit?

MR. JOHNSON: Both. Probably mostly a dollar figure, a target to hit for my division, my segment, and then usually for the overall company. So my compensation would have been half in cash, salary, bonus, and half probably in equity.

COMMISSIONER MURREN: And the profit figure would have been same level as the prior year?

MR. JOHNSON: Usually above the level have the prior year.

COMMISSIONER MURREN: So effectively it was you were paid in part on growth?

MR. JOHNSON: Absolutely.

COMMISSIONER MURREN: Did you say "absolutely"?

MR. JOHNSON: Yes. I don't recall a year where we -- well, I'll take it back. At WaMu there was probably a year that we said maintaining was probably growth given the market.

COMMISSIONER MURREN: And based on looking at return on equity, would you say that leverage played a role in that at all?

MR. JOHNSON: The entitiesthat I worked at?

COMMISSIONER MURREN: Yes.

MR. JOHNSON: Leverage did play a role in our growth as a bank, yes.

COMMISSIONER MURREN: So commenting now on your experience as a variety of different firms, could you talk a little bit about the accountability of executives who either themselves are part of the process where we end up in a situation where so many bad loans are in the system, either as a participant because you are in the market, or as an observer because you are evaluating the loans themselves.

It sounds as though the reaction that all of you are having -- or both of you -- is that you were paid to do a job and your job was simply to determine whether or not these particular loans fit the criteria of the banks themselves. And I can certainly understand that.

But to what extent -- given the history and your observation of how some of these firms can fail, did you feel any sense of obligation to note that there was apparently a problem, that these loans were being sold to firms who were then turning around and marketing them as perhaps something they weren't or certainly without full disclosure? You are a sophisticated guy.

MR. JOHNSON: I don't -- during the middle of the bubble, I don't think you would come to the realization at that time. You know, we did what we thought was appropriate. We weren't sure exactly what loans went into securitizations.

In 2006, when we saw the declining exceptions and the 54 percent, that number came to us in 2007, we took action. We went to the rating agencies. Not all for the benefit of goodwill, for a profit as well as, you know, building our business.

But I think we took the -- we also went back to our clients with these reports for each one of them and said, "Look, this is what you are doing and this would could be a very viable tool for you to use as you manage your factory going forward. And you could take this tool and perhaps create broker score cards and correspondence score cards, and create score cards on your own loan officers to make you a better manager." That's basically what we were trying to do.

COMMISSIONER MURREN: Did you have those conversations yourselves or yourself?

MR. JOHNSON: We broke up the conversations. I did a few. I did Goldman Sachs, Morgan Stanley, I probably did a few others, but most of them were very receptive on receiving this type of data and saying they want to become a better, you know, issuer, a better securitizer. Unfortunately, when we were able to get this data, the market was sort of crashing.

COMMISSIONER MURREN: I see. Thank you.

CHAIRMAN ANGELIDES: Can I ask just one quick follow-up very quickly?

I have a note that -- I think from you, Ms. Beal, in your interview you said you did take the trending reports at Deutsche Bank, but they didn't really like the product because I think they were concerned that if it got in the hands of the wrong people, it would be misunderstood, so they were concerned about what you were showing them?

MS. BEAL: Yes. We took the reports to

Deutsche Bank and their transaction management team that we worked with day-to-day, they were overall very positive, as were most of our -- all of our clients that we spoke with. They liked that we had the capability to start developing reports to use the data to show them trends. They were giving feedback on how to make the reports more meaningful.

In the instance of Deutsche Bank, one of their senior managers joined the meeting and he took a look at it. And understanding the process that Deutsche Bank used where they had a -- grade more loans as a material exception based on their client tolerances, and then took away that discretion from Clayton to grade loans 2s with compensating factors so that they wanted to look at the loans.

So there again we were generating more Level 3 loans. They showed more loans graded than the 2-W and the 2-T. And he was concerned that the reports could be misunderstood, which we agree with that concern because that was our beta version. We understood we needed to standardized the reports, so that --

CHAIRMAN ANGELIDES: Of course information is information. If it's properly presented, people can make determinations.

MS. BEAL: Yes.

CHAIRMAN ANGELIDES: All right. Mr. Georgiou.

COMMISSIONER GEORGIOU: Professor Eggert, I would like to start with you, if I could. There is a central question that we have been looking at on this Commission for some time which concerns the issue of securitization.

I think we can all stipulate that the notion of securitization, qua securitization by itself is somewhat neutral. That is, it was intended to and enables the raising of capital from a disbursed way from investors all over the world and disperses risk all over the world and enables the spreading of risk and the spreading of certain loans or other obligations far and wide.

The question, I guess, we are troubled about is whether in this particular run-up of securitization and the utilization of it in connection with the mortgage securitization market, the extent to which that was based on incentives that enabled the creation of a super structure of securitizations that created part of the risk and was one of the causes of the financial crisis.

And I guess I would like you -- if I could, I would like to give you an opportunity to tell us why as I read your testimony you believe that it did. And I would also like you, if you could, to identify who it is that you think believes the opposite.

That is, that who it is that we could inquire from that would tell us that in their view a securitization wasn't a significant factor in the run-up to the crisis.

MR. EGGERT: Well, I think it would be hard to find somebody who says that it was uninvolved; however, there has been a debate between what is more important in the boom and bust and whether it's securitization or housing prices.

There is an argument out there that what we saw was a boom in mortgages caused by housing prices, and then when housing prices started dropping, that that's what led to the mortgage bust, more than securitization. I don't know that there is anyone who would say securitization was uninvolved, but there is the argument out there that says it wasn't securitization so much as a housing price issue.

I don't happen to agree with that. I think it was more caused by securitization and that to some extent even the housing price bubble was a product of securitization. That it wasn't -- that wasn't all that was there, but that if you look at the markets that were the most bubble markets, they were ones where securitization was widely used.

As far as the structure of securitization, while I agree that different forms of securitization can be structured differently and that not all forms exhibit the grave problems that we have seen, there are some aspects of securitization that are kind of universal that are kind of hard-coded into the whole process that it's hard to figure out how to work around.

For example, the whole element of securitization is that you take something of value and you put it in a pool of securities and then you sell securities to investors who weren't present at the creation of whatever it was.

By doing that, you have almost inevitable information loss. The person who makes the initial loan will know more than the investor who buys the security about that loan, even if they -- just because they have met the borrower.

So when you are designing the new structure, what you have to do is try to figure out how to minimize that information loss, but I don't think you can eliminate it. So I think by and large what we have to do is recognize the structural flaws in securitization and try to create a structure that minimizes those flaws, recognizing that we can't completely eliminate them.

COMMISSIONER GEORGIOU: But one thing you say in your testimony is that it's too facile to just characterize the lack of skin in the game and the lack of transparency as being the only difficulties presented by the securitization of mortgages that led to the problems, but that there were other aspects of it that led to the diminution in underwriting standards and to the creation of bad loans. And I wish you could speak to that.

MR. EGGERT: I think that's very important because if you look at people who are trying to fix it, to a great extent they're focusing on those two aspects. And I don't want to say those aren't important aspects. I think they are. But as we have seen, you -- there are other issues as well that are, I think, very important and have to be addressed as well.

So for example, one of the things that securitization did in the private mortgage label market was it caused pushing to the risk of in every level of the system. And for example, if you take a -- if you're rating corporate securities -- I am not a securities guy so I am coming to this from the mortgage market, but my understanding is if you are rating corporate securities, you will have securities you will create sort of bands of risk and so some will be AAA some will be A. And within those bands, the securities can kind of exist all throughout that band. Some AA will be almost AAA, some will be at the bottom, but there will be a range.

When you are securitizing mortgages, though, the people who are arranging them could make the security, the resulting securities at the bottom of whatever range they were. If you have a pool of -- you know, access to a lunch of loans, the question for the Wall Street firm was: "What is the worst pool of loans that we can assemble to get the ratings that we want? And what is the lowest number of credit enhancements we can add to get that level?"

And the effective securitization is that you will have -- when you are making investment grade loans, you'll make -- you know, the weakest level of investment grade loans is that the credit rating agencies will bless. That's part of the securitization process. And I don't see anyone trying to address that issue.

COMMISSIONER GEORGIOU: And that feeds a little into what I think Ms. Beal and Mr. Johnson said, which is that your analysis at Clayton was utilized frequently by the securitizers to bargain down the price of the pool of loans that they were purchasing from the originators, but that didn't necessarily translate into that information being utilized to structure the ultimate pool of loans that was put into the securities up the line.

Of course, you didn't really know what they did with that; is that correct, Ms. Beal?

MS. BEAL: That's correct. We didn't know what they did with the data we gave them and the results.

COMMISSIONER GEORGIOU: Back to Dr. Eggert, if I could.

This is an important point for us and I am trying to get to what -- what utilization was made of the originally distributed model that structurally impaired the process and led to a greater degree of risk. And I don't know that I have your views on that very fully.

MR. EGGERT: Okay. Well first of all, I'm not a -- I don't have a doctorate, so if you could call me "professor."

COMMISSIONER GEORGIOU: All right. Got you. Very well.

MR. EGGERT: People with a doctorate frown on those of us without.

But as far as I would like to note, it's interesting, the testimony about the use of these due diligence reports and how securitization changed the use. Back when people were buying to hold, due diligence was something that they did so they wouldn't buy bad loans.

Under securitization, due diligence was something that they did so they could get a better price on pools of loans. It wasn't a way to --

COMMISSIONER GEORGIOU: By better price on a pool of loans by identifying some of the poor loans they'd have to pay less for.

MR. EGGERT: Right. By telling the originators, "I'll still buy it, but I won't pay as much because of the due diligence problems." It's a very different result than "I won't buy the bad loans."

COMMISSIONER GEORGIOU: Right. But doesn't that go, to some extent, to the skin-in-the-game notion; that is, if you are either originating loans or purchasing loans that you actually wish to see paid back, you wouldn't do it if you were holding them.

If you could pass them along at 100 percent at full par, you would do so if you could sell them for that. But if you actually had to hold them, then you could run the risk that has already been disclosed to you by the due diligence information that they could fail. So that wouldn't make economic sense if you actually had a hold -- a long hold position with regard to some significant portion of those loans with those securities, correct?

MR. EGGERT: I think that --

CHAIRMAN ANGELIDES: Do you want another minute?

COMMISSIONER GEORGIOU: Yes.

MR. EGGERT: I think that's correct. And I think you see that both in the origination and also in the securitization. Originators have their own issues with, say, housing appraisals. It used to be when originators held loans, they wanted an accurate appraisal because it protected them against risk of default.

Once there's securitizing, housing appraisals are just a hurdle you have to jump over so you can securitize it. So their interest was, instead of having an accurate housing appraisal, was having an inflated one because it made it easier to securitize loans.

If they are forced to retain risk, then they would have a greater interest in doing real underwriting, having accurate housing appraisals. And so I think that's a central of element of the fix that needs to be made.

COMMISSIONER GEORGIOU: Mr. Johnson, you raised your hand to make a comment.

MR. JOHNSON: I just want to clarify that I don't know of any Wall Street issuer in my history that ever wanted to find loans with exceptions to go back and negotiate a lower price to profit on their securitization.

In fact, as earlier -- like, in 2000 to 2005 probably the seller had more power than the Wall Street issuer because the seller -- if you weren't going to buy at Wall Street firm A at par or 101, I got another one down the street who will pay 101 and take the loans with you.

I do think that what happened is exceptions got higher, Wall Street got smarter, and then priced those loans cheaper. I don't believe that was the model. I just want to go on record. No one ever came to us and said, "Hey, we're funding a bunch of bad loans."

COMMISSIONER GEORGIOU: No, I am not suggesting that but they would utilize your information in part to price the loans they purchased?

MR. JOHNSON: Sure.

COMMISSIONER GEORGIOU: Right. Okay. Thank you very much.

CHAIRMAN ANGELIDES: Mr. Thompson.

COMMISSIONER THOMPSON: Mr. Eggert, I am not a doctor, either, so we can smile at one another.

You are not suggesting that securitization is bad; you are suggesting that the process by which it was executed during this bubble period was perverse; is that fair or not?

MR. EGGERT: I am not suggesting -- securitization, like --

COMMISSIONER THOMPSON: I want to get at what you think the real issue is. Is it the process that's broken or is it a product that shouldn't exist? What are you telling us?

MR. EGGERT: Securitization has flaws and it has good points. And what we have to do to re-start securitization is to minimize and fix the flaws as much as possible, recognizing that they will still exist. But as it existed from 2006, 2007, the flaws were much greater than the value. We have to work on the flaws to try to turn that around.

I think it's important to recognize that lending -- mortgage lending people have sort of villainized subprime lending. There is a usefulness to lending to people who are not prime borrowers. Even people who are prime borrowers, if they can afford a house, should be able to buy that.

So we have to figure out how to make good loans to non-prime borrowers, not the kind of loans that were made and that have exploded. So that's the challenge is how to set up the system in order to encourage better lending to non-prime borrowers.

COMMISSIONER THOMPSON: So you make the point that it would be good if people had current information about the status of the loans that were in those portfolios. So how practical, really, is that?

MR. EGGERT: If you look at the -- well, first of all, that information exists. I mean, people are keeping track of the status of loans all the time. The question is how practical it is to disclose.

And there we are having an interesting conversation between the association of mortgage investors -- whatever they are called -- and the Wall Street firms talking about how current the information should be, what information should be provided, and I think that's an important discussion. But it's clear that we can have better disclosure than we had.

I think everybody -- I think even Wall Street agrees that it can be done better and will be. But the question is how we balance the cost of, you know, making sure everything is completely up-to-date and versus giving investors the information that they need. And that's a decision that is going on right now and is an important one.

The other thing we had to include in that discussion is making sure that we don't disclose so much information that borrower's privacy is violated. That's another factor that has to be balanced in the equation.

COMMISSIONER THOMPSON: Mr. Johnson, you talked about the incredible transaction that happened with Freddie. Was that typical or not?

MR. JOHNSON: We had done several other ones in earlier years but much smaller.

COMMISSIONER THOMPSON: So atypical.

MR. JOHNSON: Atypical. We did a similar transaction with Fannie Mae the same year for the same amount, 6 billion and charged them nothing.

COMMISSIONER THOMPSON: Charged them nothing?

MR. JOHNSON: Charged them nothing.

COMMISSIONER THOMPSON: The logic for that?

MR. JOHNSON: They were a strategic partner we agreed to work better on multifamily transactions. Washington Mutual wanted to buy and own adjustable rate multifamily and Washington Mutual could not originate fixed rate and hold them on our books, so we wanted to sell that to Fannie Mae. So that was the pre quo quo.

Also, I would say the executives at Fannie Mae were not ones that you could negotiate 100 million. The executives at Freddy Mac at that time were in chaos and it was --

COMMISSIONER THOMPSON: Management matters.

MR. JOHNSON: Management matters and Dan Lundgren (sic) never have thought of paying us that type of money.

COMMISSIONER THOMPSON: So that transaction with Freddie was atypical?

MR. JOHNSON: Yes. And that's why we asked for it to be disclosed, be reported to their board to make sure their legal counsel signed off. We wanted that done because it just didn't make economic sense to us.

COMMISSIONER THOMAS: But in the end, it worked out for everybody -- you, Freddie, and those who were a part of the process at the borrowing end?

MR. JOHNSON: It had no impact on our borrower. It was just a swap of paper. Swap of paper. There's nothing economically changed, the list stayed with us, the yield stayed with us. It was, "You get the affordability credits and we get 100 million."

COMMISSIONER THOMPSON: I wish I could have been a part of that transaction.

MR. JOHNSON: It had no impact on my bonus.

COMMISSIONER THOMPSON: So can you distinguish -- you talk about private-label securities that's non-GSE ; is that right?

MR. EGGERT: Yes.

COMMISSIONER THOMPSON: So will you spend any time with us here this afternoon on your observations about the GSEs in this whole process?

MR. EGGERT: Well, I think -- I think the GSEs played a role in the process in two regards: (1) is the way that they securitized prime loans; and the other is the way that they invested in subprime loans.

There are some who argue that Fannie and Freddie were a primary cause of the subprime meltdown and I don't agree with that. I think my concern about them is they didn't do enough to prevent the problem rather than they caused the problem.

COMMISSIONER THOMPSON: So what evidence do you have that would suggested they didn't cause the problem?

MR. EGGERT: Well, part of it is their subprime presence was decreasing. During the period that --

COMMISSIONER THOMPSON: So they were losing shares?

MR. EGGERT: They were losing market shares during the time when the problems were mounting. If they were the cause, them losing shares should have meant that the problem was abated, but instead it was growing dramatically as they lost shares. When they were more active in the subprime market in, say, 2004. Things were better than they were in 2006 when you were less active.

So I think if you track Fannie's participation, it's hard for me to say they were the cause. But again, I think it's unfortunate that they didn't do something which they could have done if they had stayed more active, which is be the cop on the beat that says these subprime securities stink and this system has to be reformed. And they should have been shouting that and demanding change, but I didn't hear that in 2006.

COMMISSIONER THOMPSON: Thank you very much.

CHAIRMAN ANGELIDES: All right. We -- just one wrap-up question because we have to move on and I just have a question which is I am looking at a standard disclosure and it says, "On a case-by-case basis, the originator" -- you know, put in the company's name -- "may determine that based on compensating factors, a prospective mortgagor not strictly qualified under the underwriting guidelines warrants an underwriting exception."

It goes on to say, some, a substantial a significant number of mortgage loans included in the loan pool represent such exceptions. Weren't investors entitled to know the basic due diligence information. I mean, the issuers had it. Weren't they entitled to know? Was there -- wasn't that something that should have been in the marketplace?

MR. JOHNSON: That has been our argumentative for 2006 and 2007 is that we thought it should. The only time I found one is -- I think I saw a European securitization which did disclose due diligence was done and they'd laid out the exceptions to LTV, et cetera.

So I believe the market is going toward that now, and that is the boilerplate we looked at and said, you know, exceptions could be material. Well, is material 4 percent or is material, you know, 60 percent?

CHAIRMAN ANGELIDES: If I know that 10 percent had been sampled and X percent failed, I would at least think that was a big enough sample to give me a magnitude of challenge.

MR. JOHNSON: In my opinion as a businessman, not wearing the Clayton hat or the Long Beach hat or anything, I think the exceptions were an indicator. I was very proud of this report that we did come up with. And that, to me, this is one of the areas is that if we worked with better we could have helped present value the pain and stopped the factory from producing.

CHAIRMAN ANGELIDES: Well, thank you very, very much. As I said, one of the big questions I always get in this community is: "How did it come -- go from here to there?" You've at least given us something to think about for people to hear and understand about how these simple mortgages that people used to buy or refinance their homes, migrated on their way to Wall Street and around the world. Thank you very much.

We are going to take literally -- everyone in the audience, we're going to take a 2-minute break while this next panel is assembled. We're going to catch up some time. Two minutes.

…

CHAIRMAN ANGELIDES: Welcome back to the final session of today's hearing of the Financial Crisis Inquiry Commission. This final panel is on the Impact to the Financial Crisis on Sacramento Neighborhoods and Families. And I might add, given the people at table of Sacramento, families, neighborhoods, and businesses. I want to thank you all for taking the time to be here.

And I would like to start this off by doing what we customarily do for all our witnesses as we have done in all 19 days of hearings across this country and ask that you all stand and raise your right hand so you can be sworn in.

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

(All sworn.)

CHAIRMAN ANGELIDES: Thank you very much.

I think that's the last time I am going to say this as Commission Chairman, unless I say it in our Commission meetings.

Let's do this: I think for this panel -- I think we are going to start and we are going to go from my left to right. So Ms. Canada -- Canada, correct?

MS. CANADA: That's right, yes.

CHAIRMAN ANGELIDES: We are going to start with you and go across and end up with Mr. Wirz. So if you would begin your testimony, it would be terrific. As I've indicated earlier, there is a light here. It turns to yellow -- you have five minutes up to five minutes to provide your oral testimony. At one minute to go, the yellow light will come in. When your time is expired, the red light will go on. So if you will please commence.

MS. CANADA: Thank you. My name is Pam Canada. I'm the CEO of NeighborWorks Sacramento. NeighborWorks is a premier member of the NeighborWorks network for non-profit organizations chartered by NeighborWorks America. And we carry out a mission to provide stable, sustainable home ownership through a comprehensive process that includes pre-purchase home buyer education, responsible lending, and post purchase counseling.

In 2006, we started to feel a bit of an up-tick in the number of people coming in for foreclosure prevention information and counseling. Almost not a measurable number, it was significant in that it was measurable and previous to this we had helped maybe half a dozen people a year that would come in with severe credit issues that were in need of some kind of assistance.

Beginning then in first quarter of 2007, the foreclosure crisis for us had begun to show its full force. With hundreds of existing homeowners seeking help and advice, it would give them an understanding of the situation they were in and what they could do to preserve their home ownership.

NeighborWorks Sacramento joined with various other private non-profits, public sector agencies, and officials to begin offering informational workshops around the region. The workshops drew thousands of people everywhere we went.

To further begin to build our response to this growing number of client requests, we reorganized our work flows, added capacity, hired and trained more housing counselors, and built some internal efficiencies.

People came into our office beginning in '07 and through '08 and '09, and particularly with boxes, armloads of papers, personal financial records, anything they felt that would help them tell their story and help us figure out a solution for them. They were begging for an appointment immediately so NeighborWorks could help them save their family home.

It was a daily tragedy in process and taking place right in our own community, in our own neighborhoods, and playing out in our office lobby every single day.

It was, and is to this day, an overwhelming experience that cannot be adequately expressed in words. These people who were coming for help were from all walks of life, across all socioeconomic and demographic levels with their own stories of confusion and fear.

Typical stories we would hear every day were about the single mom with three boys who lost her job, was desperate to stay in the home where her boys knew the neighborhood and knew their way to school, and how could she stay in this home in this safe neighborhood now?

The elderly couple that had refinanced a couple of years ago using a cash-out refi to pay the extraordinary costs of care for their daughter who had a health-related emergency and now their loan payment was adjusting, would almost double. They had a fixed income, no savings, and limited retirement. What should they do now?

The man who had gotten an inheritance when his father passed away, used that as a large down payment on a modest home with a reasonable loan product but his small business was suffering and so he put money into his small business and wasn't able now to make his loan payments that had just adjusted. The bank was foreclosing. He would lose his home and his greatest concern was the dishonor on his father for losing the inheritance money his father had worked so hard to build.

The majority of people who came in for mortgage problems had not previously had credit problems. They paid their debts on time and were willing but no longer capable of making that house payment. At every client appointment for housing counselor, we were routinely asked for basic information about foreclosure process.

And some people actually expected, when they got a late notice from their lender that -- this was the first time they had ever gotten a letter to that extent with that severity -- they thought the sheriff was going to come and throw them on the streets the very next day and they were humiliated and scared.

We needed to dramatically increase our internal capacity. We added a foreclosure workshop every week. And we had people come into the foreclosure workshop that would tell them in 90 minutes what the basic -- what their letters meant, what's the basic process of foreclosure, what are the timelines, what are the legal steps to follow, and what should they expect next, because people just had no idea what to do or how to respond.

From that, we offered that weekly seminar in Spanish, Russian, and English. We had an average of 30 people every week for 50 weeks a year come to that class for three years. Following the class they would have an individual counseling time with our trained counselors.

In addition to the scores of homeowners with mortgage payment issues, we began having a significant number of people who believed they had been victims of mortgage fraud or some form of misrepresentation, and some were weighing the decision of filing bankruptcy or walking away from their home or other similar decisions. So we forged an innovative arrangement with the University Pacific McGeorge School of Law that allowed us to bring in legal expertise to advise people of what the consequences would be for that.

In 2010 now, we have hundreds of open cases. Loan modifications are taking nine months to a year, minimal to no response from lenders and servicers on these issues, trial modifications extending beyond -- well beyond the 90-day time frame that they were intended to. And even then, some of the trial modifications are being denied and loan modifications are nonexistent.

People more and more with home values drawing down are looking at what is called "strategic default" or walking away, and that's become now a very common and almost accepted conversation with our counselors as a solution that people are taking.

CHAIRMAN ANGELIDES: Can you please wrap up? If you want to just make a closing comment.

MS. CANADA: I think the closing comment is not only the families, it's the neighborhoods. NeighborWorks, as many non-profits across the nation, do a lot of community development and community engagement work in the neighborhoods. And block after block of empty houses has deteriorated a lot of the work and investment that we and many others have made. And it's disheartening, to say the least.

CHAIRMAN ANGELIDES: Thank you very much.

Ms. Tawatao. Did I pronounce that correctly?

MS. TAWATAO: Yes.

CHAIRMAN ANGELIDES: Could you also pull the microphone towards you. Thank you. Thank you very much.

MS. TAWATAO: Thank you, Mr. Chairman, Vice Chairman, and Commissioners. My name is Mona Tawatao. I am regional counsel with Legal Services of Northern California, a legal aid organization based here in Sacramento and also serving 22 additional Northern California counties.

I greatly thank the commission for the opportunity to testify this afternoon. The main message I want to convey is that this crisis has had a devastating impact on this area and on lower and middle income people, our clients, and that there needs to be a systemic fundamental change to fix what has happened and to prevent this from happening again.

I understand that the Commission chose to come to Sacramento and the Stockton area recognizing it as an epicenter of this crisis, so I won't spend time talking about those statistics.

I would only ask that the Commission look carefully at the subprime -- the high rate of subprime and apparently securitized mortgages that have come to people in this area and what impact that has had.

Regarding the impact on our organization's practice and what we are seeing, our foreclosure homeowner caseload literally increased by tenfold from 2005 to now.

So in 2005, we saw 47 cases involving homeowners in foreclosure. This year we have seen almost 500 and it's only September. And that is just homeowners that doesn't count the hundreds and hundreds of tenants we are seeing in foreclosure.

And that isn't the entire story even still because what the housing bust has meant was loss of jobs, including -- especially construction jobs which, in turn, has meant loss of revenue for state and local governments. And thus, there are fewer essential services at a time when they are needed the most.

We help people with unemployment claims. We help people fight county cuts so they can get life-or-death medical care. So what I am saying is people are hurting like never before. Our waiting rooms and waiting lists are always -- always have more people than we can assist and it is, as Ms. Canada said, difficult to describe what it's like to see a good case and say, "I am sorry, we can't help you."

Now, for those that we can assist on the foreclosure side, we see lots of kinds of cases but primarily three. Of course, predatory lending and subprime lending, people who got steered or defrauded into entering option ARMS with teaser rates or pick-a-pay loans forcing them to pay into -- pay loans that they could never pay off.

Prevalent among these clients are seniors, people of color, people with disabilities, and limited English speakers and seniors who are African-American and Latino. Second type of thing, mortgage-rescue scams are the double whammy.

So you have gotten tricked, defrauded into entering into a bad loan, you are trying to keep up with the payments and be a good person, and someone comes along and says, "I will help you fix everything. I will take care of the dealing with the servicer and lender, stop making your payments but pay me some money."

And often our clients -- we have seen clients pay their very last dollar with the hope that their home could be saved only to have that money taken and find themselves in foreclosure and then facing eviction.

I hope Lovey Hollis, who I mention in my written submission who is 79 will be here later this afternoon to tell you her story because this happened to her.

Then there is HAMP and those cases with loan modifications, which I know Ms. Canada also talked about, rife with problems. Counselors and advocates spending 30 minutes just getting a servicer to actually believe them that they are authorized to talk to them. So 30 minutes later, you know, you finally get to the problem.

Paperwork needing to be submitted over and over again, people getting approved -- worst of all, people getting approved for a tempering modification, making all the payments, hearing nothing from the service rep except "Keep sending us your checks. Keep sending your money," and then being foreclosed on and now facing eviction.

Our clients Nia Lavulo and Bernard Mose are here today, and I ask that they be given some time to testify.

So what to do as a lawyer and advocate, you might expect my response would be "We need more resources." And that certainly is true, but I am going to say that, you know, honestly, throwing more lawyers at this is not -- it is a piece of the puzzle because my clients have been helped by my colleagues and good tremendous members in the private bar who have helped them -- literally helped some of them save their homes, but there really needs to be a real change that takes consumers and people like our clients into account. More than lip service, more than programs that don't work.

So in closing, I would say the paradigm needs to be shifted to take into these sorts of problems and the effect that all these complex phenomenon that we have been hearing about today, the effect they have often real people and that's really where it matters.

I would just ask that -- there are three witnesses, clients who are scheduled to be here, and I would ask that they be given some time after we are done.

CHAIRMAN ANGELIDES: After this session I will cede my time -- the balance of my time so we can get very brief statements from the folks who can tell us very directly what they face.

MS. TAWATAO: Thank you very much, Mr. Chairman.

CHAIRMAN ANGELIDES: Mr. Wagstaff.

MR. WAGSTAFF: Chairman Angelides, Vice Chair Thomas, and members of the Commission. I am Bruce Wagstaff, administrator of Sacramento County's Countywide Services Agency.

I would like to welcome you to Sacramento and thank you for your work to examine the cause of our country's financial crisis and for conducting this hearing today to explore the impact on our community.

My agency includes our county's programs to provide financial assistance, indigent health care, mental health and homeless services, food assistance, child family welfare, and a number of other services to those who are most in need.

There is no question that the financial crisis has had impact statewide as well as locally on individuals and families with children, many of whom are already living on the edge.

Statewide and locally, caseloads and human services programs have surged since the onset of the recession in 2007. One in every three Sacramento County residents is now served in some fashion by our Department of Human Assistance.

Since January of 2008, our economic decline and high unemployment rate have resulted in a significant increase in our version of a national TANF program which in California is called "calWORKs."

This occurred following a period of significant caseload decline after the implementation of welfare reform in the late '90s. The number of individuals receiving calWORKs in January 2008 was about 77,000. The number is now nearly 90,000, a 17 percent increase. And I have to say this includes over 65,000 children age 18 and under.

The number of people receiving food stamps has climbed from over 129,000 to about 188,000, a substantial increase of over 40 percent.

The number of MediCal recipients has risen from 127,000 to 145,000, a 15 percent increase. And our general assistance program, which is targeted for single adults who do not qualify for other programs, has suffered an increase of about 20 percent.

The increase in applications and caseload has been both rapid and dramatic and shows no signs of slowing. We see those needing our services lining up at our doors hours before our office is open, and demands on our workers being at an all-time high.

Our community providers have also seen increased demands for emergency food, clothing, parenting supplies, and other essentials.

For example, the Sacramento Food Bank assists about 1,000 clients each day reporting a 30 percent increase since 2007. It's been clear that not only are higher demands for services occurring, but that the characteristics of the person seeking our help are changing dramatically.

We have seen a significant increase in seeking aid for the first time, those who have recent work history but have lost their jobs, and those who for the first time are at risk or who have become homeless.

The increased level of stress and tension is felt every day. Those who initially are found to be ineligible for aid because of available assets, for example, are frequently returning a few months later when those assets have been used up and are then approved for assistance.

Shane and Jennifer Taylor who have three children are an example of this new face of public assistance. When Jennifer, the primary breadwinner, was laid off from her banking job of 15 years in June of 2009, the family was faced with becoming homeless. They never expected to have to apply for calWORKs, cash assistance, food assistance and MediCal.

Jennifer found temporary employment working for the U.S. Census, but that ended in June of 2010. She now participates in Community Work Experience to fulfill her family's Welfare-to-Work requirement, a condition of receiving calWORKs. She is hopeful to find a job that pays enough to support her family without the help from public assistance.

A critical aspect of our situation in Sacramento and the situation throughout the state is that these increased demands for services are occurring at a time that resources available to provide those services are being dramatically reduced. This is the result of reductions in state and federal funding as well as local revenues due to declining properties and sales tax.

In Sacramento County, more than 3,000 positions have been eliminated countywide over the last three years. That's why we refer to our current situation as "The Perfect Storm."

I should note that we have effectively utilized available federal stimulus funding to help address our situation. This includes TANF emergency contingency fund, of which we have used 2.7 million as of June 30th and anticipate expenditures to go to 3.3 million by October 1st.

Using this funding, we have placed 450 adults and 392 youths in subsidized employment positions in our community. Of the adults placed, 216 have resulted in permanent employment so far. Unfortunately, this funding expires at the end of this month, unless there is some last-minute action to extend it.

Sacramento's Homeless Prevention and Rapid

Rehousing Program has aligned a total of 9 million in one-time funding through September of 2011 to find housing or prevent homelessness for a targeted number of 1,800 families and individuals. To date, over 1,320 households have received assistance to leave homelessness or to stabilize their housing situation.

CHAIRMAN ANGELIDES: If you could wrap up, Mr. Wagstaff.

MR. WAGSTAFF: I will do that. I will wrap up.

Our experience dramatically shows that the situation the country has been dealing with is not just a financial crisis affecting financial institutions; it's absolutely a human crisis as well. And while some economic organizations have indicated that the recession has ended, I can tell you that it has not ended for the hundreds of families and individuals that we see every day who continue to need our help.

So your Commission certainly has a huge challenge in looking for the causes of our current situation. I want to thank you again for taking on this important task. My hope is that you are successful and are able to provide key information that could prevent future collapses and save future generations from facing the struggles that so many are facing today. Thank you.

CHAIRMAN ANGELIDES: Thank you very much, Mr. Wagstaff.

Mr. Williams.

MR. WILLIAMS: Good afternoon, Mr. Chairman and Commissioners. My name is Clarence Williams. California Capital Financial Development Corporation, a non-profit organization that provides business development and financing programs for small businesses throughout Northern California.

Thank you for allowing me to offer testimony related to the financial crisis that has so unforgivingly devastated many businesses, individuals, and families.

The testimony I offer today relate to the effect this financial crisis has had on Sacramento County families and neighborhoods is through the eyes of California Capital and the stories of our clients. California Capital was founded in 1982 and over the past 22 years I've had the privilege to serve as president. I can say without hesitation that this has been the most difficult challenging two years we have ever experienced.

Historically, Sacramento's small businesses have played a vital role in the strong economy and employment; however, the critical role that small businesses have played in supporting Sacramento's economy has gravely diminished as a result of drastic cuts to small business loans.

A look at the statistics of the biggest banks in the Sacramento region provides evidence that the struggles many of our clients have faced are not isolated incidents, but instead reflect a larger negative trend in the local economic climate.

According to the FFEIC, among the largest banks in Sacramento, including Bank of America, Citibank, U.S. Bank, and Wells Fargo, small business lending has dramatically decreased from 2007 to 2009. The total number of small business loans in Sacramento County decreased from 32,280 in 2007 to 9,790 in 2009, or an almost 70 percent decrease.

The decrease in small business lending has greatly impacted businesses in low-moderate income communities.

For example, Bank of America provided 2,957 loans to small businesses in low-mod income communities in 2007 compared to 161 loans to the same population in 2009; in other words, in 2007, 60.5 percent of Bank of America's small business loans were directed towards businesses in low-mod income communities, while in 2009, only 25.9 percent of the total small business loans were provided in the LMI communities.

California Capital has been guaranteeing for the past -- guaranteeing business loans for the past 27 years serving as an intermediary between banks and borrowers, making it possible for small business owners to secure financing.

Between 2006 and 2009, we guaranteed an average of 230 loans per year creating and retaining over 1,800 jobs. The loans we have guaranteed have ranged in size from $5,000 to $1.7 million for small businesses ranging from 1 to 300 employees.

The types of businesses we finance range from retail, contracting, and professionals -- including doctors, dentists, attorneys -- including many minority- and woman-owned businesses; however, in the past year our ability to infuse wealth into the community has decreased as a result of financial crisis and ensuing budget cuts.

A quick look at our loan-guarantee data paints a bleak picture of the detrimental effects of the financial crisis. In 2007/2008 fiscal year, California Capital guaranteed a total of 250 loans, of which 73 were new loan guarantees, and there were a total of 2 default payments on those guarantees.

In 2008/2009 fiscal year, California Capital guaranteed 217 loans, of which 22 were new loan guarantees, a 13 percent decrease from the previous year.

In 2009/2010 fiscal year, California Capital guaranteed a total of 115 loans, a 47 percent decrease from the previous year and 54 percent decrease from two years earlier. Of these loans, only three were new loan guarantees. In addition, in the 2009/2010 fiscal year, there were 25 default payments on the guarantees a 1,250 percent increase from 2007.

You've asked me to explain how small businesses in Sacramento have been affected by the financial crisis. I can tell you from my experience that the impact has been devastating.

In conclusion, the impact on the Sacramento area has been overwhelming and reaches far beyond the realm of business.

Those on Main Street and throughout the community have been negatively affected in countless ways. You invited me to speak on the impact of financial crisis on Sacramento, and I trust that I have conveyed the severity of the situation.

Thank you for your time and interest in our community.

CHAIRMAN ANGELIDES: Thank you very much, Mr. Williams.

Mr. Wirz.

MR. WIRZ: Thank you, Chairman Angelides, Vice Chairman Thomas, and Commissioners. Thank you for allowing me to present the challenges experienced by SAFE Credit Union, our members, during this financial crisis. As background, I have been CEO at SAFE Credit Union since 1984.

SAFE has more than 1.7 million in assets and about 150,000 members from every level of society. We have 21 branches. We serve 12 counties surrounding Sacramento. SAFE serves 3,000 small businesses and is ranked No. 2 by the SBA in the number of SBA loans in our area.

SAFE has a $1 billion loan portfolio. 33 percent of that is in autos, 46 percent is in mortgages, 11 percent in business loans, 10 percent in credit cards.

I am proud to say SAFE has always been a prudent lender. We never qualified members for long-term mortgage loans using a teaser rate. We never offered pick-a-pay loans. Both practices are contrary to our mission of helping to improve our members' financial well-being.

The financial crisis had a big impact on the

Sacramento region and on SAFE. During the crisis, unemployment increased from 4 1/2 percent in 2006 to 13.1 percent today. At SAFE, we believe future layoffs of public employees will increase unemployment in our area. We are not at the bottom yet.

We have seen home prices decline in Sacramento County by 48 percent since December 2006. SAFE's mortgage loans made at an 80 percent loan-to-value ratio are now under water by $39 million, declining home values have eroded member equity.

The economic crisis and loss of jobs have reduced our members' credit scores, increasing the calls to SAFE. The total dollars in delinquent SAFE loans increased from $6 million in 2006 to $32 million in 2009. SAFE's loan losses increased from $4 million in 2006 to over $33 million in 2009. At the same time, SAFE's loan production decreased by about 20 percent from 2006 to 2009. The financial crisis has resulted in fewer qualified borrowers.

SAFE has done everything possible to help our members get through this crisis. SAFE has modified more than $41 million of member loans. The default rate on these loans is about 16 percent, evidence of our well-thought-out modifications and lower than the national average of about 50 percent.

Modifications allow our members the opportunity to stay in their homes, retain their vehicles, and most important, maintain their peace of mind.

I would like to pass on some lessons that we have learned in this crisis. High-risk lenders who offered loan programs such as pick-a-pay hurt borrowers and gained market share from prudent lenders like SAFE. Risky lending drives out prudent lending. I would encourage more oversight of risky lenders is essential.

Government policies make a difference. State and federal tax -- state and federal tax rules no longer assess income taxes when mortgage debt is forgiven. This policy has increased the number of members who have the ability and the means to repay their loan to strategically walk away from their mortgage loans.

Mortgage loans are now a no-lose wager for consumers. When home prices rise, the borrower profits; when home prices decline, they walk away. This behavior will result in higher-priced mortgage loans in the future.

SAFE actively teaches financial literacy to high school students so that the next generation does not repeat our mistakes. It should be a national policy to teach financial literacy in high school. Financial education may prevent the next crisis.

At SAFE, we identify members of default and proactively contact them. Other lenders require them to be delinquent before they consider a workout, which lowers that member's credit scores. Any new policy should address this issue.

The best time to help is before the problem is out of hand. The best way to prevent a future crisis is with proactive oversight and an informed public. Examination results in all regulatory action by regulators should be made public. Transparency will make regulators better regulators and will make the public part of the solution. Thank you.

CHAIRMAN ANGELIDES: Thank you, Mr. Wirz. I appreciate your testimony.

Thank you to all of you for your testimony. It was excellent, it was illuminating, and for those of us who have been on this journey for a year, these are things we know and feel, but to be reminded in the course of our inquiry is fundamentally important.

I am going to be the clean-up hitter in this last hearing in this last session, so I am going to start this round of questioning with the vice chairman.

Mr. Vice chairman.

VICE CHAIRMAN THOMAS: Are there any media or press in the room? Show of hands.

Oh, all right. I want to make note of the fact this has happened repeatedly. It happened down in Bakersfield, it happened in Las Vegas, in Miami, that what you are hearing are people who bought into the American Dream. They wanted to own their own home.

I am not talking about all the fraudulent activity; I am talking about people who accepted a commitment, they understood the commitment, and they are trying to honor the commitment.

Many of them, because of the economic situation, still want to honor their commitment, and all it takes is a modification of a loan. Modification, if they can't pull that off, at least try to find someone in a short sale, foreclosure, causes all those community problems.

And what we have heard over and over again is people tried to work it out, they talked to machines or people on the phone, they submit papers, they are promised a timeline, it isn't honored, they go back and try to get the papers, they submit them again.

The quickest way to handle this panel is to say: "Do any of you working with those kinds of individuals have any success stories to talk about?" And the answer is virtually none.

Ms. Canada.

MS. CANADA: We are able to get successful loan modifications on approximately one out of every five people that come through.

VICE CHAIRMAN THOMAS: Well, that's not bad.

MS. CANADA: So we consider that the best success we are likely to achieve.

VICE CHAIRMAN THOMAS: That's 20 percent, yeah.

MS. CANADA: It's reasonable.

VICE CHAIRMAN THOMAS: 80 percent --

MS. CANADA: 80 percent aren't, yes.

VICE CHAIRMAN THOMAS: Okay. One in five sounds better than 80 percent failure.

MS. CANADA: That's why we say it that way, yes.

VICE CHAIRMAN THOMAS: Ms. Tawatao.

MS. TAWATAO: Yes, in my survey of the counselors at -- well, the counselors that I talk to, it's about 1 in 10. And in the small program that I spoke to up in our rural area of Lake County, the one that succeeded was because of the local congressman intervened. The other nine people weren't quite as fortunate.

VICE CHAIRMAN THOMAS: Well, I tell you, if that were made public as well, the other nine might have an opportunity for relief because publicity is one of the -- transparency, sunshine is one of the best things you can do because many of these financial institutions are currently running ads in newspapers and on television touting how sympathetic they are and how much they want to help, and yet the reality is they aren't responding in the way that they should.

The only way you can really get some of them -- I'm sorry to say -- is to embarrass them. And so my goal here is to try to embarrass them. Some folks mentioned some names of companies. If anybody wants to mention the companies that seem to be -- for want of a better term -- the most deadbeat companies, I invite you to let us know.

No, you don't want to? You know who they are.

MS. CANADA: It would probably be easier to say, you know, there are one or two that are reasonably responsive. But really, the majority of lenders that we talk to, it's difficult. It's, as you say, fairly non-responsive.

VICE CHAIRMAN THOMAS: Okay. If we aren't willing to name names and point fingers, our chances of getting a response out of those folks is not very high because they have dodged the bullet, the bullet is exposure. And I am looking at the journalist, these people are willing to talk to you and be quoted as others might.

I don't know of any other solution at this point but frank public embarrassment, threatening additional ability to serve the community if they don't respond at this time. I am not asking for charity; I am asking for a reasonable timeline for modifications of loans that can be modified. And you have seen a lot of them and you are just not getting any results. I think that's the best way to spend my time, Mr. Chairman. And I yield back.

CHAIRMAN ANGELIDES: Let me actually follow-up on Mr. Thomas's question. Are there particular lenders who have been responsive, aggressive in the best way? Have there been lenders who have been particularly non-responsive in this region?

MS. TAWATAO: I would like to name names of the ones that have not been responsive. CitiMortgage --

VICE CHAIRMAN THOMAS: That would take more time, but I'm certainly willing to make sure that we cover it.

MS. TAWATAO: Well, the ones that we've seen, CitiMortgage, Aurora Loan Services, Bank of America, Wells Fargo.

VICE CHAIRMAN THOMAS: Should I get the phone book so you can just go down the list?

CHAIRMAN ANGELIDES: Have there been any that have been particularly responsive?

MS. CANADA: It has really been more about the consumer situation as much or more than -- you know, I can't think of a one that I would name that has been particularly responsive. I wish I could. I would like to point them out, but I cannot honestly think of one that has been reliably responsive on a timely basis.

We have gotten some through, obviously, but it has been more on the persistence of the counselor, the persistence and determination of the customer to fulfill every -- you know, cross every "t" and dot every "i" and be there every day and harass, basically, the lender until there is no other way other than to give an answer.

And so I hesitate to say, you know, point out some five-star lender. It has really been the counseling and the customer that have made it positive.

CHAIRMAN ANGELIDES: I see Mr. Wirz. His finger wants to go to that mike.

Mr. Wirz, do you want to comment? This issue is also what your practice is as a local lender.

MR. WIRZ: I would just like to remind the committee it's our testimony that we proactively contact our members. We look for members who have negative equity. We look for members who have distressed credit scores. We call them. We contact them. We say, "We're here to help," and we put the onus on the member. If they want to work with us, we will work with them. I think that makes a critical difference.

I think our experience has been, as I said in my testimony, that when we talk to members who have a second with us and first with someone else, they are being told they need to be delinquent before the financial institution will work with them. We don't believe that's the right time to work with a member. The right time to work with a member is when they are in trouble.

VICE CHAIRMAN THOMAS: Mr. Wirz, now, let's be frank is this because you are a tax-exempt institution and you want to stay that way, or do you think that when people pool their money together and create a co-op loan arrangement, it has a slightly different attitude in terms of those who run the shop and those who receive the help?

MR. WIRZ: I don't think it has anything to do with our tax-exempt status.

VICE CHAIRMAN THOMAS: So you don't need to worry about maintaining it?

MR. WIRZ: No. Mr. Thomas, I think that there are a number of credit unions that would find the grass much greener on the taxation side. If it weren't for the onerous conditions that the regulators put on us in terms of converting, I think you would see more credit unions convert.

VICE CHAIRMAN THOMAS: All right. I will keep that in mind. You may lose the poll, though.

Thank you, Mr. Chairman.

CHAIRMAN ANGELIDES: Again, on your time since you asked the question, what is your record on modifications? How many borrowers do you have? How many come in the door? Where do you sit in that process, Mr. Wirz?

MR. WIRZ: Can you repeat the question, please?

CHAIRMAN ANGELIDES: The question is: In your portfolio of borrowers, how many are in a modification process? Kind of what's the --

MR. WIRZ: Well, if you take the 41 million that we have modified so far, that represents about 4 percent of our portfolio. I think we're modifying the loans as quickly as they come into our view as being distressed.

It -- I think all of the other panelists will tell you it really requires the borrower to be willing to be foursquare with the lender and tell us what their problems are. We won't modify a borrower unless they can afford to continue the payments.

And I can send you the details, but I believe the threshold is we try to get the borrowers so that the mortgage payments is about 30 percent of their income. If we can't get them there, then we feel it's probably not feasible to modify them. Our modifications are designed to keep the member in the home, and if they can't stay in the home, it isn't a feasible transaction.

CHAIRMAN ANGELIDES: All right.

I think Mr. Georgiou.

COMMISSIONER GEORGIOU: Mr. Wirz, you have a different model. You hold all your loans, don't you? I mean, they are on your portfolio?

MR. WIRZ: We try to hold them. There is one criteria. We model our interest rate risk using a stress test of an instantaneous increase in interest rates. And if our interest rate risk exceeds a certain threshold, we will begin selling the mortgage loans.

As you may know in the last year or two because of interest rate risk we have sold more loans than we have in the past, but it is our policy to keep the loan if we can. We believe mortgage loans are a great asset.

COMMISSIONER GEORGIOU: And the interest rate risk, is it since rates are down you are concerned that people will, what, refinance out of them?

MR. WIRZ: We believe that interest rates may rise, which would reduce the cash-flows from our real estate loans and put us in a position of having a liquidity problem.

COMMISSIONER GEORGIOU: I understand. Okay. I guess I want to ask all the panelists, if I can, we have had prior testimony elsewhere, and I think in the written testimony of Professor Eggert, that entities that are servicers -- that are exclusively services -- servicers have a skewed incentive structure that may lead them more likely to recommend and to proceed with foreclosure than a modification in the circumstances where loans have been securitized and these subprime loans are now being serviced, as opposed to what a direct holder of a loan might do.

Can anybody speak to that question or has anybody had any experience with having to deal with servicers rather than the current holder of the actual mortgage?

Ms. Tawatao.

MS. TAWATAO: Yes, we have had to deal with servicers rather than the holder. And, you know, I don't know -- I can only base my response on the conduct of those servicers and what they seem interested in doing and not, and it certainly doesn't seem like they are motivated to work with our clients to make it -- I mean, honestly, it seems like they make it as difficult as possible to have a permanent modification outcome. At least that's what it seems like.

And it really takes -- in our trainings, what we say is, "You just have to really be on top of it with each case where, you know, that we take on to that assistance level and just keep submitting the papers and go after them and after them and go up the food chain in the entity."

And sometimes that works but our experience has been -- there is -- you know, again, I'm just -- I'm basing this on the behavior of the servicer staff that we encounter.

COMMISSIONER GEORGIOU: Mr. Wirz, you had your hand up.

MR. WIRZ: Yes. We at first were against doing principal reductions in our mortgage loans. What we found was when we weren't doing those, the loan typically went to a short sale and we ended up losing money on the loan and the loan ended up in a transaction where the ownership of the property changed.

And we've made a judgment now that it's probably better to work with the borrower, keep the homeowner in the property, take the loss which we would have taken anyway, and retain our member, retain the person in the property. And I think that's a fundamental issue for someone that holds a loan, whereas a servicer might not be inclined to do the same thing.

COMMISSIONER GEORGIOU: Right. That's what we have heard and at a couple of hearings now, that part of the difficulty that people have had in retaining modifications that there's really a financial disincentive for the servicers to -- to engage in the capital in the principal reduction.

Whereas a portfolio holder of the loan might make the judgment that they are better off keeping people in the home at the end of the day, even if they have to take some kind of a modification hit.

Can I ask you, when you do a principal modification, does that ever lead you to re-rate or to downgrade, take losses on other loans in your portfolio that are similarly situated?

MR. WIRZ: Our -- in terms of setting a reserve and calculating the allowance for loans for loan losses, yes.

COMMISSIONER GEORGIOU: Exactly.

MR. WIRZ: Yes, it does.

COMMISSIONER GEORGIOU: You do. So that really has a magnifying consequence, does it not, for your institution when you start doing capital principal reductions?

MR. WIRZ: It really is an inevitable consequence of the financial crisis. I think whether we did the principal reduction or not, it's a reality of what is out there in the marketplace. As I said, we face two choices. We either allow the property to go to a short sale where someone other than the member who is in the property ends up with a benefit of the short sale or we can do a principal reduction and pass that benefit to the member and keep the member in the property. It's an equivalent transaction either way.

COMMISSIONER GEORGIOU: Right.

Ms. Canada, do you have a difference in your -- in the clients that you have been able to serve with respect to dealing with servicers or entities that actually hold the loan?

THE DEPONENT: We have primarily dealt with servicers. Most of the servicers that we have talked to directly, there was one based here in Sacramento for quite some time, Home Ec, that was recently sold and is now -- I think they laid off about 800 people here in Sacramento. And we visited their shop several times and knew their local executives and talked to them quite a bit about what is their rationale, how are they handling these, can we work together on some sort of formula process?

And they were very open with us about the fact that they have contracts and they are essentially a servicer, if you will. They are not the holder. They are not in control. They go by what the contract is with their investors on that particular loan or, you know, group of loans. And most investors, according to them, were not willing or able to even consider principal reduction. It was not in the contract for them to allow.

So they would service the loan and consider modification or any sort of -- any level of modification, not just principal reduction issues. Although I know that's what you are dealing with here in your question. Even interest rate reductions, payment extensions, terms, anything that wasn't already within the contract and allowed by the investor for them to consider was just off the table.

So, you know, it was it was hard to get to. And then the investor, of course, was not -- we wouldn't be able to get any contact with the investor. It was always the servicer.

COMMISSIONER GEORGIOU: For the record, it appears to us from what we have heard from others that this is a continuing problem, and I think we have asked our staff to look into some of the structural difficulties associated with servicers. And that being one of the consequences, I think, of the securitization process --

MS. CANADA: Yes.

COMMISSIONER GEORGIOU: -- that led to the sale of a lot of these loans is a failure to really even have accountability in the late stages of the loans when they are being downgraded, and an ability to act with dispatch to preserve the highest level of recovery for the lender and also the highest level of safety, really, for the borrowers.

Thank you for your courtesy and thank you for joining us today.

CHAIRMAN ANGELIDES: Mr. Thompson -- before I actually go to Mr. Thompson, let me just make an observation. When we were appointed last year, as I said in my opening statement today, many people predicted that the financial crisis would be past tense, a distant memory, the country will have moved on. And as we race towards our report on December 15th, we'll be reminded every time we come out to the field, every time we do our work, we are reminded that the financial crisis is very much still us and will be until the day we issue this report and beyond.

Mr. Thompson.

COMMISSIONER THOMPSON: Thank you, Mr. Chairman. I am reminded by one of our presenters earlier today, Dr. Fleming, where he said that the solution to the housing challenge or crisis is, in fact, in getting people working again. Yet when I hear the statistics from Mr. Williams about small business lending, recognizing that small businesses employ more people than probably this economy in our global economy than almost anything else, I am shattered to think that that recovery and therefore the problem in housing is going to get solved any time soon.

So, Mr. Williams, can you talk a little bit about the downstream consequences of small business lending volume reduction on employment or unemployment and what you think has happened in that regard in the economy directly by the organizations or institutions you serve?

MR. WILLIAMS: I think it's some of the testimony that I presented it was pointed out. Sacramento area is somewhat -- I won't say "unique," but what is unique about the Sacramento area is that we are not a headquartered type of town.

A lot of Sacramento's economy is driven by real estate, driven by development. As the housing industry goes, so goes our economy and this is especially so as we have seen a downturn in terms of government and several years ago the closure of several military bases.

Unless we begin to turn around demand, unless we begin to turn around the business situation, the employment is not going to increase here in the Sacramento area, and housing is critical to it. It is a vicious circle. We talk about it in many press accounts in terms of it being cyclical, of it being self-fulfilling.

I am somewhat optimistic. I am optimistic as recently as last week in the passage of the HR5297 in terms of the small bank financing and some of the components therein, that we may begin to see some small banks begin to increase their lending.

From my testimony you can see the drop off in terms of small business lending has been catastrophic. The jobs have fallen with them. It's the horse or the cart sort of situation.

The banks are saying, "We're not lending because of two things: (1) There is not demand; (2) If we make some of these loans, the regulators are going to classify them. We go to the regulators and they say that's not so.

The businesses -- the banks will also say that they are not lending because the demand is not there. The demand is not there because people are afraid, they are not necessarily comfortable in terms of their employment situation.

So how do we break this vicious cycle I think is the key, and the most optimistic thing I've seen in the last week, as I said, is the likelihood that the HR5297 will be signed by the President as early as next week.

COMMISSIONER THOMPSON: Mr. Wirz.

MR. WIRZ: One of the things that I would suggest is that at SAFE -- we are the No. 2 SBA lender in the area -- we are seeing a lot of demand from the really small businesses, $100,000 and less. In Sacramento, credit unions hold 25 percent of the deposit base.

Congress has put a cap on what we can do in terms of business lending. I think that cap ought to be removed. We could add a lot of business lending to small businesses in areas where banks aren't particularly active in the $100,000-and-less category.

And I would urge the Commissioners to look into that as one thing that they could recommend.

COMMISSIONER THOMPSON: Unfortunately, our statute doesn't ask us to make recommendations, just to point to where the problems are. But your point is well made.

MR. WAGSTAFF: I was going to just beef up the -- my colleagues here because I see the effects of the folks -- when small businesses fail and when our caseworkers speak to the folks coming through our door, it has been a major contributing factor to those increased caseloads that I mentioned.

So I was going to urge the Commission to look for whatever it could do to make recommendations, although you just mentioned you don't make recommendations.

But in any event, whatever can be done to strengthen small businesses in this area is a key to turning things around here, I think.

COMMISSIONER THOMPSON: When we were in Las Vegas, there was a great deal of discussion about the need to diversify their economy away from construction or home building and, quite frankly, the hotel industry.

Is there any discussion going on within the community leadership here in Sacramento about the need to diversify the workforce or the economy here in Sacramento?

MR. WILLIAMS: I think one of the most optimistic things going on in Sacramento, is Sacramento is fast becoming a very green and energy efficient hub. We see that as the fastest-growing sector in terms of the economy going forward. And Sacramento has staked a claim in that area and we have seen growth that has exceeded the rest of California.

In addition to that, given the fact that UC Davis is actually right here in Sacramento for all practical purposes, biosciences is another area that we are looking at expanding in this area outside of just the regular real estate.

COMMISSIONER THOMPSON: Sure.

Final question, Ms. Canada -- Canada?

MS. CANADA: Canada.

COMMISSIONER THOMPSON: Canada. Of the four that fail, in your opinion, should they truly pass or are there problems with them that would suggest that you really won't ever get to 100 percent?

MS. CANADA: It's not likely we would ever get to 100 percent. I would give you that. Certainly, some people don't want to stay in their homes. I mean, there are some people who come to us to find a pathway out of their situation and not to preserve home ownership.

So, you know, each of these are very dynamic situations and very personal and emotional. Some people have lost their employment as they were just talking about. Jobs -- you know, there is job loss nationally and certainly in the Sacramento region, and they may have been able to afford the home they purchased under the terms and the income they had at the time they purchased but they can't anymore. One spouse or both may have lost income and reduced income.

I mean, our own state, we have a lot of state workers that come to us and the furloughs have cut into their income, so, you know, even though they are still employed they have reduced income.

A lot of people in those situations, really, it's not likely that they will get a successful modification. Many of the modifications, trials and others, aren't at current market rates. So they are higher than market rates, their homes are valued -- basically they are under water.

So there is a lot of dynamics going on with these and I think you do have to look at the big picture and understand all the things at play in the deal, if you will. And our efforts from the counseling standpoint is to try to do just that, to be as pragmatic as possible and look at the current circumstances of the borrower, the homeowner, the motivation they have to stay in their home, and the likelihood that that is going to come to some kind of positive outcome and work with them to find that solution.

COMMISSIONER THOMPSON: So if 100 percent is unlikely --

MS. CANADA: Yes.

COMMISSIONER THOMPSON: -- and 20 percent is unreasonable, what is the right point?

MS. CANADA: Well, when we started this, we were thinking 50 to 60 percent was, you know, our target. We have certainly vacillated from that goal because we found that it just wasn't a realistic goal. But based on what we see and based on the people that come to us, you know, on paper that could fit and that appear to qualify for the modification, we don't -- we don't ask the servicer to modify a deal that doesn't make any sense. That puts our credibility at risk as well. And it's just not fair to the homeowner to say, "Let's just go for this 0 percent, you know, 50-year loan term," and see if they will go for it. That's not reasonable.

We understand what reasonable is and we -- our counselors are trained to understand and put a package together and come up with a scenario that makes sense. It's hopefully a win-win. And that is what's submitted. When we submit those, we expect to get a positive response. It's a reasonable presentation 50 to 60 percent of those ought to get approved.

COMMISSIONER THOMPSON: Thank you.

CHAIRMAN ANGELIDES: Ms. Murren.

COMMISSIONER MURREN: Thank you, Mr. Chairman. Thanks to all of you for being here. I've a question that I was hoping each of you could respond to briefly, and that is: If you look, based on your experience now in the trenches at the impacts of the financial crisis, and also those within the broader community, whether it's the public sector or the private sector, at the different enterprises and individuals who have been able to find ways to reach creative solutions -- and I mean that in the positive sense of "creative" -- in terms of flexibility either in offering people different employment or offering people different terms for the provision of health care or housing or credit -- in other words, what I am looking for is: Are there some success stories in all of this? Meaning that there have been ways that people have found to work within the community to help advance it? And if so, could you share some of those with us so that we might have an idea of what kinds of solutions might be present, not only here but perhaps could be applicable in other places?

For example, you mentioned the right -- you know, being able to get to a point where you have done analysis that suggests that it might be better to keep someone in their home and not allow it to go through in a short sale, even if that means bringing down -- modifying the principal amount, those kinds of things but in different settings.

Ms. Canada, if you could start.

MS. CANADA: Well, we have been trying to work out a lease-purchase option and have talked to a few of the lenders and servicers about if they won't reduce the principal -- which seems to be a pretty significant obstacle, to get principal reduction -- would they consider essentially short-selling, if you will, to us, to the non-profit.

And we have an investor who will do lease purchase, so it is possible for us to come up with a significant amount of capital, do a lease purchase with the present homeowner under essentially modified circumstances, a short sale, if you will, to the same homeowner. And we have been repeatedly denied that as an option because the lenders -- the holder of the note will not sell to or benefit the existing homeowner.

They would rather, apparently, go through a short sale or some other -- just basically strip the home away from -- go through the foreclosure or go through a short sale, strip the home away from the homeowner.

And then essentially time after time, that homeowner watches as the home that they lived in for 4, 5, 6, 10 years just sold for a price that they could have afforded had they been able to get a modification or a lease purchase or some other form of creativity, as you say.

So we are trying -- there are vehicles, there are tools that can be put in place even on a pilot process to try, but we have not been successful in getting that accomplished as yet.

COMMISSIONER MURREN: Would you be willing to submit to us just a brief summary of what you've attempted to do?

MS. CANADA: Certainly.

COMMISSIONER MURREN: That would be helpful, thank you.

Ms. Tawatao.

MS. TAWATAO: Yes, I have to confess I am struggling a little bit to respond to your question, probably because of the nature of what we do. But I guess on the homeowner's side, it has really been a matter of when we are -- when we do chose that case to pursue and take all the weight on behalf of a very -- on behalf of a family that's in a very difficult and dire situation, it has been gratifying to work with people in the private bar who have stepped forward and helped us. And, frankly, in litigation strategies because sometimes that's what it takes to, you know, make things right on behalf of the homeowner.

I will say on the tenants' side because that's a lot of what we do. The HPRP, Homeless Prevention Rapid Rehousing, has been a very useful tool in -- sort of in situations where we can prevent homelessness on the part of the renter who is -- that has been affected by the downturn and can get that extra bit of cash to be able to move into or stay in a place.

Still takes people to intervene and make sure that it works well, but that has been pretty good. Also, Protecting Tenants in Foreclosure Act, really a very, very useful tool not adhered to as much as it should be, but it has been useful to us in ensuring that tenants who are often called the innocent victims of this crisis are taken care of and given time to move or are able to stay until their lives are stabilized.

So I think all those things have been relative positives in our work. Thank you.

COMMISSIONER MURREN: And the Protecting Tenants in Foreclosure Act -- I'm guessing, perhaps I'm wrong, you can correct me -- but that was likely advanced by the people that are involved in that process in your community, whether it be the constables or the people that are sort of directly involved with having to go to the places and evict people as they are, in fact, tenants. At least that's what happened to Nevada when we changed our laws.

Would you say that it takes people coming forward in a variety of different walks to be able to move forward legislation, regulatory change to effect those things?

MS. TAWATAO: Yes, absolutely. That would be correct.

COMMISSIONER MURREN: Thank you.

MR. WAGSTAFF: In terms of your general question of different ways peoples are navigated successfully through this crisis, what I've seen in the human services area is a community-wide response, quite frankly, to develop different ways of doing business to meet the need.

Because as I said earlier, the need has gone up, the resources have gone down. So we really have had to re-invent the way we do business.

Larger role for non-profit community, oftentimes by partnering amongst themselves; larger role for the private sector in terms of raising matching funds and things like that for our Homeless Prevention Program, which was just mentioned; and a larger role from a faith-based community as well, I think, in providing services, providing time, providing housing. So it has been a community-wide response, I would say.

And to that extent, it really has been inspiring to see the way the community has responded and see previous barriers of resistance kind of breaking down and responding to the crisis.

COMMISSIONER MURREN: Thank you.

MR. WILLIAMS: That's a great question. And I've two examples. Two banks here in Sacramento, one a smaller local bank, Bank of Sacramento and another example from a larger bank, U.S. Bank, both have the same thing, I think, in common and that is certain leadership, important decision-making is based in this area.

In the case of the Bank of Sacramento, I have a guarantee on a loan with a business that is an association. A lot of the clients have been in the real estate. Now, for all practical purposes, this loan should have been buried. It would have been. But because the client did not walk away, could have very easily brought in the keys of the businesses, they persevered, they worked with the bank, the bank itself agreed to restructure this loan, work it out, along with having our guarantee and worked -- the transaction costs in terms of the time they put in on this loan has been above and beyond the call of duty. And the fact that the character of the people who are running this business has been such that they have been informative, they have been close to the bank, they have kept the bank apprised, the bank has bent over backwards to keep this business in business.

The other case is I have several loans with U.S. Bank, but because the executive vice president in terms of small business is located here in the area understands the nature of the program that we have been working with, we have seen a tremendous effort on their behalf in terms of working with individual clients on lines of credit to keep those lines in effect, although those lines, for all practical purposes, have been stressed, payments are being made but is a very challenging environment.

I would say in both of these cases, if you would look at them as just numbers or code names on a book, a lot of these loans would have been called or would have been foreclosed. Those businesses would have been shut down. But in these two instances, both the Bank of Sacramento and U.S. Bank, I think they have gone above and beyond the call of duty in terms of seeing that these businesses stay in business by working with us, with the loan guarantee, and working directly with the borrowers.

COMMISSIONER MURREN: Thank you.

MR. WIRZ: SAFE is a state-chartered credit union. Our regulator is a the Department of Financial Institutions. Our priority when we work with a member is, first and foremost, if they are in distress, is to keep them in their home. And one of the anomalies is we use a program that's very similar to the HAMP program, the Federal Housing Assistance Program, and the Department of Financial Institutions criticized our modification process because our modification process assumes that the first priority is to keep the member in the house.

And what the Department of Financial Institutions has criticized us for is that we base our analysis on what it's going to take for that member to be able to afford the housing payment and we are making an assumption that the credit cards, the auto loans, and whatever else is superfluous to that decision.

And they came in and wrote us up this last year saying that our modification programs weren't acceptable to them because we weren't calculating enough money in the plan to pay credit cards or auto loans or other loans beyond the home loan.

Our point is we want to keep that person in their home. Let the other loans go, maybe that has to be part of the solution, but the solution should be to keep them in their home. And I think the Commissioners ought to look at that. I think it doesn't make sense. Something has got to go. Something has to be forgone. These people don't have the income to cover everything.

COMMISSIONER MURREN: Do you hold the credit card or the auto loans?

MR. WIRZ: In some cases we do; in some cases we don't. But our priority is keep the member in the home.

Look, the basis of a sound family of -- of preserving lifestyle is to keep that member in the home. We think that's the most important thing. That ought to be the first priority. And it doesn't make sense to us to have an analysis that requires us to build in money for those other loans. It ought to be first and foremost the home.

COMMISSIONER MURREN: Thank you.

Thanks to all of you. There is reason for optimism, I guess, out there. Thanks.

CHAIRMAN ANGELIDES: Thank you, Ms. Murren.

What I would like to do now very quickly is ask Mr. Wagstaff, Mr. Williams, Mr. Wirz, if you would retire to those three seats right there, but stay here. I said that I would cede my time because we wanted to hear directly from a couple of folks who have been affected in this process.

I am going to ask, because we are running late, that we could ask people to make two-minute statements, very quick statements, so we can get it on the record.

Ms. Tawatao.

MS. TAWATAO: Thank you very much.

CHAIRMAN ANGELIDES: Could you ask your clients or colleagues to please come forward?

And while your colleagues come forward, let me say something to everyone here -- who's here in the audience. We invite the public to participate in our inquiry by submitting written testimony about how the financial crisis has affected you to the Commission, and that testimony may become part of our final record and report.

To do that, please go to FCIC.gov where you will find instructions on how to provide a written submission to this hearing under the "Contact us" tab or send us your stories to personalstory@FCIC.gov. So one more time, the web site is FCIC.gov and the e-mail address is personalstory@FCIC.gov.

And I do want to say we have received a number of submissions. In fact, they have been distributed to Commissioners. I had the chance to review some of them last night and I appreciate anyone who has done that and would encourage others to do so.

If you would each quickly introduce yourselves I am going to ask you to limit your remarks to two minutes if possible. But please why don't we start here. If you would please pull the microphone towards you, make sure it's on, and give us your name and identify yourself and please tell us what is going on with you.

THE DEPONENT: My name is Nia Lavulo and this is my partner Bernard Mose.

Chairman Angelides, Vice Chairman Thomas, and members of the Commission, I live in the city of Sacramento with my partner Bernard Mose who is here with me today, my son, and five nieces and nephews, who also -- I take care of and live with us also.

Bernard and I are here today to tell you about how we may lose our home at any minute despite trying to do everything the right way. We have been living in my childhood home which I've lived in the last 28 years.

In the spring of 2008, Bernard bought the home after my sister lost the home. Since this was our family home and where we have lived for many years, it was important to us to keep it in our family.

We've saved every penny we could for the down payment deposit. We also put -- we put 15,000 down and financed the remaining 135,000 with a fixed-rate 30-year loan. Our loan payments included property taxes and insurance which came to a total of $1,412.95 a month.

Both Bernard and I were employed when we bought the house and the payments were affordable to us. Unfortunately, Bernard was laid off about a year after we bought the house. Even with Bernard collecting unemployment insurance and doing odd jobs on the side, we could no longer afford our mortgage payments.

By June 2009, we were behind in payments. After getting behind in our payments we contacted CitiMortgage about getting a loan modification. In January of 2010 we entered into a HAMP trial period plan. Under that trial period plan, we had to make mortgage payments of $1,126.66 for four months.

If we made these payments, our trial period plan agreement said we would receive a permanent modification. We made the four payments, four months of payments.

At the end of the four months, we contacted CitiMortgage to find out about the status of our permanent modification. We were told it was being reviewed and that we would make -- that we would have to make a fifth payment. We made the fifth pavement and kept calling CitiMortgage about the status of the permanent modification. We were told over and over again that was under review. We were also told by CitiMortgage that we need not to worry about our home being sold in foreclosure sale because this was put on hold until the modification review was final.

We never received any written notices from CitiMortgage about the status of our modification. We only received written receipts about -- with our monthly payments that we were making. Then we were shocked when we received the notice on our door on July 29, 2010, that told us that our home was now owned by Fannie Mae.

Without our knowledge, our home was sold -- been sold at a foreclosure sale on July 26 which -- to Fannie Mae which had owned our mortgage. About a week later, we received the permanent modification agreement from CitiMortgage. The servicer informed us that we were approved for the permanent modification. Unfortunately, we no longer owned a home at this time.

On August 20th Fannie Mae filed an eviction case against us and we were currently trying to contact and see if they're willing to stop the eviction and work with us to get the title of our home back and permanently modify our mortgage; however, at any moment, Fannie Mae can go ahead and evict us and we can be on the streets. We hope our story sheds some lights on the changes needs to the modification process.

We tried to do everything right from the beginning. We saved money for the down payment. We also fixed had a fixed-rate affordable loan. It was only after Bernard was laid off that we fell behind. We then made all the trial period payments and ultimately were approved for a permanent modification; however, because of a mistake or I don't know what happened by our loan servicer, we and our son and nieces and nephews may lose our home and financial investment.

Thank you for taking your time today to hear our story.

CHAIRMAN ANGELIDES: Thank you very much.

I just want to note I was asked by a reporter earlier today whether we learned anything at these field hearings and, unfortunately, we do every time.

VICE CHAIRMAN THOMAS: Mr. Chairman.

CHAIRMAN ANGELIDES: Mr. Vice Chairman.

VICE CHAIRMAN THOMAS: We have talked a lot about what our statutory power isn't. We're dealing with an aspect of the federal government. And I think we ought to think about composing a letter outlining what happened and at least require Fannie Mae to tell us what the process was that had these two ships passing in the night and these people doing the right thing, obviously getting the wrong response.

That's a federal agency that we have an affiliation with -- not a federal agency -- but I would think of all people Fannie Mae or Freddie Mac ought to think about being responsive at this time. I just think that's an extra step and I think we ought to take it.

CHAIRMAN ANGELIDES: I would say without objection --

COMMISSIONER GEORGIOU: Yes.

CHAIRMAN ANGELIDES: Yes. Absolutely. Done. Thank you.

Ma'am. Next. Can you pull the microphone towards you, ma'am?

MS. HOLLIS: Okay. Thank you.

CHAIRMAN ANGELIDES: And maybe pull it down a little.

MS. HOLLIS: All right.

CHAIRMAN ANGELIDES: And you're good to go.

MS. HOLLIS: All right. My name is Lovey Hollis born in Sulligent, Alabama, September 7th, 1931, moved to Sacramento 50 years ago. We bought our first home and raised five daughters. We both worked and we paid off our mortgage.

In 2006, my husband, Grafton, was in a wheelchair and could not get up the steps in the home that we had bought, so we bought a bigger home and paid 50 percent down which was $155,000, payment was 400 -- I meant to say $546 a month. It went up a little bit at the time over three years, which at this time the payment would be $1,421.

My husband, Grafton, died May 2008. My income went down to $1,599. I answered an ad for a modification. Tom answered my ad and came to my door. He offered to get the loan amount payment reduced to 4,000 -- I meant to say if I paid him $4,000.

I signed an agreement to pay him $4,000. It was called "Economic Survival Home Retention Program Contract."

I gave him $1,000, the only cash I had. He brought over his friend Dorothy. They said they would take my Mercury Grand Marquis to cover the other $3,000. Dorothy signed an agreement to pay $6,500 Blue Book price.

They took the car. That was over a year ago. They never paid me anything. Tom told me I did not have to make any payments while he was working on the modification. I do not know if Tom did anything, but he did not get my loan modification.

The bank foreclosed and my home was sold at an auction. The bank sued and evicted me. That's where we are now. The Senior Legal Hotline got the eviction dropped while they worked on getting my home back. I guess I am bankrupt. The hotline lawyer showed me bankruptcy case filed in the Federal Court in Sacramento. Dorothy signed the paper as a petition preparer. Somebody signed my name.

CHAIRMAN ANGELIDES: May I ask, Ms. Tawatao, has -- I assume this matter has been turned over to the U.S. Attorney or the D.A.?

MS. TAWATAO: Yes, it has.

VICE CHAIRMAN THOMAS: When?

MS. TAWATAO: A couple of weeks ago.

CHAIRMAN ANGELIDES: Thank you very much, ma'am.

Sir.

MR. CARPENTER: Chairman Angelides, Vice Chairman Thomas, and members of the Commission. My name is Allen Carpenter I used to work as a general contractor but now I am retired.

My wife and I live on my Social Security check and her income from her retail job. My wife and I bought a home in Pleasant Grove in 2001 and owned it for nine years. Our loan was with Washington Mutual. It was a 30-year fixed loan at 7 percent rate. GMAC was the servicer.

As the housing market began to slow and my income was dropping, we had to refinance three times in order to make ends meet. The last time we refinanced was in 2000 (sic), right before the housing market crashed and construction completely dried up.

During the times we refinanced, I was ignorant, to my chagrin, about all the risks involved in taking an option ARM, an interest-only loan based on stated income.

My wife and I wanted to do the right thing and pay all our bills even as the mortgage payment adjusted to a very high rate. We cashed in our 401(k) plan which we had $200,000 in -- that was all of our retirement savings -- just trying to keep our heads above water, but eventually we simply could not keep up.

We ended up having to file for bankruptcy in 2008 -- I'm sorry, 2009. I wanted to try to hang on to our home so my bankruptcy attorney suggested that I try to get a loan modification and I contacted GMAC for that purpose.

Trying to work things out through GMAC was a nightmare. They would rarely return my calls. And when I could get through they denied that I had ever called them before.

I also tried to get modifications from other companies but got the same runaround. Even though I understand from consulting with someone at the Senior Legal Hotline in Sacramento that I was a good candidate for a modification under the HAMP program, if you plugged in your financial information into the HAMP formula.

During the whole time that we were attempting to do a loan modification, I was sweating bullets and felt stressed day and night. We ended up having to declare bankruptcy and lost our home in a foreclosure sale this year.

Though I am very unhappy about losing our home and angry about the ordeal we went through, I am at peace with our situation. At least the headaches are gone. Still, I feel the federal government and the banks are not doing nearly enough to protect consumers like my wife and me and others.

Wells Fargo and other big banks got bailed out even though they were a big reason for the financial mess we are all in because they knew and still know that there is an option ARM or an interest-only loan they are dealing with a situation where income has not been verified and probably isn't enough to make the payments once the rate adjusts.

It seems that the government is more interested in supporting banks, servicers, Fannie Mae, Freddie Mac, than homeowners and consumers. This needs to change. Thank you.

CHAIRMAN ANGELIDES: Thank you, Mr. Carpenter.

Thank you all for having the courage and taking the time to come down here today. And as I listen to you, I'm struck by the fact that two years ago when the banks came calling the taxpayers returned the call and stepped up. I'm sorry that that hasn't happened for each of you.

Thank you very much for coming here today. I want to thank each of the witnesses. I do want to ask the members of the panel if they have any more questions for the folks who are here with us today or the previous panelists.

The testimony has been very powerful. I would like to know if any members have any questions or would like to make a comment.

All right. Well, thank you.

And let me just say this: It has been one year of hearings, 19 hearings across the country. I think for us it has been powerful and revelatory. I want to make some thank yous before we close today.

First of all, I want to thank all the witnesses and all the citizens who came here today and watched us by live streaming.

The Commission is very grateful to each of you. I would like to thank all the members of the public and the people of my hometown and people across the country who have watched us on our journey, and hope you wish us well as we do our report by December 15th and try to do our best job for the country.

As I said earlier, people can participate by submitting written testimony at FCIC.gov or going to personalstory@FCIC.gov.

I would like to also thank, as we close here today, Superintendent of Public Instruction Jack O'Connell, as I did earlier, for his generosity in hosting the Commission.

And I want to let the superintendent know, who leaves office at the end of this year to return to private life after many years of good public service, that he has an outstanding staff and they have been wonderful. Hillary McClain, Jacqueline Krooks and her staff.

And finally, a huge thank you to our staff and ground coordinators for helping on the logistics of this field hearing. That includes Courtney Mayo, Gretchen Newsom, Rob Bachmann, Scott Ganz, and I want to thank all our staff, and Mike Roth and Nikki Pashcal and Tony Ingoglia who helped coordinate this at the ground level.

And finally, a heartfelt thank you to my fellow Commissioners. Good people who care about their country, trying to do the best they can with the mandate we have been given. We are privileged to have the honor to do this work and we hope that we can make a difference.

Thank you each and every one of you and God speed.

This meeting of the Financial Crisis Inquiry Commission is adjourned.

(Meeting adjourned at 3:51 p.m.)