Minutes

of

The Meeting of the FDIC Advisory Committee on Economic Inclusion

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

July 16, 2007 - 9:14 A. M.

The meeting of the FDIC Advisory Committee on Economic Inclusion ("ComE-IN" or "Committee") was called to order by ComE-In Chairman Diana L. Taylor.

The members of ComE-IN present at the meeting were: Diana L. Taylor, ComE-IN Chairman and immediate past New York State Superintendent of Banks; Ted Beck, President and Chief Executive Officer, National Endowment for Financial Education; Kelvin Boston, Executive Producer and Host of PBS' *Money wise with Kelvin Boston*; Martin Eakes, Chief Executive Officer, Self-Help/Center for Responsible Lending; Lawrence K. Fish, Chairman and Chief Executive Officer, Citizens Financial Group, Inc.; Rev. Dr. Floyd H. Flake, Senior Pastor, Greater Allen AME Cathedral of New York; Ester R. Fuchs, Professor, School of International and Public Affairs, Columbia University; Wade Henderson, President and Chief Executive Officer, Leadership Conference on Civil Rights, and Counselor to the Leadership Conference on Civil Rights Education Fund; Alden J. McDonald, Jr., President and Chief Executive Officer, Liberty Bank and Trust Company, New Orleans, LA; Frederic S. Mishkin, Governor, Federal Reserve System; John W. Ryan, Executive Vice President, Conference of State Bank Supervisors; Robert K. Steel, Under Secretary of the Treasury for Domestic Finance, U.S. Department of Treasury; Peter Tufano, Sylvan C. Coleman Professor of Financial Management, Harvard Business School, and Senior Associate Dean and Director of Faculty Development; and Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard University. Erica F. Bovenzi, Designated Federal Officer for the Committee and Deputy General Counsel of the

Federal Deposit Insurance Corporation ("Corporation" or "FDIC"), was also present at the meeting. Committee members Ronald Grzywinski, Chairman, ShoreBank Corporation of Chicago; Manuel Orozco, Senior Associate at the Inter-American Dialogue, and Senior Researcher, Institute for the Study of International Migration, Georgetown University; Maria Otero, President and CEO, ACCION International; and Deborah C. Wright, Chairman and CEO, Carver Bancorp, Inc., were absent from the meeting.

Members of the Corporation's Board of Directors present at the meeting were Sheila C. Bair, Chairperson; Martin J. Gruenberg, Vice Chairman; and Thomas J. Curry, Director (Appointive). Corporation staff that also attended the meeting included Alice C. Goodman, Lisa K. Roy, Sara A. Kelsey, Sandra L. Thompson, Lee Bowman, Michael H. Krimminger, David M. Barr, Andrew B. Stirling, Jr., Angelisa M. Harris, Valerie J. Best, and Leneta G. Gregorie.

William Apgar, Jr., Faculty Chair, Kennedy School of Government Senior Executive Program for State and Local Government Officials, and Senior Scholar, Joint Center for Housing Studies, Harvard University; John C. Weicher, Director, Center for Housing and Financial Markets, Hudson Institute; Michael Shea, Executive Director, ACORN Housing Corporation; Diane Thompson, Supervisory Attorney, Land of Lincoln Legal Assistance Foundation; Kenneth D. Wade, Chief Executive Officer, NeighborWorks® America; Michael Desmond, Tax Legislative Counsel, Office of Tax Policy, U.S. Department of Treasury; and Jack M. Guttentag, Professor of Finance, Emeritus, Wharton School, University of Pennsylvania, also attended the meeting.

Committee Chairman Taylor opened and presided at the meeting.

FDIC Chairman Bair welcomed ComE-IN members and guest speakers. She then provided an update on several matters: (1) the FDIC Board of Directors approval of the Committee's recommendation at its March meeting to initiate a pilot program of low cost, small dollar loans to be launched by individual banks; (2) the progress of meetings held with the securitization industry on subprime lending; and (3) the launching of a new program by the Alliance for Economic Inclusion and NeighborWorks America to provide affordable refinancing opportunities. Chairman Bair also advised that staff are continuing to look at the legal and practical implications of banks investing in the Prosper Marketplace, Inc. lending platform—an issue that was raised at the March meeting.

Committee Chairman Taylor then introduced the first two speakers, William Apgar, Jr. of Harvard University and John C.

Weicher of the, Hudson Institute, who would discuss the factors that contributed to the current subprime mortgage situation.

Mr. Apgar began his presentation by summarizing recent data on mortgage delinquencies and foreclosures, noting that they were at historical highs in the 1st Quarter 2007 and likely to go even higher as adjustable rate mortgages funded through 2006 began to reset. He then identified as contributing factors consumer behavior, the existing market structure, and a fragmented regulatory framework.

Mr. Apgar offered a three-part solution to the subprime mortgage crisis: (1) consumer education; (2) uniform rules that hold brokers and mortgage companies to the same standards as loan officers and banks; and (3) a requirement for marketplace accountability for failure to exercise due diligence in the purchase of mortgage obligations.

Next, Dr. Weicher provided a brief history of the subprime mortgage industry. He noted that although it had not existed 20 years ago, subprime loans currently represented 15 percent of the market. He then cited the factors that led to the rise of the subprime mortgage market. Mr. Apgar stated that while he anticipated problems in the subprime mortgage market to continue until sometime in 2009, when the most recently funded adjustable rate mortgages would reset, mortgage counseling and loan forbearance could help to mitigate the default rate.

Committee Chairman Taylor then opened the floor to questions and comments. In the discussion that followed, Committee members, Mr. Apgar, and Dr. Weicher explored additional factors which may have contributed to the growth of the subprime loan market, including affordability constrained real estate markets, an information revolution that facilitated wide availability of credit scores and automated underwriting systems, and, in many low-income, minority communities, the proliferation of unregulated, non-bank entities that filled the void created by the absence of banks. The discussion revealed a discrepancy in the connotation of the term "subprime." Mr. Fish indicated that his institution did not engage in subprime lending because of perceived reputational and financial risks. Mr. McDonald, on the other hand, indicated that the majority of loans made by his institution are by definition "subprime," albeit with a higher, but manageable risk. Committee Chairman Taylor agreed that it was important not to blur the distinction between subprime lending and predatory lending.

The Committee also discussed in more detail the various ways in which the regulatory environment could be altered to enhance the ability of banks to offer alternative products in the subprime market. Chairman Bair expressed support for responsible subprime lending by insured financial institutions and suggested that perhaps the bank regulators should examine whether capital treatment of subprime lending operated, either explicitly or implicitly, to discourage such lending. Several Committee members suggested that perhaps a fresh look at the Community Reinvestment Act ("CRA") might be warranted to see if the methodology for defining an institution's assessment area and their "community" remain relevant in the current structure of the financial services industry. There was a general consensus that uniform application of existing regulatory guidance on subprime lending to non-bank entities would allow banks to compete favorably in the subprime market.

Committee Chairman Taylor announced that the meeting would recess briefly. Accordingly, at 10:59 a.m., the meeting stood in recess.

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The meeting reconvened at 11:12 a.m. that same day, whereupon Committee Chairman Taylor introduced the second panel of speakers, Kenneth D. Wade of NeighborWorks® America; Diane Thompson of the Land of Lincoln Legal Assistance Foundation; Michael Shea of ACORN Housing Corporation; Michael Desmond of the U.S. Department of Treasury; and panel moderator, Sandra L. Thompson, Director, FDIC Division of Supervision and Consumer Protection ("DSC Director Thompson").

DSC Director Thompson initiated the panel presentation by noting the recently issued regulatory guidance by the FDIC and other federal financial institution regulatory agencies on subprime lending. She further advised that the regulatory agencies also issued guidance in April 2007 that encourages financial institutions to work constructively with delinquent residential borrowers.

Mr. Wade discussed NeighborWorks® America's efforts to assist borrowers in avoiding foreclosures, including the establishment of the Center for Foreclosure Solutions ("CFS"), an organization whose focus includes: building foreclosure counseling capacity; working with local coalitions to assist homeowners; conducting research on foreclosure prevention initiatives; and a public education campaign. He particularly noted the public education campaign, which is jointly sponsored with the Ad Council, and is primarily aimed at increasing consumer awareness of the options available for avoiding foreclosure, including a toll-free number for consumers to call and receive individual counseling assistance. Mr. Wade then thanked FDIC Director Curry for his work as Chairman of the NeighborWorks® America Board of Directors and expressed his appreciation for the assistance of NeighborWorks® America's many partners, including the FDIC.

Next, Ms. Diane Thompson briefed the Committee on the typical characteristics of mortgage loans she saw in her legal aid practice in East St. Louis, Illinois. She advised that the majority of her cases involved extensive fraud by brokers and appraisers, and what she characterized as "willful blindness" by lenders, with inadequate or falsified documentation of borrower income, inflated property appraisals, "upselling" of loan products to generate greater broker compensation, and lack of due diligence on the part of lenders, typically resulting in 2/28 or 3/27 mortgage loans at excessive interest rates to marginal borrowers. She noted that in many instances, such loans were unaffordable and in default even before the rate reset and that frequently the borrowers were never told what kind of loan they were getting or saw any of the loan documents until the time of closing thereby depriving them of the opportunity to make rational, informed decisions.

Ms. Thompson then advised the Committee on the problems encountered by legal advocates in assisting troubled borrowers. She noted that, despite the existence of regulatory guidance on subprime lending and non-traditional mortgage loans, foreclosure counsel frequently argue that compliance with guidance is not mandatory and, therefore, unenforceable. Ms. Thompson suggested that certain basic principles should be encouraged by the regulators for servicers in developing sustainable workout arrangements (e.g., affordable loan modifications) with borrowers in default, and that such arrangements should be available at the outset, for example, (1) the loan principal should be written down to the actual value of the residence (by a properly conducted appraisal); (2) if the interest rates have been boosted because of "upselling," the interest rate should be reduced to the par rate; and (3) small loan emergency funds; or (4) making second mortgages available rather than forcing the borrower to refinance entire mortgage.

Next, Mr. Shea, echoing Mr. Apgar's earlier comments regarding the lack of uniformity in rules applicable to bank and non-bank lenders, stated that there was also a lack of uniformity in the practices and policies of subprime mortgage servicers resulting in inequities for borrowers in default. He observed that, with one or two notable exceptions, subprime servicers took a case-by-case approach to borrowers who fell behind on their payments; that most subprime servicers not affiliated with banks employed only collections personnel who were unable to offer the full range of loss mitigation solutions; and that, therefore, all but a few subprime servicers continued to place borrowers into unaffordable workout arrangements rather than providing loan modifications offering long-term affordability.

Ending his presentation, Mr. Shea stated that over the past year, his organization and others had noticed a reduction in the number of lower income borrowers being steered into subprime loans, particularly for home purchases; and that in recent weeks, larger subprime servicers, generally those affiliated with banks, were entering into more loan modification agreements, with a greater willingness to modify ARMs by locking in the initial rate if a borrower could demonstrate that the reset rate would be unaffordable.

Mr. Desmond provided an overview on tax issues that could arise in connection with real estate mortgage investment conduits ("REMICs"), cancellation of indebtedness income, and information reporting requirements with respect to cancellation of indebtedness income. In response to a question from DSC Director Thompson as to whether extension of an initial ARM rate would trigger the information reporting requirement, Mr. Desmond advised that cancellation of debt only occurs when there is a change in the principal amount of the loan.

During the ensuing discussion, a number of issues were explored by Committee and panel members, including the higher rates of foreclosure in minority communities and their impact on those communities; methods that could be employed to encourage borrowers in danger of default to be more proactive in contacting their lenders; and the extent to which insured financial institutions' willingness to restructure securitized loans was limited by the terms of complex and varying Pooling and Servicing Agreements ("PSAs"). Also discussed were various recommendations for improving the outcome for troubled subprime borrowers. Recommendations included development of a national foreclosure policy to replace individual state policies which, in some instances, allow foreclosure proceedings to be initiated within as few as 30 days from the date of default; a nationwide moratorium on foreclosures for a sufficient period of time to allow the adoption of standardized solutions to the subprime crisis; an industry-wide incentive structure that encourages loan modification, rather than foreclosure as the initial approach to addressing defaulted mortgage loans; and across-the-board voidance of prepayment penalty provisions in subprime mortgage loans. Several legislative remedies were also advanced. Mr. Henderson suggested legislation to ease the restrictions on restructuring REMIC assets, and Ms. Warren suggested amendment of the Bankruptcy Code to place mortgage lenders on equal footing with other secured lenders with respect to the rescheduling of debt, thereby providing borrowers with more leverage in getting servicers to negotiate loan modifications.

Vice Chairman Gruenberg summarized the consensus of the Committee by noting that, since not every borrower would have access to a legal advocate like Ms. Thompson or community advocates like Messrs. Shea and Wade, it was important to impose as much uniformity as possible on the handling of defaulted subprime mortgage loans because, in the absence of such uniformity, many borrowers would lose their homes.

Committee Chairman Taylor announced that the meeting would recess for lunch. Accordingly, at 12:52 p.m., the meeting stood in recess.

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The meeting was reconvened at 1:30 p.m. that same day at which time Committee Chairman Taylor introduced Jack M. Guttentag, Professor of Finance, Emeritus, Wharton School, University of Pennsylvania, to discuss the role of mortgage brokers in the subprime mortgage industry.

Professor Guttentag began by stating that, in his opinion, the immediate cause of the crisis in the subprime market was not mortgage brokers, which were a consistent presence in the market, but the rising rate of foreclosures triggered by the general decline in real property price appreciation, which had previously allowed homeowners to refinance before ARM resets. He acknowledged, however, that brokers were central actors in a system that delivered loans at high cost, discouraged escrow accounts, and steered borrowers into unfavorable loan products such as 2/28 ARMs.

Offering proposals to address the problem of loan overcharges, Professor Guttentag advised that one proposal, included in legislation currently pending before Congress, was a requirement that brokers act as agents of the borrower. He suggested that such a requirement would only be effective if it set forth specific broker obligations. As an alternative proposal, Professor Guttentag suggested adoption of a rule mandating that any rebate paid by a lender be credited to the borrower, not paid to the broker, thereby requiring borrower authorization of the amount paid to the broker. He cautioned that under the second proposal, it was important to define "broker" as a loan provider who does not take market risk. He explained that the current definition of a "broker" as someone involved in providing loans to borrowers but who does not advance funds excludes correspondent lenders who, except for one minor difference, provide services identical to those provided by brokers. For loan officers, he proposed that the same rule should include a provision that prohibits lenders from deviating from their posted rates, thereby preventing loan officers from marking up lender price sheets.

In the discussion that followed, Committee members sought to clarify what was meant by "overage" and "upselling," and asked questions to clarify the specifics of Professor Guttentag's recommendations. Ms. Warren stated that it should be made clear that the proposal to credit lender rebates to the borrower for broker compensation should be accompanied by a disclosure that the amount of the rebate was directly correlated to the borrower's acceptance of an above par rate. She stated that without such a disclosure, crediting the rebate to the borrower would be meaningless.

Committee Chairman Taylor then introduced Sara A. Kelsey, FDIC General Counsel, to discuss the existing legal framework for addressing the crisis in the subprime mortgage industry. Ms. Kelsey briefly summarized the laws pursuant to which federal bank regulators could promulgate rules and guidelines relative to subprime loans, including the CRA, the Homeowners Equity Protection Act ("HOEPA"), and Federal Trade Commission Act. She indicated that although the federal financial institution regulatory agencies had issued guidance on non-traditional and subprime mortgages, the problem with guidance was its lack of enforceability. She noted, however, that the Board of Governors of the Federal Reserve System ("FRB") had recently held hearings on its authority under HOEPA and expressed hope that the FRB would soon initiate rulemaking on subprime mortgage loans that would be applicable to both bank and non-bank entities.

Ms. Kelsey also advised that the states, which had proposed a wide range of legislative and regulatory proposals with respect to subprime lending, were a major source of innovation. She observed, however, that the differing state rules and regulations contributed to the lack of uniformity. She suggested that any federal regulation should be viewed as a floor, rather than a ceiling, thereby allowing continued state innovations to determine the most effective and efficient means of regulating the subprime industry.

The Committee members then discussed at length issues for national standards relative to the subprime mortgage industry, including how best to define "subprime," the stigma associated with current usage of the word "subprime," and the distinction between subprime and predatory loans. Chairman Bair expressed the general consensus of the Committee that defining "subprime" according to the number of percentage points above par would provide a clearer indicator for the purposes of HOEPA rulemaking than defining based on borrower characteristics. The Committee also discussed a number of other issues, including disclosure and accountability, prepayment penalties, assignee liability for abusive loans, and whether lenders who offer only subprime loans have a responsibility to refer borrowers who qualify for prime loans to other lenders who can better serve their needs.

The Committee then made the following suggestions for the FDIC's consideration: (1) that "subprime" be defined on the basis of the extent to which a loan exceeds a specified number of percentage points above par rate as defined in the Home Mortgage Disclosure Act (HMDA) and include fees in the calculation; (2) that prepayment penalties be prohibited, except to the extent necessary to cover administrative costs for processing the loan; (3) that secondary market liability be established for securitized loans and loans underlying collateralized debt obligations; (4) that escrow accounts for taxes and insurance be required for all loans below a certain dollar amount threshold, with the option for all borrowers to pay additional funds into an escrow account; (5) that mortgage brokers be subject to uniform education and licensing requirements and standards of behavior, enforceable through regulatory oversight, with primary oversight responsibility at the state level and federal preemption only in the event state laws fail to meet a minimum federal threshold; (6) that meaningful, binding, and timely disclosure of mortgage terms, sufficient to facilitate marketplace comparisons, be mandated, with the specifics of recommended disclosures to be determined after Committee members had an opportunity to review a model disclosure form developed by the Conference of State Bank Supervisors; (7) that stated income loans should be prohibited, with provision for use of alternative documentation of income by self-employed individuals; and (8) that mortgage loans be underwritten, at a minimum, to the fully indexed, fully amortized rate.

There being no further business, the meeting was adjourned.

Executive Secretary
Federal Deposit Insurance Corporation
And Committee Management Officer
FDIC Advisory Committee on Economic
Inclusion

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of

The Meeting of the FDIC Advisory Committee on Economic Inclusion

of the

Federal Deposit Insurance Corporation

Held in the Executive Dining Room

Federal Deposit Insurance Corporation Building

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Open to Public Observation

July 16, 2007 - 9:14 A. M.

I hereby certify that, to the best of my knowledge, the attached minutes are accurate and complete.

Diana L. Taylor
Chairman
FDIC Advisory Committee on Economic Inclusion

Dated: October 10, 2007