Responses to Sub prime Mortgage & Housing Crisis

AB 69 (Lieu)

Debt management and settlement: credit counselors: This requires mortgage lenders to report to their respective regulatory agency information regarding loan loss mitigation efforts.
Status: Chaptered by Secretary of State, Chapter 277, Statutes of 2008.

AB 180 (Bass and Lieu)

Mortgages: foreclosure consultants: This bill amends existing law relative to foreclosure consultants. AB 180 prohibits a foreclosure consultant from entering specified pre-foreclosure agreements with a homeowner, allows a homeowner to cancel within five days of signing a contract with a foreclosure consultant, and requires the foreclosure consultant to maintain a surety bond. Also has a translation provision to allow owners to request a completed copy of the contract if any language described in Civil Code Section 1632 (Spanish, Chinese, Tagalog, Vietnamese, and Korean). The surety bond requirement requires a single $100,000 surety bond in favor of the State of California for the benefit of homeowners damaged by the foreclosure consultant's violation, and allows the Department of Justice to refuse to issue or revoke a certification of registration for violations of the chapter on Mortgage Foreclosure Consultants.
Status: Chaptered by Secretary of State, Chapter 278, Statutes of 2008.

AB 529 (Torrico)

Mortgages: adjustable interest rates: notification: This bill requires a borrower to receive notice if their loan is scheduled to switch from an initial fixed rate to an adjustable rate, or set to reset to a fully amortizing loan. This notification must occur between 90 and 120 days before the loan is scheduled to switch or reset. The notice must include the current payment, the month and year the loan will change, an example of the potentially monthly payment after reset, and a number the borrower may contact for more information about the terms of the loan.
Status: Vetoed by the Governor.

AB 628 (Price)

Residential mortgage loans: gifts: This bill would prohibit that real estate broker or a residential mortgage lender or servicer from making a gift, as defined, to a borrower or a potential borrower.
Status: Vetoed by the Governor.

AB 941 (Torrico)

Real property loans: documents: This bill requires the Department of Real Estate to review the real property transaction disclosure process, and to post a draft report on its Internet Web site by July 1, 2008. The Department would be required to consult with other departments as necessary, and submit a final report to the Legislature by January 1, 2009.
Status: Vetoed by the Governor.

AB 1538 (Lieu)

Housing Trust Fund: home loan refinance assistance: This bill establishes a home loan refinance assistance program to be administered by the California Housing Finance Agency (CHFA) to assist borrowers who may face foreclosure.
Status: Died in Assembly Appropriations Committee.

AB 1830 (Lieu, Bass, Nava, Wolk)

Lending: This bill enacts duties, requirements and prohibitions relating to higher priced mortgage loans. Establishes consumer protections for borrowers who receive subprime mortgage loans and requires that mortgage brokers act as fiduciaries of borrowers.
Status: Vetoed by the Governor.

AB 1837 (Garcia)

Consumer loans: subprime and nontraditional loans: This bill prohibits a covered loan from including a prepayment penalty after the first 24 months from the date of consummation of the loan and would authorize a covered loan to include a prepayment penalty before that time period if specified conditions are satisfied. The bill would also prohibit a licensed person from receiving any compensation for originating a subprime loan or nontraditional loan with an interest rate above the wholesale par rate for which the consumer qualifies.
Status: Held in Assembly Banking & Finance Committee.

AB 2161 (Swanson)

Loans: consumer complaints: This bill requires the Department of Real Estate, the Department of Financial Institutions, and the Department of Corporations to report to the Legislature on consumer complaints related to nontraditional loans.
Status: Held in Senate Appropriation Committee.

AB 2187 (Caballero)

Mortgages: foreclosure: This bill imposes certain requirements on mortgage lenders that are foreclosing on property. AB 2187 requires a lender foreclosing on real estate property to include with the notice of default a foreclosure statement of rights, which specifies the process of foreclosure and sets forth the rights of the borrower regarding contracts with mortgage foreclosure consultants. Also, requires that the foreclosure notice be provided in the language of the borrower. Provides, until January 1, 2013, a mortgage lender or other person acquiring a property through the foreclosure process maintain the exterior of vacant residential property. This bill authorizes governmental entities to levy fines of up to $1,000 per day for violations. However, it requires the governmental entity to provide the owner with notice of the claimed violation and an opportunity to correct the violation within 30 days prior to levying the fine.
Status: Died in Assembly Appropriation Committee.

AB 2359 (Jones)

Loans: This bill provides that an originator, beneficiary, trustee or assignee shall not require as a condition of an agreement regarding a covered loan, subprime loan, or non-traditional loan that the applicant waive any duties, remedies, or forums of California law with respect to a residential mortgage or mortgage foreclosure.
Status: Died in Senate Banking, Finance & Insurance Committee.

AB 2509 (Galgiani)

Housing finance: mortgage guarantee program: This bill requires the California Housing Finance Agency (CalHFA) to establish the Homeownership Preservation Mortgage Guarantee Program (Program).
Status: Died in Senate Banking, Finance & Insurance Committee.

AB 2740 (Brownley)

Home loans: servicing: This bill establishes various prohibited acts and requirements applicable to the servicing of home loans. AB 2740 regulates

how and when a fee may be imposed by a home loan servicer, requires a servicer to respond within specified periods to a borrower's request for information, documents, and dispute resolution and to promptly correct errors, authorizes the recovery of damages by a borrower or other party who is injured by a servicer's violation, and authorizes the Commissioner of Financial Institutions, the Commissioner of Corporations, and the Attorney General to bring an action to recover damages.
Status: Died in Senate Banking, Finance & Insurance Committee.

AB 2751 (Strickland)

Mortgages: residential property: insurance money: This bill would require every person or financial institution that makes loans upon the security of real property containing only a one- to 4-family residence and that is located in this state, or purchases obligations secured by that property, that receives money for payment of settlement proceeds, as defined, to place that money in an interest bearing account. The bill would require, when the damaged property is replaced or repaired to the satisfaction of the claimant, that the person or entity holding the money pay to the claimant any remaining balance in the account together with all interest that accrued while the funds were in escrow.
Status: Held in Assembly Banking & Finance Committee.

AB 2880 (Wolk)

Mortgage lending: This bill specifies that mortgage brokers have a fiduciary responsibility to borrowers and requires mortgage brokers to maintain a surety bond.
Status: Held in Assembly Appropriation Committee.

AJR 45 (Coto)

Mortgage loans: federal conforming and FHA mortgage loan limits: This resolution memorializes the Congress of the Untied States to enact, and the President of the United States to sign, a permanent increase in the conforming mortgage loan limit and the Federal Housing Administration limit, to the levels to which these limits were increased in the Economic Stimulus Act of 2008.
Status: Chaptered by Secretary of State, Resolution Chapter 81, Statues of 2008.

AJR 59 (Solorio)

California subprime mortgage foreclosures: This resolution urges the President of the United States and Congress to require more oversight of

mortgage lenders and loan servicers and increase disclosures and enforcement of mortgage laws. Asks Congress, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation to recognize the important role of states in the regulation of mortgage lending and in providing customer protections.
Status: Held in Assembly Banking & Finance Committee.

SB 385 (Machado)

Real estate: mortgages: real estate brokers: This bill applies federal guidance relating nontraditional mortgage products to state-regulated mortgage lenders and brokers.
Status: Chaptered by Secretary of State, Chapter 301, Statutes of 2007.

SB 1053 (Machado)

Real estate: brokers and salespersons: This bill requires real estate brokers that make, arrange, or service residential mortgage loans to notify the Department of Real Estate of their business activity, and requires brokers to file certain reports and statements with DRE.
Status: Held in Assembly Banking & Finance Committee.

SB 1054 (Machado)

Real estate: brokers and salespersons: This bill allows the Department of Real Estate to prohibit, bar or suspend a real estate salesperson or broker from participating in any business activity relating to real estate for up to 36 months.
Status: Failed Passage in Assembly Banking & Finance Committee.

SB 1065 (Correa)

Home financing programs: This bill allows cities and counties to use revenue bond funds to make or purchase refinanced home mortgages that are federally insured, federally guaranteed, or eligible to be purchased by the Federal National Mortgage Association or the Federal Home Loan and Mortgage Corporation.
Status: Chaptered by Secretary of State, Chapter 283, Statutes of 2008.

SB 1137 (Perata)

Residential mortgage loans: foreclosure procedures: This bill enacts changes related the foreclosure process in response to the subprime lending/foreclosure crisis. Requires face-to-face contact with a borrower at

least 30 days before the filing of a notice of default. Gives tenants of foreclosure property additional time to vacate the property after it has been sold at a foreclosure auction.
Status: Chaptered by Secretary of State, Chapter 69, Statues of 2008.

SB 1448 (Scott)

Real estate brokers and salespersons: fines: This bill increases the maximum fine for an unlicensed person acting or advertising themselves as a real estate broker or a real estate salesperson from $10,000 to $20,000 and for an unlicensed corporation from $50,000 to $60,000, and requires any fine collected in excess of $10,000 from an individual or in excess of $50,000 from a corporation be deposited into the Real Estate Fraud Prosecution Trust fund if one exists in the county where the conviction occurs.
Status: Chaptered by Secretary of State, Chapter 156, Statues of 2008.

SJR 21 (Machado)

Mortgage loans: conforming loan limit: This measure would respectfully memorialize the President and Congress of the United States to enact legislation that would increase the federal conforming loan limit.
Status: Held in Assembly Banking & Finance Committee.

Consumer Loans

AB 7 (Lieu)

Armed service members: consumer loans: This bill provides that on or after October 1, 2007, that deferred deposit transaction (DDT) licensees and California Finance Lender (CFL) licensees must comply with federal regulations relating to the extension of credit to members of the armed services.
Status: Chaptered by Secretary of State, Chapter 358, Statutes of 2007.

AB 634 (Charles Calderon)

Deferred deposit transaction licensees: This bill clarifies that a deferred deposit transaction, under the Deferred Deposit Transaction Law (DDTL), is an agreement where a person defers the deposit of a customer's check pursuant to an agreement for a fee or charge.
Status: Chaptered by Secretary of State, Chapter 235, Statues of 2007.

AB 1528 (Committee on Banking & Finance)

Military service: This bill prohibits any person or entity from marketing financial services or products to a service member, or former service member, or the spouse of a service member in a false or deceptive manner.
Status: Chaptered by Secretary of State, Chapter 363, Statues of 2007.

AB 1534 (Nunez)

Deferred deposit transactions: Commissioner of Corporations report: This bill requires the Department of Corporations to prepare a report containing specified information relating to payday lending.
Status: Put on the Inactive File in the Senate by Senator Perata.

AB 2845 (Jones)

Deferred deposit transactions: This bill states the intent of the Legislature to enact and implement changes to the California Deferred Deposit Transaction Law that include recommendations made by the Department of Corporations.
Status: Held in Assembly Rules Committee.

Pawnbrokers

AB 264 (Mendoza)

Pawnbrokers: This bill prohibits a pawnbroker from charging more than 2.5% per month on the unpaid principal balance of any loan and prohibits the pawn loan setup fee from exceeding $5 or 2%, whichever is greater, not to exceed $50.
Status: Vetoed by the Governor.

SB 580 (Calderon)

Pawnbrokers: This bill revises limits on pawnbroker compensation and loan setup fees. SB 580 provides for a minimum charge of no more than $3 a month on any loan and prohibits the pawn loan setup fee from exceeding $5 or 2%, whichever is greater, not to exceed $10.
Status: Chaptered by the Secretary of State, Chapter 340, Statutes of 2008.

Credit

AB 372 (Salas)

Consumer credit reports: security freezes: This bill revises the consumer credit report security freeze law.
Status: Chaptered by Secretary of State, Chapter 151, Statues of 2008.

AB 588 (De Leon)

Credit history: public utilities: This bill requires utilities, as defined, to allow subscribers to choose to release their utility service payment history to a financial institution or consumer credit reporting agency (CRA).
Status: Held in Senate Judiciary Committee.

AB 1313 (Charles Calderon)

Credit cards: cancellations: This bill provides that a private label credit card issuer, as defined, may terminate a class of the card issuer's credit card accounts if the issuer provides the cardholder with written notice with 60 days of the termination.
Status: Held in Assembly Judiciary Committee.

AB 1570 (Mendoza)

Retail sales: credit applications: This bill requires a retailer that offers a limited-term special price, sale, or interest rate on any purchase to extend that promotional offer by one business day under specified circumstances.
Status: Died in Assembly Banking & Finance Committee.

AB 2021 (Fuentes)

Credit cards: personal information: This bill provides that an entity that accepts credit cards for the transaction of business via Internet, telephone or mail may use personal information, as defined, for the purpose of fraud detection or prevention.
Status: Failed Passage in Senate Judiciary Committee.

SB 500 (Corbett)

Credit service organizations: This bill expands the list of prohibited lending practices a credit services organization, as defined, may not be engaged in when it seeks annual registration, as required, with the Department of

Justice/Attorney General. This bill also provides that the Department of Justice/Attorney General shall not register any credit services organization that engages in any of the lending practices that will be prohibited by this bill.

Status: Chaptered by Secretary of State, Chapter 91, Statues of 2007.

Community Investment

AB 1418 (Arambula)

Credit Union Membership Investment Model: This bill requires the Credit Union Advisory Committee (CUAC) to develop a Credit Union Membership Investment Model (Model) to identify best practices for credit unions relating to community development, small business and micro enterprise financing and investments of credit union capital.
Status: Vetoed by the Governor.

AB 1502 (Lieu)

Banking development districts: This bill establishes a Banking Development District (BDD) program to encourage the establishment of bank branches and services in locations with a demonstrated need for mainstream financial services. Was later amended into
Status: Vetoed by the Governor.

AB 3045 (Committee on Jobs, Economic Development, and the Economy)

Economic development: This bill adds definitions to the statute relating to the states economic development programs.
Status: Vetoed by the Governor.

Regulatory Reform

AB 1301 (Gaines)

Financial institutions: deposits: This bill revises and recasts provisions of the Banking Law and the Department of Financial Institutions (DFI) regulatory oversight.
Status: Chaptered by Secretary of State, Chapter 125, Statues of 2008.

AB 1508 (Lieu)

Money transmission: licensees and agents: This bill provides for technical and restructuring changes to the statutes regulating money transmitters.
Status: Chaptered by Secretary of State, Chapter 242, Statues of 2007.

AB 1516 (Maze)

Commissioner of Corporations: This bill would authorize the Commissioner of Corporations to develop, recommend, and implement guidelines to achieve greater efficiency and cost-effective services in connection with certification or licensure, examination, investigation, enforcement, and other responsibilities, as needed, to carry out these various provisions under the commissioner's jurisdiction.
Status: Held in Assembly Banking & Finance Committee.

AB 1518 (Committee on Banking & Finance)

Credit unions: This bill enacts a variety of changes intended to modernize the Credit Union Law, by allowing credit unions to share the results of their regulatory examinations with more professionals, as specified belong to economic development and trade organizations, make large gifts and donations, make loans on which one member and one non-member co-sign, and establish executive committees with broader responsibilities than those provided for under current law, among others.
Status: Chaptered by Secretary of State, Chapter 148, Statutes of 2007.

AB 2749 (Gaines)

Financial institutions: disclosure and reporting requirements: This bill recasts and clarifies provision of the banking law.
Status: Chaptered by the Secretary of State, Chapter 501, Statutes of 2008.

SB 998 (Cox)

Commissioner of Corporations: business regulation: This bill enacts various changes to the laws governing entities licensed under the Department of Corporations (DOC).
Status: Chaptered by Secretary of State, Chapter 101, Statues of 2007.

SB 1037(Committee on Banking, Finance and Insurance)

Banking and trust business: This bill makes technical changes to the laws administered by the Department of Financial Institutions (DFI).
Status: Chaptered by Secretary of State, Chapter 99, Statues of 2007.

Financial Literacy

AB 150 (Lieu)

California Financial Literacy Initiative: This bill establishes the California Financial Literacy Initiative for the purpose of improving financial literacy by offering instructional materials for teachers and parents to provide high-quality financial literacy education for pupils in kindergarten and grades 1 to 12, inclusive. The initiative would be administered by the Superintendent of Public Instruction. The Superintendent would be authorized to provide, among other things, an online library of financial literacy resources and materials to be made available for schools, teachers, parents, and pupils. The Superintendent also would be authorized to convene a Financial Literacy Advisory Committee that may include representatives of the office of the Superintendent, the office of the Treasurer, the Department of Corporations, the Department of Financial Institutions, and the office of the Controller. **(Note: This bill was not heard in this committee)**
Status: Vetoed by the Governor.

AB 2123 (Lieu)

California Financial Literacy Initiative: This bill establishes the California Financial Literacy Initiative, administered by the State Controller, and authorizes the Controller to convene a Financial Literacy Advisory Committee. AB 2123 requires the Controller to establish and oversee a California Financial Services Corps, subject to the availability of resources for that purpose, and requires the Controller to make annual reports to the Legislature.
Status: Vetoed by the Governor.

Investment advisors

AB 1583 (Maze)

Investments: investment advisers: securities: This bill makes various changes to the law governing investment advisors.
Status: Held in Assembly Banking & Finance Committee.

AB 2149 (Berg)

Broker-dealers and investment advisers: This bill prohibits an investment advisor or broker-dealer from using specific credentials or professional designations in such a way as to mislead any person.
Status: Chaptered by the Secretary of State, Chapter 476, Statutes of 2008.

AB 2460 (Davis)

Redevelopment agencies: affordable housing: Redevelopment agencies: affordable housing: Extends the authority for Los Angeles County to make assistance available from its low- and moderate-income housing fund directly to home-buyers and separately defines affordable housing cost
for these purposes.
Status: Re-referred to Assembly Rules Committee.

Credit Counseling & Debt Settlement

AB 2611 (Lieu)

Debt management and settlement: credit counselors: This bill provides for the regulation of debt settlement organizations and non-profit credit counselors.
Status: Held in Senate Banking, Finance & Insurance Committee.

SB 1678 (Florez)

Debt management and settlement: This bill provides for the regulation and licensing of debt settlement organizations.
Status: Held in Senate Rules Committee.

Personal Information

AB 703 (Ruskin)

Social security numbers: This bill prohibits a person or entity from using a social security number as an identifier, except as required by federal or state law. AB 703 would also require that records containing social security numbers be discarded or destroyed in a specified manner, and would require the encryption or locked storage of records containing social security numbers.
Status: Held in Assembly Judiciary Committee.

AB 1656 (Jones).

Personal information: security breaches: This bill prohibits a person, business, or agency that sells goods or services to any resident of California and accepts as payment a credit card, debit card, or other payment device, from storing, retaining, sending, or failing to limit access to payment-related data, as defined, retaining a primary account number, or storing sensitive authentication data subsequent to an authorization, unless a specified exception applies. Provides that if the owner or licensee of the information is the issuer of the credit or debit card, or the payment device then the owner or licensee must provide to the consumer a notification of the breach that includes specified information. (Note: this bill was not heard by this committee)
Status: Vetoed by the Governor.

AB 2918 (Lieber)

Employment: usage of consumer credit reports: This bill prohibits, except as specified, the user of a consumer credit report from procuring a consumer credit report for employment purposes unless the information in the report is either substantially job related, as defined, or required by law to be disclosed to, or obtained by, the user of the report.
Status: Vetoed by the Governor.

SB 328 (Corbett)

Personal information: prohibited practices: This bill includes a telephone calling pattern record or list, as defined, in the definition of personal information" that a business is required to ensure personal privacy. The bill also prohibits any person, as defined, from, among other things, obtaining or attempting to obtain, or causing or attempting to cause the

disclosure of, personal information about a customer or employee contained in the records of a business through specified methods, such as by making false, fictitious, or fraudulent statements or representations, with specified exceptions. The bill provides civil remedies for the violation thereof, and would make related and conforming changes in that regard.
Status: Held in Assembly Banking & Finance Committee.

Escrow

AB 804 (Huff)

Escrow agents: This bill enacts various changes to the laws involving independent escrow agents, some of which are technical, some of which are intended to ease compliance burdens for licensed escrow agents, and some of which are intended to be pro-consumer.
Status: Chaptered by Secretary of State, Chapter 237, Statues of 2007.

AB 1188 (Coto)

Escrow: disbursements: This bill requires an escrow agent or title company who make disbursements in conjunction from an escrow account of loan funds to notify the lender as to the disbursement date of the loan funds.
Status: Chaptered by the Secretary of State, Chapter 428, Statutes of 2008.

AB 2323 (Huff)

Escrow agents: This bill expands the background checks currently required to be performed on applicants for an escrow agent license and an Escrow Agents Fidelity Corporation certificate from a state-only background check to a state and federal background check, and requires the information returned from the background checks to be given to the Department of Corporations and EAFC.
Status: Chaptered by Secretary of State, Chapter 262, Statutes of 2008.

SB 1286 (Machado)

Escrow Agents' Fidelity Corporation: This bill requires that any private insurance policy maintained by an escrow agent be applied as primary coverage, in the event of a loss covered by both the private insurance and the Escrow Agents Fidelity Corporation. SB 1286 clarifies the procedures that must be followed by a person who has had their EAFC Certificate revoked or their EAFC Certificate application rejected, before they may reapply for an EAFC Certificate. This bill also requires Escrow Law licensees who use the services of accountants or 3rd party-contractors, to require these accountants or 3rd party-contractors to notify the Department of Corporations and Fidelity Corporation upon the occurrence of various events or discoveries. SB 1286 specifies that an agreement between an Escrow Law licensee and a financial institution be accompanied

by a letter from the licensee authorizing and requesting the financial institution to immediately notify DOC and Fidelity Corporation of account closure or the occurrence of an overdraft balance, with the opportunity for a waiver of this requirement if the financial institution fails to agree. The contents of this bill were later amended to become SB 1604 (Machado).
Status: Failed passage in Assembly Banking & Finance Committee.

Miscellaneous

AB 251 (DeSaulnier)

Corporations: distributions: This bill prohibits a corporation and its subsidiaries from making a dividend distribution if it has failed to make a payment into its pension plan.
Status: Failed passage in Senate Banking, Finance & Insurance Committee.

AB 786 (Lieu)

Financial institutions: greenhouse gas emissions: This bill states that banks providing financial incentives to assist other entities in reducing greenhouse gases prior to January 1, 2012 may receive an appropriate credit under the greenhouse gas emissions reduction program adopted by the Air Resources Board.
Status: Failed passage in Assembly Appropriation Committee.

AB 952 (Mullin)

Common interest developments: assessments: low- and moderate-income residents: This bill requires a Common Interest Development to establish a payment plan for all regular and special assessment imposed on units for those owner occupants who request one.
Status: Vetoed by the Governor.

AB 1104 (Aghazarian)

Small Business Expansion Fund: This bill allows the California Small Business Expansion Fund (CSBEF) to expand its authority to provide small business loan guarantees to areas of the state affected by a state of emergency as declared by the President of the United States, or the U.S. Small Business Distraction, or as declared by the Governor.
Status: Chaptered by Secretary of State, Chapter 624, Statues of 2007.

AB 1533 (Committee on Banking and Finance)

Registered warrants: reimbursement warrants: This bill authorizes the State Controller to sell registered reimbursement warrants, also known as RAWs (revenue anticipation warrants), at fixed or variable rates in

negotiated sales on the terms and conditions the State Controller shall approve. This is in addition to current law, which only allows the ale of RAWs at fixed rates in public sale under competitive bidding.
Status: Chaptered by Secretary of State, Chapter 336, Statues of 2007.

AB 2249 (Niello)

Financial institutions: accounts: This bill provides for specific circumstances in which a government entity may access account information of a customer's account at a bank, credit union or savings association.
Status: Chaptered by the Secretary of State, Chapter 234, Statutes of 2008.

AJR 17 (Lieu)

Currency: accessibility: This resolution urges the United States Treasury Department to withdraw its appeal in a case regarding accessible currency, and urge Congress and the President to enact legislation requiring the U.S. Treasury Department to make its currency accessible to persons who are blind or visually impaired.
Status: Chaptered by Secretary of State, Chapter 74, Statues of 2007.

SB 1007 (Machado)

Exchange facilitators: This bill requires a person or entity engaging in business as an exchange facilitator (EF) to comply with certain bonding and insurance requirements.
Status: Chaptered by the Secretary of State, Chapter 708, Statutes of 2008.

SB 1224 (Machado)

Insurance viatical and life settlement contracts: This bill expands the definition of security to include a fractional or proportional interest in a life insurance policy benefit, including a viatical settlement contact. Enacts the Life Settlement Consumer Protection Act of 2008
Status: Failed passage in Assembly Banking & Finance Committee.

SB 1311 (Simitian)

California Pollution Control Financing Authority: Capital Access Loan Program: This bill reduces the monetary contribution of the California Pollution Control Financing Authority to an amount equal to the amount of fees paid by a participating financial institution. Also provides that CPCFA

may withdraw from the loss reserve account all interest or other income that has been credited to that account for the purpose offsetting administrative costs and contributions.
Status: Chaptered by the Secretary of State, Chapter 401, Statutes of 2008.

SB 1409 (Ackerman)

Corporations: annual reports: This bill authorizes certain California corporations to follow a recently-issued Securities and Exchange Commission rule allowing proxy materials to be provided over the Internet.
Status: Chaptered by the Secretary of State, Chapter 177, Statues of 2008.

SB 1511 (Ducheny)

Common interest developments: mortgages: successors in interest: This bill allows an association, with respect to separate interests governed by the association, to record a request that a mortgagee, trustee, or other person authorized to record a notice of default regarding any of those separate interest to mail to the association a copy of any trustee's deed upon sale concerning a separate interest. This bill requires the mortgagee or trustee to mail that information to the association within 15 business days following the date the trustee's deed is recorded. This bill specifies that failure to mail the request, pursuant to that provision, would not affect the title to real property.
Status: Chaptered by the Secretary of State, Chapter 527, Statutes of 2008.

Bills Heard in Special Session

ABX 4 (Lieu)

Residential mortgage loans: foreclosure. Required loan servicers to provide evidence of a comprehensive loan modification plan that meets specific criteria to the Secretary of the Business, Transportation and Housing Agency. A servicer that does not have a comprehensive loan modification plan would have to delay foreclosure on specified properties for 120 days.
Status: Vote was not taken. Bill heard in committee for informational purposes only.

California State Assembly
Banking & Finance Committee
Informational Hearings

Assembly Committee on Banking & Finance
Informational Hearing

The Current State of Financial Literacy in California

February 20th, 2007
1:30 p.m.
Room 444

"All the perplexities, confusion and distress in America arise, not from defects in their Constitution or Confederation, not from want of honor or virtue, so much as from the downright ignorance of the nature of coin, credit and circulation."
John Adams-1787

Annual percentage rate, compound interest, adjustable rate mortgage, FICO score, reverse mortgage, universal default, prepayment penalties, negative amortization, 401(k), IRA, annuity, Certificates of Deposit, capital gain, equity, principal and balance transfer fees are just some of the terms of the contemporary financial universe. Access to credit is available now more than ever before allowing millions of Americans to own homes, access goods and services and pay for educational needs. This world of growing credit also means greater responsibility on the part of consumers and providers. The market place functions best when educated consumers are able to make informed choices regarding their personal financial needs and goals. A well informed and financially literate consumer can save thousands of dollars at the closing table, avoid abnormal fees and charges and build up savings for retirement. Financial literacy is not only about learning the skills need to balance a check book, it is about personal empowerment.

The statistics on American's financial literacy present a contradiction between the existing knowledge of financial matters and the actual use of finances. *For example, in early 2006 there were 190 million credit card holders who charged an average of $8,500 during 2005, with the average outstanding credit card balance for American households with at least two adults is over $13,000.*[1] Contrasts these statistics with the revelation that only 27% of Americans feel well informed about managing household finances.[2] Furthermore, in 2006 the savings rate for Americans fell to negative 1 percent, the lowest margin since the great depression![3]

Many explanations for this abound, however among the most widely held, is a lack of financial awareness: "Economists have put forward various reasons to explain the current lack of savings. These range from a feeling on the part of some people that they do not need to save because of the run-up in their investments such as homes and stock portfolios to an effort by many middle-class wage earners to maintain their current lifestyles

[1] Prepared statement of Robert D. Manning, PhD, Research Professor of Consumer Finance and Director of the Center for Consumer Financial Services, US Senate Committee on Banking, Housing, and Urban Affairs, 1/25/07
[2] Networks Financial Institute, Indiana State University.
[3] Report of the US Commerce Department

even though their wage gains have been depressed by the effects of global competition."[4]

As mentioned before, the financial market place works best with informed consumers, and obviously this is the philosophy of many conumser protection laws at the federal and state level. Current statututorily required consumer protections in the financial arena are, in most cases, centered around consumer disclosures of terms and obligations. Needless to say, disclosures are ineffective when the consumer is unable to place the information in the proper context.

Apply for a credit card and you will receive a large pamplet of disclosure notices discussing interest rates and late fees. Thinking of buying a home? Almost 20 different state and federally mandated disclosures will find their way into a consumers hands even though most americans don't have the financial background to properly compute a mortgage amortization table.[5]

What is Financial Literacy?:

Before continuing, it is important to establish what exactly is the meaning of financial literacy, or what skills would we expect a person to have if they were financially literate? The National Endowment for Financial Education defines Financial Literacy as:

> *"Personal financial literacy is the ability to read, analyze, manage, and communicate about the personal financial conditions that affect material well being. It includes the ability to discern financial choices, discuss money and financial issues without (or despite) discomfort, plan for the future and respond competently to life events that affect everyday financial decisions, including events in the general economy."*

The U.S. Financial Literacy and Education Commission defines financial literacy as "the ability to make informed judgments and to take effective actions regarding the current and future use and management of money."

Financial literacy is not only the basic skills of balancing a checkbook, or computing interest rates, but the ability to use that information to make informed decisions about ones financial future and stability.

Financial Literacy Among Students:

---

[4] 2006 personal savings fall to 74-yr. low, *Business Week*. February 1, 2007

[5] For an overview of state and federally mandated mortgage transaction disclosures go to the "existing law" section of the Assembly Banking Committee analysis of AB 459 (Oropeza) of 2005, April 26, 2005 version.

Financial literacy education often doesn't receive the same attention as other life skills such as math and science education. Furthermore, with decreasing resources to devote to education, government officials and educators must make difficult decisions as to what subjects they will teach to students in the k-12 setting. Vital subjects such as financial literacy left behind. However the importance of financial awareness may have a direct impact on other vital learning skills. A recent study examining the overall literacy of college students found that 20% of students in 4-year colleges and institutions have basic or below average quantitative literacy skills.[6] Considering this result, it is not surprising that Nellie Mae, an originator of student loans, found that 83% of undergraduate students have at least one credit card with an average balance of $2,237 and by the time they graduate with will have an average of $20,402 in credit card and education loan balances.

The Jump$tart Coalition for Financial Literacy conducted a survey of high school students that resulted in 52.4% of survey respondents getting the right answers, a score that translate to an F minus.

Undergraduates reported freshman year as the most prevalent time for obtaining credit cards, with 56% reporting having obtained their first card at the age of 18 with an average balance of $1,585.[7] Young people are using credit and engaging in the financial mainstream, yet appear to have a lack of basic skills and knowledge. Needless to say, this is a dangerous contradiction.

Furthermore, the overall results for adult Americans also reveals a dismal picture. While 65.1% of Americans consider themselves very knowledgeable when it comes to personal finance, 52% do not regularly review their credit reports, and 36.1% do not use any type of budget to manage their family expenditures.[8] In 2005 the Capital One Financial Back to School survey, found that 91% of students whose parents would be with them on their back to school shopping trips revealed that their parents had not discussed back to school finances with them. With 60% of parents spending at a rate of $125 per child this is a vital opportunity missed. In addition, a recent A.G. Edwards Nest Egg Score Survey (March 2006) found that:

---

[6] "The Literacy of America's College Students." American Institutes for Research, January 2006. (Quantitative literacy was defined as the ability to perform computations such as balancing checkbooks, calculating tips and completing order forms.)

[7] *Undergraduate Students and Credit Cards in 2004: An Analysis of Usage Rates and Trends*, Nellie Mae, May 2005.

[8] Results of a Capitol One/Consumer action joint survey.

- Only 57 percent of parents with children ages six to 17 have ever discussed savings or investing with their kids, while only 53 percent of parents with children aged six to 12 have.

- 40% of parents of six- to 17-year-olds consider their children too young to understand. That number increases to 48 percent for parents of children aged six to 12.

Many other opportunities are missed for linking together the everyday activities of teens and young adults and financial literacy. We are no longer in the days where we must use hypothetical abstractions such as the number of apples and oranges in a transaction. For those students with Ipods, they pay up to 99 cents a song on Itunes, which can only be accomplish with a credit or debit card. Many popular video game servers and sites offer online gaming a content, which also can only be acquired with credit or debit cards.

Programs and Approaches:

A myriad of programs and options exist to assist and direct the financial literacy education of students and young adults. Most all banking institutions offer some type of literacy program or make materials available educators to use in the class room. However, efforts have come about in recent years to find creative approaches to this problem.

For example, the Sargent Shriver National Center on Poverty Law established the Curie Branch of Park Federal Savings Bank is a student-run bank located in Curie Metro High School in Chicago, Illinois. Each year Curie High School selects 10 students to be hired by Park Federal and trained as bank tellers, savings counselors, or teller supervisors. The student bankers earn wages working about 15 hours per week as part of the Chicago Public Schools' Education To Careers program in accounting at Curie High School. The Curie Branch opened on April 12, 2005. The branch is open to students, faculty, staff, parents, and others at Curie on school business. Account holders have access to all Park Federal products. The Shriver Center is currently working other efforts to open similar branches in schools across the country including locations in California.

Student run banks are not alone in this approach, as currently, 74 credit unions in 25 states operate student-ruin branches in 238 schools.[9]

---

[9] Colleen Kelly, *Financial Literacy* in Schools: The Credit Union Commitment*, (Washington, D.C.: Credit Union National Association, 2002).

California's credit unions also engage in numerous programs and approaches. The California Credit Union League and the Richard Myles Johnson Foundation (a 501(c)3 charitable organization affiliated with the League) provide credit unions with access to many financial literacy programs.

Eight credit unions participate in USA TODAY Education's "Choice is Power" program. Schools receive daily delivery of 20 copies of the USA TODAY newspaper, and a lesson plan that is specific to the news in that day's paper. Credit union sponsorships reach more than 35,000 students. Fifteen or more credit unions are expected to participate in the 2007-08 school year. Credit unions are also the sole sponsors of an upcoming PBS television program, "Biz Kid$," which teaches entrepreneurship and basic money management skills. The program will debut with a special episode in April, during Financial Literacy Month.

Other innovative approaches include using board and computer games to teach financial skills. The oldest of these is the Stock Market Game, which allows students to simulate the trading of stocks on the stock market using real time data. Starting with a virtual cash account of $100,000, students strive to create the best-performing portfolio using a live trading simulation. They work together in teams, practicing leadership, organization, negotiation, and cooperation as they compete for the top spot. In the process of playing this, game students learn core financial concepts and skills. Since 1977, more than 8 million students have participated in The Stock Market Game.

West Virginia has a new state law mandating financial education as a high school graduation requirement with the West Virginia Treasurer's office tasked with delivering financial education to the schools in that state.

In order to assist in ensuring that all West Virginian high school students receive the appropriate knowledge Visa, in partnership with the National Football League, recently developed an educational video game and accompanying curriculum called Financial Football. Based on the model of other popular football video games, players advance down the field and score points by correctly answering questions about personal finance. This innovative approach to learning financial life skills quickly turned into a classroom favorite for teachers and students alike. Financial Football is offered free of charge and can be accessed over the Internet or shipped on a CD.

The Treasurer's Office conducted a multi-week pilot program to test the effectiveness and response of the curriculum. The pilot was conducted in five West Virginia high schools and the response from the teachers and students was overwhelmingly positive. Visa simultaneously hired a West Virginia educational expert to ensure that the lessons learned in the Financial Football curriculum mapped closely with state academic requirements.

Based on the success of the pilot program, the Treasurer's office and Visa agreed to a statewide roll out of Financial Football. The statewide roll out will begin on December 19, 2006 and will involve the Treasurer's office sending Financial Football CDs to all 184 high schools and 176 libraries in West Virginia. The CDs will be co-branded with the Treasurer's name and Seal and will be accompanied by a letter from the Treasurer explaining the program, along with an informational brochure describing Practical Money Skills for Life.

Government Response:

Title V of the Fair and Accurate Credit Transaction Act (FACT Act) established the Financial Literacy and Education Commission (Commission) with the purpose of improving the financial literacy and education of persons in the United States. This program is a partnership between twenty federal agencies to provide materials and resources for those interested in providing financial literacy services and programs. Congress charged the commission with improving "the financial literacy and education of persons in the United States through the development of a national strategy to promote financial literacy and education." In 2006, the Commission released their strategic plan for national financial literacy entitled, *Taking Ownership of the Future, the National Strategy for Financial Literacy.*[10]

The Federal Deposit Insurance Corporation (FDIC) created Money Smart, a financial literacy program composed of ten training modules that can be used by financial institutions and schools. The FDIC also provides trainers to assist in teaching the program or to bring together interested parties to form partnerships.

At least 37 states have personal finance educational standards, however, these standards are often included in courses on general economics. At least seven states, Idaho, Illinois, Kentucky, Louisiana, New York, South Carolina and Utah, have actual requirements that students complete a personal finance management skills course.

[10] Report can be found at http://www.mymoney.gov/

Currently in California, there is no mandated curriculum on financial literacy. Many other states have financial literacy programs that are fully funded, or have created public-private partnerships. Also, some states have taken a creative approach by creating a central clearinghouse of information and curricula available for schools who decide to teach courses in financial literacy.

Policy Recommendations:

The National Conference of State Legislatures, in their report on financial literacy outlined some policy choices for legislatures around the country.

- **Personalized flyers to send to constituents and to use in events.** Many state agencies and organizations have flyers and pamphlets that legislators can personalize and distribute to constituents through mailings, town hall meetings and other constituent contacts. Another option for legislator involvement is to participate in activities such as housing fairs, which often are used to reach out to low- and moderate-income individuals who may be buying their first homes. Fairs and other activities often occur in April, which several states have designated as "Financial Literacy Month." Legislators' involvement in financial literacy efforts demonstrates to constituents the importance of this issue.

- **Build partnerships between private and public organizations.** State legislators can help build partnerships between private and public organizations to encourage these groups to work together on financial literacy efforts for school and college age individuals, and for adults. New Jersey, for example, created the New Jersey Financial Literacy Awareness Network (NJFLAN) through the state Department of Banking and Insurance. The network is a statewide distribution channel that aggregates and provides easy access to existing financial education programs and materials through a learning center display and resource guides, both online and in book version, to children and adults.

- **Federal and state financial literacy initiatives for adults.** The federal Financial Literacy and Education Commission established under the Financial Literacy and Education Improvement Act of 2003 as part of the Fair and Accurate Credit Transactions Act of 2003—could focus increased attention on the financial literacy needs of baby boomers and older people

- **Establish interagency councils to coordinate efforts.** Interagency councils could be used to coordinate existing and future efforts to increase financial literacy. These councils could include organizations and agencies that serve older persons, such as financial service providers, consumer groups, researchers, educators and government agencies, such as a state Department of Aging.

- **Increase funding for financial education efforts.** Funding and assistance for student financial education efforts can be increased through the Excellence in Economic Education Act of 2001, created through the federal No Child Left Behind Act. The Excellence in Economic Education Act promotes economic and financial literacy for K-12 students. The objectives of this program are to: 1) increase students' knowledge of and achievement in economics; 2) strengthen teachers' understanding of economics; 3) encourage economic education research and development, disseminate effective instructional materials, and promote best practices and exemplary programs that foster economic literacy; 4) help states to measure the effects of education in economics; and 5) leverage and expand increased private and public support for economic education partnerships at the national, state and local levels.

- **Create state-level office to coordinate state financial education policies.** A state-level office dedicated to coordinating and promoting the state's financial education programs and policies could further a state's financial education policies, similar to an office created in Pennsylvania. The Office of Financial Education will help state agencies work together and with community and private sector partners to create and maintain a clearinghouse with an accurate and up-to-date inventory of help available.

- **Include financial education in assistance programs.** States could include financial education efforts for low-income families through the Temporary Assistance for Needy Families (TANF) program. Legislatures could recognize participation in financial literacy training as an approved work activity meeting the 30-hour per week work requirement for TANF recipients, similar to the state of Illinois. TANF funds can be used to support financial education strategies. States could also increase funding for individual development account (IDA) programs, which often include financial education as part of participation requirements.

- **Financial literacy professional development for teachers.** Investing in professional development for teachers and encouraging and motivating teachers to incorporate financial literacy into their lesson plans will help further financial literacy efforts. The Pennsylvania Governor's Task Force concluded that, " … it cannot be assumed that all teachers have a full understanding of financial principles themselves.

Professional development opportunities must be made available to teachers to enhance their own knowledge and skills."

- **Sponsor additional research to improve the effectiveness of financial literacy programs.** The private sector, foundations, federal and state governments, and others could support additional research aimed at improving the effectiveness of financial literacy and consumer counseling programs, particularly with regard to obtaining outcomes that lead to better money management and wealth-building behaviors and skills.

Conclusions:

Financial literacy is not just about computing the interest on an auto loan, or the rate on a savings account or government bond. Financial literacy is the foundation to personal financial empowerment and a powerful defense mechanism against bad actors in the financial market. As mentioned previously, the majority of our consumer protect laws are disclosure based, or at the least require the consumer to know who they should report to in the event of an incident. These skills can ensure that a borrower gets the best mortgage for which the qualify, or how to spot unusual fees or charges. If a young consumer never learns to examine their credit report, or that they can access their three reports for free once per year, they may never learn that they are victims of identity theft or false charges against their credit. If they are unaware of the difference between a 550 and a 750 FICO score they will never know the benefits of maintaining good credit.

While numerous programs exist in California from the financial community and from non-profit organizations, no central authority determines what materials or programs are best suited for students in high schools. If a high-school in California decided to teach a course in financial education they would not find any guidance from the state, nor a central location to go for materials. At this point, educators are on their own to find materials and speakers for a personal finance class.

Assembly Committee on Banking & Finance

Informational hearing

The Un-banked and Methods of Access to the Financial Mainstream

California State Capitol, Room 444

April 9th, 2007

The American financial landscape contains a mix of financial services and sectors from banking institutions, investment houses, and check cashing centers. However, when we think of banking and financial services most often we imagine the quintessential bank branch or credit union. Many Americans are so accustom to mainstream banking and electronic transactions that rarely is any thought given to those systems that are outside of the mainstream. In 2003, electronic payments surpassed other types of payments for in-store purchases for the first time in the United States.[11] In an evolving electronic financial world, those with out a banking relationship can loose out on many cost savings benefits.

The unbanked, or those without a transaction account with a financial institution constitute approximately 22 million, or 20% of Americans. This population spends $10.9 billion on more than 324 million alternative financial service transactions per year. BearingPoint, a global management and technology consulting company, estimates that the unbanked population expands to 28 million when you include those who do not have a credit score. In addition, BearingPoint puts the underbanked population, defined as those with a bank account but a low FICO[12] score that impedes access to incremental credit, at an additional 45 million people. Although estimates find that at least 70% of the population has some type of bank account, these individuals continue to use non-bank services, ranging from the purchase of money orders, use of payday lenders, pawn shops or sending of remittances.[13] The Federal Reserve Board has noted that 50% of current unbanked households claim to have had an account in the past.

In California, 28% of adults do not have a checking or savings account, according to the U.S. Census. In San Francisco, the Brookings Institution estimated that one in five San Francisco adults, and half of its African-Americans and Hispanics, do not have accounts. Recent market research indicates that Fresno and Los Angeles have the second and third highest

[11] Dove Consulting
[12] A FICO score is a credit score developed by Fair Isaac & Co. Credit scoring is a method of determining the likelihood that credit users will pay their bills. Fair, Isaac began its pioneering work with credit scoring in the late 1950s and, since then, scoring has become widely accepted by lenders as a reliable means of credit evaluation. A credit score attempts to condense a borrowers credit history into a single number. Fair, Isaac & Co. and the credit bureaus do not reveal how these scores are computed.
[13] Center for Financial Services Innovation, *Making Financial Services Work for Everyone*, October 2005.

percentages of un-banked residents in the country

Nationwide, the unbanked are disproportionately represented among lower-income households, among households headed by African-Americans and Hispanics, among households headed by young adults, and among renters.[14] A Harvard Poll of Hurricane Katrina evacuees in the Superdome found that seven out of ten did not have a checking or savings account.

The unbanked poor pay more to conduct their financial lives. Check cashing outlets can charge between 2-3 percent of the face value of a check. So, an individual
who makes $30,000 a year can pay $800 a year in fees to cash their payroll checks and pay their bills. The lack of access to mainstream banking cost both consumers and society, as well as, the financial community that misses out on this untapped market.

Families without accounts don't have a safe place to keep their money. They may walk around with wads of cash in their pockets, or keep it at home in a coffee can. Robberies are more prevalent around check cashing outlets. A burglary, or a fire, could cost them their life's savings in a matter of moments. A bank account helps people take the first step onto this path. Without an account, it is much more difficult to get well-priced car loans, credit cards, or mortgages—the exact financial tools needed to climb up the economic ladder. Stable societies are built on financially stable families who have access to high-quality, low-cost financial services.

A 2001 Federal Reserve study on consumer finances asked "Why don't you have a checking account?" The reasons given were:

- Do not write enough checks to make it worthwhile (28.6%).
- Do not like dealing with banks (22.6%).
- Do not have enough money (14%).
- Service charges are too high (10.2%).
- Cannot manage or balance a checking account (6.6%).
- Minimum balance is too high (6.5%).
- Does not need/want a checking account (5.3%).
- Credit problems (3.6%)
- No bank has convenient hours or location (.4%)
- Other (2.1%)

How did we get here?[15]

[14] John P Caskey, *Bringing Unbanked Households into the Banking System*, January 2002.
[15] Seidman and Tescher, *Unbanked to Homeowner: Improving Financial Services for Low-Income, Low Asset Customers.* 2005, Brookings Institutions Press. (Guidance for this section)

The general assumption in the past involves low-income customers, who are likely unbanked or underbanked, had low account balances and high transaction volumes, which is an unprofitable combination for the traditional banking model. Unlike a number of other states that required lifeline banking accounts for seniors and the poor, little emphasis was made to service this market. Banking regulators focused on the importance of providing loans and investments to lower-income communities, rather than asset building services.

Greater recognition has occurred in the financial services environment of the unbanked in regard to the asset poor and the connection to asset building.

What has led to this newfound recognition of the unbanked? First, technological innovation that assisted the increase in homeownership through risk-based automated underwriting models began to have an impact on the retail market with a greater use of automated transactions and internet banking. For example, some financial institutions offer full service ATMs that allow the reloading of a payroll card, payment of bills, money order purchase, deposit into a savings account and check cashing service. These electronic systems have brought down the cost of serving retail banking customers and allowing greater innovation relating to expanding services to fringe markets.

Second, the Debt Collection Improvement Act of 1996 required all federal payments to individuals be made by direct deposit. In the process of implementing this new law, the Treasury Department realized that many federal benefit recipients did not have bank accounts. This led to the Treasury commissioning research to examine the reasons why people were unbanked.

Third, alternative financial sectors exploded in growth in the 1990s. The number of payday lenders, check cashing outlets, pawn shops tripled and sometimes quadrupled in locations, particularly in states with relaxed regulation of these types of providers.

Finally, the United States underwent major demographic changes as found in results of the 2000 Census. These changes encouraged financial service firms to focus more heavily on the opportunities presented by these changes. Specifically, the Latino population grew by 58% in the 1990s and by 2004 totaled 13% of the total U.S. population. Sixty percent of Latinos were born in the U.S. with 55% residing in the suburbs with a purchasing power estimated at $600 billion annually. In spite of this sizable economic power, estimates reveal that as many as 34% of Latinos are unbanked. These growing demographic trends have forced mainstream financial institutions to reexamine this once overlooked market.

Products and services currently targeted toward unbanked and underbanked.

The last decade has seen a rise in product offerings to the unbanked population. This section will provide a brief overview of some products and innovative approaches that not only target those without a banking relationship, but target those who may have minimum contact with mainstream banking.

Stored value cards (SVC), specifically, payroll cards have emerged as a growing trend and product marketed to the unbanked and underbanked population. Growing numbers of employers use SVCs as a way to provide employees with wages or other benefits such as flexible spending accounts that pay for out-of-pocket medical expenses. It is estimated that in 2004 2.3 million payroll cards were issued, and the use of these cards may climb to over 6 million workers.[16]

Payroll cards can be a cost-effective way for employers to pay their employees because the cost of loading funds on a card can be less than the cost of issuing a check. SVCs can also be cost-effective for employees, particularly for those employees without a bank account, because accessing funds through a SVC may cost little or nothing while check cashers typically charge high fees for their services.

Once the wages are credited to the account, the wages can be withdrawn using the payroll card at an ATM, which may charge a fee. The card can also be used to purchase goods and services like a debit card. If a payroll card is reported stolen or lost within 48 hours, it will be replaced and the lost pay restored. An employee may incur a fee to replace a card.

University Bank in St. Paul, Minnesota, and Central Bank of Kansas City have emerged as innovators in serving the unbanked through stored value cards.[17] Both institutions tried to create a "personal spend card" which is a stored value card that combined the functions of the single-purpose products that are typical in today's market, while also retaining the ownership and administration of the account underlying the SVC cards The rationale for the multi-purpose card is if the product is to be an alternative

[16] Diane E. Lewis, *It's all in the Card.* Boston Globe. February 15, 2004
[17] From Margins to the Mainstream: A Guide to Building Products and Strategies for Underbanked Markets. National Community Investment Fund..

to a checking account or ATM-enabled savings account, then it must have the same versatility and functionality.

University Bank began developing its stored value card, which aimed to give customers a banking product that combined the retail features of a bank account—a place to keep money, the ability to withdraw cash, make electronic payments, debit purchases—with the benefits of a credit card—retail and online purchases, flexibility, the absence of cash—but without the risks associated with either one. Once customers had established a relationship with University Bank and accustomed themselves to bank-like transactions through the SVC, the bank hoped users would eventually move into a traditional banking account and on up into other financial vehicles.

Second chance checking accounts have also emerged as a growing product for those individuals who had a bank account in the past but incurred several overdraft charges that made them risky customers to banks. Legacy Bank of Milwaukee, Wisconsin, originally designed its Financial Liberty First Accounts for those customers who never had a bank account, but this soon changed into a product to capture those customers who are underbanked.[18] Part of the design this particular account included early monitoring by the bank for potential problems that customers may face, such as overdrafts. This approach known as tech-meets-touch is a system that combines electronic monitoring of accounts with employee to customer outreach if a problem is spotted. Legacy Bank has a strict intervention policy that requires financial education classes in combination with credit counseling if they have more than three overdrafts. This program effectively used community partnerships to overcome three of the most important barriers to becoming banked: financial illiteracy, market penetration, and a lack of trust among customers. The success of Legacy is rooted in its institutional strategy to reach the unbanked. The bank estimates that one-third of overall staff time goes into reaching out to the unbanked through classes, new accounts, monitoring and account administration.[19]

An early innovation in providing asset-building opportunities for the underbanked includes Individual Development Accounts (IDAs). IDAs represent one of the first attempts to create a vehicle for underbanked individuals and families to save and build assets. By rewarding participants with matching money added to their monthly savings, IDAs programs promote home ownership, educational attainment and economic independence. There appears to be more than 500 IDA initiatives in

---

[18] Ibid.
[19] ibid.

existence in communities across the country, with at least 15,000 people saving in IDAs.[20] Though they vary in design and implementation, IDAs are dedicated savings accounts that match participants' contributions to the account. Participants have a strong incentive to save as their contributions are matched at very favorable ratios by government, philanthropic and private-sector institutions. The programs have a cap on matching funds and a vesting period in which to earn them. The participants can withdraw their own funds before the vesting period is completed, but will lose the matching money. Participants can only withdraw the matching money for an asset purchase, such as paying for college, buying a home or starting their own business. While eligibility guidelines vary by program and by region, IDAs are generally available to those with household incomes below $35,000 a year. An additional component of IDA programs is financial education and counseling to help participants manage and repair their credit, set a budget and savings schedule, and prepare to purchase and manage an asset.

As individual IDA participants have succeeded in buying homes, starting businesses, going to college and saving for retirement, they have helped to prove that lower-income,
underbanked families can and will save if given the appropriate access, ease and
incentives. Within the American Dream Demonstration (ADD), a 13-site IDA demonstration that began in the late 1990s, participants accumulated an average of $700 per year including matches. More importantly, as their savings increased, participants were more likely to achieve their monthly deposit targets, demonstrating that their saving behavior, like that of wealthier individuals, is influenced by the incentives they receive. Financial institutions play a variety of roles in IDA programs, from providing the accounts to holding the pooled matching funds, to providing financial coaching and making financial contributions. IDA-sponsoring institutions are overwhelmingly commercial banks and thrifts (81%), with credit unions making up the remaining total (19%). Citigroup, Bank of America and others have been at the forefront, serving as depositories for IDAs and providing matching funds.

The Federal Deposit Insurance Corporation (FDIC) offers a financial education program, Money Smart, which encourages participants to open an account. This program provides participants with financial literacy skills to assist them in making informed financial decisions. The program consists of 10 instructor-led training modules that cover various topics. The FDIC does not look to Money Smart to encourage the opening of an

---

[20] Center for Financial Services Innovation, *Marrying Financial Transactions with Asset-Building Opportunities.*

account but to give participants the skill needed to make the most appropriate decisions based on their circumstances which may not be a bank account.[21]

The success of innovative product solutions has built upon successful models that incorporate some key concepts related to the unbanked. Some of those strategies have included:

- Developing an understanding of the needs and demographics of the unbanked market by acknowledging that the unbanked are not just people with less money.

- Mimicking the transactional aspects of non-traditional products, such as payday loans, while limiting their predatory aspects. Several banks and credit unions offer competing products for payday loans and check cashing services.

- Understanding that families' living paycheck to paycheck access to cash is critical. Institutions seeking to service the unbanked have had more success when designing products that take into account the need for quick cash as small dollar amounts.

- Monitoring and early intervention to preemptively engage with customers before a problem reaches unfixable proportions. Early monitoring reduces risk for the institutions while helping a customer develop good financial habits.

- Products that meet immediate needs, such as payroll cards, check cashing services, starter accounts and others should serve as entry points to more traditional products that help with long-term asset building needs.

- Leveraging public and private partnerships to assist in reaching out to customers and to ensure long-term success.

Obstacles to reaching the unbanked.

As the Center for Financial Services Innovation (CFSI) points out, a major hurdle for addressing unbanked populations is the tendency to view the population as a group who all share the same problem. CFSI continues:

> *Low-income consumers are not a homogeneous group, and a one-*

[21] Angela Lyons and Erik Scherpf. *Moving from unbanked to banked: Evidence from the Money Smart program.* Financial Services Review. 2004.

size-fits-all strategy in marketing and product development for low- and moderate-income consumers runs the risk of appealing to no one in particular. In addition to the remarkable demographic diversity in this market, we have also seen that there is substantial diversity in attitudes, preferences, and experience. For example, for the half of unbanked households that have had a bank account in the past, the issue is winning back those whose experience with the system has not been positive—a fundamentally different marketing challenge from attracting those who have never had a bank account. Customers who find managing a checking account difficult may require a different set of products and services than customers who routinely make payments with checks. Financial education curricula also need to be tailored to the needs of individual groups. Curricula developed to bring the unbanked into the banking system need to differ from curricula for segments that were formerly banked, although both need to offer preventive tools designed to address account management issues.

Other, less obvious, factors can also discourage low-income consumers. A lack of bilingual frontline services coupled with a culture that does not emphasize customer service. Also, some surveys suggest that the unbanked are concerned with privacy issues, particularly with undocumented immigrants who may fear repercussions for not possessing the appropriate identification.[22] As Seidman and Tescher note:

Comparing a typical menu of bank products with the reasons why some Americans choose not to have a banking relationship suggests that the problem may not be lack of demand, but rather the lack of an appropriate and appealing supply. While traditional banking institutions are well positioned to meet low income families' long-term financial needs, most are ill-equipped to meet their immediate and short-term needs. Traditional checking accounts are predicated on consumer liquidity, a luxury poor people generally do not have. Even banks that have one or two products appropriate for modest-income consumers generally lack a full line of products that would enable consumers to build on their initial successes. In addition, bank branches are often inconveniently located for the poor and do not offer them a comfortable atmosphere. While the financial services industry is quite sophisticated about segmenting upper-income consumers and crafting appropriate marketing messages to reach them, little attention has been paid to outreach efforts at the lower end of the income scale.

Alternative Credit Data

[22] Seidman and Tescher, *Unbanked to Homeowner: Improving Financial Services for Low-Income, Low Asset Customers.* 2005,

A growing option and trend for both the unbanked and underbanked is the use of alternative credit data. An estimated 32 million Americans have credit files that do not have sufficient information to calculate a standard credit score. Obviously, a lack of credit information can leave otherwise qualified persons outside the credit system that enables people to buy houses, cars, or in some cases simply open a bank account.

In recent decades, access to credit has dramatically expanded for the great majority of
Americans with the spread of automated "credit scoring" systems that make credit decisions easier and more consistent. For many of those outside the credit fold, the dilemma is in one sense simple and difficult in another. It is simple in that the problem of access is often a problem of information. That is, many of those with a credit disadvantage lack information in their credit files (are "thin-filed") or lack files altogether ("null-filed"). The problem is complex in that access to credit, at reasonable prices, requires payment information, which, in turn, requires credit. One solution to this hurdle is to use payment information not from lenders but from providers of "credit-like" services. These services, such as utilities, are often supplied in advance of payment, are automated and recurrent, and thereby provide sufficient information to establish patterns. Alternative or nontraditional data provide lenders with information to help evaluate the risk of lending to a consumer. [23]

The Federal Reserve Bank of Boston has revealed some companies have recently begun utilizing or investigating credit scoring models relying on alternative credit data:

• In 2005, MassHousing, the housing finance agency for the state of Massachusetts, became the first nationwide lender to qualify borrowers using a credit scoring system based on alternative sources of credit data. The scoring system, *Anthem*, was created by First American CREDCO.

• Pay Rent, Build Credit (PRBC), considered an alternative credit bureau, also calculates a credit score based on alternative data. Consumers can have Third parties (lenders or service/product providers) report payment data to PRBC, or consumers can report their data directly and have a third party verify the information. PRBC has obtained letters from the Federal Reserve and other government entities stating that lending institutions may receive credit under the CRA when they serve as a conduit for rental

[23] Sara Burr and Virginia Carlson, *Utility Payments as Alternative Credit Data: A Reality Check.* The Brookings Institution Metropolitan Policy Program. March 2007

payment information.

• In 2004, the Fair Isaac Corporation launched its *Expansion Score*, combining alternative data such as payday loan payments and product purchase-payment plans with traditional payment data.

• Fannie Mae, Freddie Mac, and CitiMortgage are jointly testing the usefulness of the alternative data collected by PRBC for use in their own credit models.

• Bank of America has examined the use of alternative data by using it in conjunction with its existing credit evaluation processes for some customers.

• Some national payday lending chains have started collecting the repayment information of customers that can printed out and used by the customer to show a history of repayment of loan obligations.

• In 2005, Experian announced that it has begun incorporating phone bill payment data into its scoring models.

The use of other sources of credit data is not without concerns. Consumer advocates are concerned that alternative credit data could turn out to be used disproportionately by high cost lenders. Advocates suggest that it is necessary to make certain that both low cost and high cost lenders reach out to borrowers with alternative sources of credit data. Because credit scoring models are proprietary, it is not always clear what data is being used in the calculations and how much weight is being given to each source. It is therefore theoretically possible for a lender to unfairly lock consumers into low scores and high interest rates. Advocates are also concerned about the potential misuse of alternative credit scoring models for non-credit purposes. Credit scores today are used for such purposes as initial employment and job retention and to determine insurance eligibility and prices. Advocates argue that the use of alternative credit scoring models for these other purposes should be limited to situations where the accuracy, relevance, and predictive value of the data have been proven.

An additional set of concerns focuses on data sharing. The potentially large number of companies that could potentially report and process alternative credit data raises questions about privacy and the potential for identity theft. Some advocates also suggest that under current law, the *accuracy* and *completeness* reporting standards for data providers are not as clear as the standards for credit bureaus and require clarification. Advocates maintain that this is of concern because alternative data providers generally do not use alternative data themselves and, therefore, have less incentive than providers of standard data to report accurate and complete information.

Conclusions and policy recommendations.

Many of the issues associated with the unbanked and underbanked community have been left to the market place outside of the legislative arena However, in years past attempts have been made to address singular objects or product solutions.

Assemblyman Benoit introduced AB 822 in February 2005. As amended on May 2, 2005, AB 822 would have allowed employers, if voluntarily authorized by an employee, to transfer wages to a payroll card that can be used to access funds at an ATM, provided that the employee was entitled to at least one pay card transaction without charge per pay period. AB 822 was held in the Assembly Labor Committee.

Even without AB 822, some California employers are already using payroll cards to provide wages to their employees. It is unclear at this time how many California employers are offering payroll cards and how many employees are using them. Based on what the Assembly Committee on Banking and Finance staff has learned, employers who offer payroll cards are issuing them only when employees voluntarily agree to accept them and at least one transaction per pay period is provided at no cost to the employee.

Assembly bill 588 (de Leon), of 2007 states legislative intent to examine issues relating to alternative credit data. At this time, it appears that Assemblymember de Leon and other Legislators are interested in finding solutions for people who have a lack of traditional credit data.

The Chair of Banking and Finance, Assemblymember Ted Lieu has introduced AB 1502, a bill designed to bring banking services into underserved communities that typically have a large number of unbanked populations. AB 1502 would create a Banking Development District program in California. The goal of this legislation is to spur increased and enhanced banking services in under-served communities that will spur greater financial inclusion. The desired outcome is that more Californians will enter the financial mainstream and build savings and wealth through participating banks' offerings and marketing of appropriate transactional, loan, and credit products that can lead to longterm wealth building opportunities.

The Banking Development District program will make available a range of state—and potentially—local government incentives available to participating financial institutions. The legislation is inspired by New York State's Banking Development District program.

While many financial institutions may see the long-term business potential of under-served area, they may have a short-term concern that it would take a number of years before they can attract enough retail deposits to become viable. Those concerns are magnified by the fact that lower income workers often need to use banking services in off-business hours because they work in multiple jobs, making it more difficult for them to attract customers. The incentives provided through the program aim to help banks get over these short-term obstacles, enabling them to branch into neighborhoods with long-term business potential or better serve low-income consumers with existing bank branches.

Assembly Banking & Finance Committee
Informational Hearing

Department of Corporations oversight hearing regarding BSA audit.

June 18, 2007

Assembly Committee on Banking & Finance
Review of the Department of Corporations
June 18, 2007

Department Background:

The Department of Corporations (DOC) is California's Investment and Financing Authority, and has exclusive authority to bring both civil and administrative actions under the laws subject to the jurisdiction of the California Corporations Commissioner.

DOC licenses and regulates a variety of businesses, including securities brokers and dealers, investment advisers and financial planners, and certain fiduciaries and lenders. In addition, they also regulate the offer and sales of securities, franchises and off-exchange commodities.

The Department has certified certain national securities exchanges under Corporations Code section 25100(o), such as the New York Stock Exchange as well as the National Global System of the NASDAQ Stock Market LLC, to exempt from the Department's review and approval process under the Corporate Securities Law of 1968, as amended, warrants or rights to purchase or subscribe to a security listed on the certified exchange. However, securities listed on the second tier of some national securities exchanges and on the NASDAQ Small Cap Market, and any warrants or rights to purchase or subscribe to those securities, remain subject to the Department's review and approval process, unless otherwise exempted under the law.

The Department reports to the Business, Transportation and Housing Agency, and is a piece of the three headed regulation of mortgage lending activity under DOC, Department of Real Estate, and the Department of Financial Institutions.

Since 2001, according to information on the DOC website, the Department has brought approximately 3,729 enforcement actions, including but not limited to, against people or companies perpetrating frauds, making misrepresentations, and pursuing predatory practices. They also have oversight over the following licensees:

- 3,472 broker-dealers,
- 251,894 agents or registered representatives,
- 2,822 investment advisers,
- 40,949 investment adviser representatives or associated persons,

- 845 independent escrow agents,
- 7,927 consumer and commercial finance lenders,
- 444 residential mortgage lenders or mortgage bankers, and
- 476 deferred deposit originators at 2499 locations.

Bureau of State Audits report:

In January, 2007, the California State Auditor (Auditor) released a report titled *"Department of Corporations (DOC): It needs stronger oversight of its operations and more efficient processing of license applications and complaints."*

In this report the California State Auditor found several weaknesses in the department and made key recommendations to improve the day-to-day functions.

The Auditor found that DOC overcharged for some fees and undercharged for others. The overcharging was so excessive that the amount collected not only covered the costs of administration for the undercharged fees, but has contributed to the large fund reserve. New legislation will require DOC to limit the size of its reserve to 25% of expenditures by June 30, 2007. DOC receives revenues earned from fees charged for processing applications for notices, registration certificates, permits, and the initial issuance and renewal of licenses. These fees are deposited in the State Corporations Fund. DOC also earns revenues through annual assessments levied on businesses conducting certain types of activities; it generates additional revenues by charging for its regulatory examinations of certain existing licensees. Fees for the licenses processed by DOC are generally set by statute. DOC has limited authority to set fees below the statutory maximum for businesses dealing with certain securities transactions, offering investment advice, and acting as broker-dealers, the only way it can increase fees above the statutory cap is to seek a change in law. Since 2001, DOC has accumulated excess revenue totaling $22.2 million. DOC will have to collect $11.1 million less than it spends in fiscal year 2006-07 to reduce its reserve to the statutory limit.

Overall, DOC's strategic planning efforts are undercut by inaccurate statistical information about its actual performance as reported in its monthly and quarterly performance reports. DOC uses both manual and automated systems to collect information and then compiles the information for summary in a performance report. The information used to produce the performance reports comes from a variety of sources, such as forms, data system queries, spreadsheets maintained by team leaders, and other documents that may or may not be reviewed for accuracy. The performance report for the quarter ending September 30, 2006 indicated that DOC fell short with 8 out of the 10 critical measures. Since DOC does not gather sufficient data and does not always identify benchmark goals for its performance measures, the effectiveness of DOC's Education and Outreach Unit is uncertain. The outreach unit has two primary consumer protection programs, Seniors Against Investment Fraud and Troops Against Predatory Scams Investor Education Project.

Unfortunately, DOC does not always process applications within the time limits set by state law. For applications submitted between January 2004 and May 2006, the average time exceeded the time intended by law for many of the application types reviewed by the Auditor.

In Addition, the Auditor found DOC did not always resolve complaints related to securities regulation and financial services as quickly as possible. Currently, there is no legal requirement dictating the length of time DOC has to resolved complaints. When DOC does not investigate complaints promptly, its ability to protect consumers from fraudulent activities is compromised. The information systems used by DOC to track complaints are unreliable because they contain a large number of blank fields, duplicate entries, and inaccuracies.

Contrary to law, DOC has not conducted at least 170 (37%) of its required examinations of escrow office licensees within the last four years. Under California law, all entities or individuals conducting business governed by DOC should be licensed or qualified before commencing business. Businesses cannot legally operate or consummate transactions before receiving DOC approval, therefore it is imperative that applications are approved or denied promptly. Delays could result in entities being unable to conduct business and could increase the likelihood that businesses will conduct unlicensed financial transactions.

After all these findings, the Auditor offered a number of recommendations to improve the operations of DOC.

The Auditor recommends that DOC:

- Consider creating a legal requirement dictating the length of time DOC has to resolve complaints; seek legislative authority allowing DOC to set fees by regulation;

- Require DOC to calculate and report performance measures quarterly rather than monthly; strengthen and promote consumer protection programs;

- Consider assessing the need for new automated data systems; and, instruct DOC to examine every licensed finance lender at least once every four years to match current law with licensed escrow offices and mortgage lenders.

SUMMARY OF LAWS ADMINISTERED AND ENFORCED BY THE DEPARTMENT OF CORPORATIONS

The following are the laws administered and enforced by the Department of Corporations (in alphabetical order):

- **Bucket Shop Law** (Corporations Code Sections 29000 – 29201) prohibits the offering or making of any contract constituting bucketing (e.g., the sale of securities or commodities in connection with certain price quotations), except as specified; and provides civil and criminal remedies for violations of law.

- **California Commodity Law of 1990** (Corporations code Sections 29500 – 29572) prohibits misrepresentation, fraudulent and deceptive acts in the offer and sale of certain off-exchange commodities, except as specified; and provides administrative, civil and criminal remedies for violations of law.

- **California Deferred Deposit Transaction Law** (Financial Code Sections 23000 – 23106) requires licensing and regulation of deferred deposit originators (so-called payday lenders), except as specified; prohibits misrepresentation, fraudulent and deceptive acts in connection with these transactions; and provides administrative, civil and criminal remedies for violations of law.

- **California Finance Lenders Law** (Financial Code Sections 22000 – 22780) requires licensing and regulation of finance lenders and brokers making and brokering consumer and commercial loans, except as specified; prohibits misrepresentation, fraudulent and deceptive acts in connection with making and brokering of loans; and provides administrative, civil and criminal remedies for violations of law.

- **California Residential Mortgage Lending Act** (Financial Code Sections 50000 – 50603) requires licensing and regulation of residential mortgage lenders and servicers of specified federally-regulated mortgage loans, except as specified; prohibits misrepresentation, fraudulent and deceptive acts in connection with making, brokering and servicing of these residential mortgage loans; and provides administrative, civil and criminal remedies for violations of law.

- **Capital Access Company Law** (Corporations Code Sections 28000 – 28958) requires licensing and regulation of capital access companies which provide financial and managerial assistance to small business firms, except as specified; prohibits misrepresentation, fraudulent and deceptive acts in connection with the provision of financial and managerial assistance; and provides administrative, civil and criminal remedies for violations of law.

- **Check Sellers, Bill Payers and Proraters Law** (Financial Code Sections 12000 – 12403) requires licensing and regulation of persons issuing negotiable instruments and paying bills or obligations on behalf of customers, except certain persons including nonprofit consumer credit counselors; prohibits misrepresentation, fraudulent and deceptive acts in connection with these business activities; and provides administrative, civil and criminal remedies for violations of law.

- **Corporate Securities Law of 1968** (Corporations Code Sections 29500 – 29572) requires persons offering or selling securities such as stocks or bonds to qualify (e.g., submit to the Department for review and approval) the proposed securities, and requires licensing and regulation of securities broker-dealers and certain investment advisers, except as specified; prohibits misrepresentation, fraudulent and deceptive acts in the offer and sale of securities; and provides administrative, civil and criminal remedies for violations of law.

- **Covered Loan Law** (Financial Code Sections 4970 – 4979.8) sets forth various limitations and prohibitions on certain mortgage loans; and provides administrative, civil, and criminal remedies for violations of law.

- **Escrow Law** (Financial Code Sections 17000 – 17654) requires licensing and regulation of independent escrow companies, except as specified; prohibits misrepresentation, fraudulent and deceptive acts in connection with certain escrow transactions; creates a private indemnity arrangement to protect licensed escrow companies against specified losses; and provides administrative, civil and criminal remedies for violations of law.

- **Financial Information Privacy Act** (Financial Code Sections 4050 – 4060) prohibits financial institutions from sharing personal financial information, as specified; and sets forth various remedies including civil penalties for violations of law.

- **Franchise Investment Law** (Corporations Code Sections 31000 – 31516) requires persons offering or selling franchises to register (e.g., submit to the Department for review and approval) the proposed franchises with the Department, except as specified; prohibits misrepresentation, fraudulent and deceptive acts in the offer and sale of franchises; and provides administrative, civil and criminal remedies for violations of law.

- **Securities Depository Law** (Financial Code Sections 30000 – 30704) requires licensing and regulation of persons holding securities as custodians on behalf of securities owners, except as specified; prohibits misrepresentation, fraudulent and deceptive acts in connection with securities depository activities; and provides administrative, civil and criminal remedies for violations of law.

NOTE: The Department also enforces Insurance Code Section 1280.7 and Corporations Code Section 25100(q) relating to physician indemnity arrangements.

Assembly Banking and Finance Committee

Informational Hearing

SUBPRIME MORTGAGE CRISIS IN CALIFORNIA:
A Community Hearing to Examine Solutions and Mitigation Efforts

November 1st, 2007
10:00am-12:30pm
NATE HOLDEN PERFORMING ARTS CENTER
4718 W. Washington Blvd.
Los Angeles, CA 90016

INTRODUCTION

The last few months have been marked by a severe market correction in the subprime mortgage industry. In response to the extreme financial losses incurred by investors, the market for subprime mortgages has adjusted sharply. Investors are demanding that mortgage originators employ tighter underwriting standards, and some large lenders are pulling back from the use of brokers. Many people hope that the reassessment and resulting increase in the attention to loan quality should help prevent a recurrence of the recent subprime problems. However, this reasoning assumes that the markets will remain in their current conservative position for the long term.

Additionally, California is now facing the prospect of reduced revenues due to foreclosures and increase local government cost to mitigate foreclosure related issues. This crisis has also been labeled as a "turning back of the clock" on the recent gains of homeownership and asset building opportunities for many communities that have been left out of other wealth building opportunities. Several California communities rank in the top ten nationwide in the number of foreclosures and defaults. According to Realtytrac, Stockton, California leads the way with 1 out of every 27 homes in foreclosure.

It is estimated that the subprime lending crisis in the United States will result in almost 2 million foreclosures nationwide.[24] In California, lenders filed 72,571 "notices of default" on borrowers in the third quarter of 2007, eclipsing a record of 61,541 set in 1996, according to DataQuick Information Systems. Most of the loans that went into default last quarter were originated between July 2005 and August 2006. Actual losses of homes to foreclosure statewide totaled 24,209 during the third quarter, the highest number since DataQuick began recording data in 1988, up 38.7 percent from last quarter and up six-fold year-over-year.

[24] *Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues and How We Got Here.* Report and Recommendations by the Majority Staff of the Congressional Joint Economic Committee. October 2007.

In the midst of this market correction, borrowers are facing increased pressures as adjustable rate mortgages (ARMS) reset to higher rates, home prices decline, and new borrowers are limited in options as the market engages in retrenchment.

The crisis is the result of a confluence of circumstances that has played into the unusually poor performance of subprime mortgages that were originated in 2006. Among the largest contributing factors were relaxed underwriting standards and subsequent deterioration in mortgage payment performance. In addition, many market participants have suggested that fraud, such as misrepresentations made by mortgage brokers, appraisers and the borrowers themselves, has also played a significant role and exacerbated the problem. Numerous sources have indicated that home values, borrowers' incomes as well as other information may have been overstated and the intended use of the home was often misstated (i.e., as a primary residence rather than an investment property).

Second, the mortgage lending system allowed incentives to push some people into loans that they should never have taken. For instance, some brokers received incentives if they placed a person in a subprime loan even though the person also qualified for a prime loan. Some brokers were also incentivized to sell as many loans as they could, since they receive their commissions regardless of whether or not a person defaulted on the loan a year or two later.

Third, the decline in home prices on a national basis has been a significant factor in the decline in subprime mortgage loan credit performance. People who now had homes at lower values, or had loans larger than the value of their homes, were frequently unable to refinance with other lenders.

Also, variety of mortgage companies that had issued subprime loans overextended themselves in the market causing many of their creditors to demand payments on lines of credit immediately. This meant that several of the largest non-bank lenders of subprime loans were forced to file bankruptcy and foreclose on loans. Stricter lending practices by remaining mortgage companies have also been a factor in the subprime mortgage crisis, since some of the homeowners were ineligible for any type of loans based on new criteria.

July 2007 marked the twelfth consecutive month of home price decline on a year-over-year basis.[25] This is the longest period of declining home

[25] *Statement of Michael Kanef*, Group Managing Director, Moody's Investors Service. Committee on Senate Banking, Housing and Urban Affairs. September 26, 2007

prices on a national basis since 1969, and declining home prices have reduced borrowers' equity in their homes and constrained their refinancing opportunities. The borrowers most affected by the housing downturn have been those who because of the timing of their purchase did not realize benefit from the price appreciation that had occurred in prior years. Compounding the problem of declining home prices is that many borrowers took out ARMs with low introductory rates in the hopes that housing prices would continue to rise and afford the borrower enough equity to refinance at a fixed APR.

Fourth, the introduction of exotic products in the market-place including option-ARMS, low teaser rate loans, no-documentation, stated-income and other non-traditional products originally meant for sophisticated borrowers were used as tools to circumvent traditional underwriting standards. In addition, the increase in zero down payment, 100% financed subprime loans increased home ownership opportunities, but at the same time increased the riskiness of those loans. People who were on a thin financial cushion were offered the opportunity to take out multi-hundred thousand dollar loans with no down payment, sometimes with no income documentation.

Finally, the stunning lack of financial literacy was a major contributing factor to the subprime crisis. A recent Wall Street Journal article noted that in a survey, approximately one-third of homeowners had no idea what type of home loan they had. The typical borrower is often overwhelmed by the complicated process of purchasing a home. In many cases, had a borrower known the right questions to ask they could have avoided long-term financial collapse. Unlike some other states, California does not require that financial literacy concepts be taught in its school curriculum.

During the past two years, serious delinquencies among subprime ARMs have increased dramatically. The fraction of subprime ARMs past due ninety days or more or in foreclosure reached nearly 15 percent in July, roughly triple the low seen in mid-2005.[26] For so-called near-prime loans in alt-A securitized pools (those made to borrowers who typically have higher credit scores than subprime borrowers but still pose more risk than prime borrowers), the serious delinquency rate has also risen, to 3 percent from 1 percent only a year ago. These patterns contrast sharply with those in the prime-mortgage sector, in which less than 1 percent of loans are seriously delinquent.

---

[26] Testimony of Federal Reserve Chairman Ben S. Bernanke. *Subprime mortgage lending and mitigating foreclosures* Before the Committee on Financial Services, U.S. House of Representatives September 20, 2007

Higher delinquencies have begun to show through to increased foreclosures. About 320,000 foreclosures were initiated in each of the first two quarters of this year (just more than half of them on subprime mortgages), up from an average of about 225,000 during the past six years. Foreclosure starts tend to be high in states with stressed economic conditions and rise where house prices have decelerated or fallen.

Adjustable-rate subprime mortgages originated in late 2005 and in 2006 have performed the worst, with some of them defaulting after only one or two payments (or even no payment at all). Relative to earlier vintages, more of these loans carried greater risks beyond weak borrower credit histories--including very high initial cumulative loan-to-value ratios and less documentation of borrower income. The originate-to-distribute model seems to have contributed to the loosening of underwriting standards in 2005 and 2006. When an originator sells a mortgage and its servicing rights, depending on the terms of the sale, much or all of the risks are passed on to the loan purchaser. Thus, originators who sell loans may have less incentive to undertake careful underwriting than if they kept the loans. Moreover, for some originators, fees tied to loan volume made loan sales a higher priority than loan quality. This misalignment of incentives, together with strong investor demand for securities with high yields, contributed to the weakening of underwriting standards.

The fragmented market structure of mortgage originators in the subprime-lending industry may also have contributed. Data collected under the Home Mortgage Disclosure Act show that independent mortgage companies--those that are not depository institutions or their subsidiaries or holding company affiliates--made nearly half of higher-priced first-lien mortgages in 2006 but only one-fourth of loans that were not higher-priced.

In addition, the sharp deceleration in home prices since 2005, including outright declines in some markets, left many of these more-recent borrowers with little or no home equity. In this situation, some borrowers (particularly owner-investors) may have found that simply walking away from their properties was their best option. Moreover, low home equity has made refinancing--the typical way for many subprime borrowers to avoid large scheduled interest rate resets--difficult or impossible for many. Thus, with house prices still soft and many borrowers of recent-vintage subprime ARMs still facing their first interest rate resets, delinquencies and foreclosure initiations in this class of mortgages are likely to rise further. It is difficult to be precise about the number of foreclosure initiations expected in coming quarters, as it will depend on (among other factors) the evolution of house prices, which will vary widely across localities.

Historically, about half of homeowners who get a foreclosure notice are ultimately displaced from their homes, but that ratio may turn out to be higher in coming quarters because the proportion of subprime borrowers, who have weaker financial conditions than prime borrowers, is higher.

The increased portion of homes lost to foreclosure reflects the slow real estate market, as well as the number of homes bought during the height of the market with multiple-loan financing. In selling a home, all loans must be paid off, which is not the case in the formal foreclosure process, where second mortgages and lines of credit are most often written off.

Exotic mortgages with low "teaser" interest rates that increase significantly after several years, interest-only mortgages, and mortgages made with little or no income verification have helped drive the homeownership rate in the United States to a record seventy percent. These subprime loans are made possible in part by mortgage securitization, where pools of principal and interest payments for mortgages are bundled into securities and sold to investors, a process that diversifies the risk of lending to borrowers with less than optimal credit. Nontraditional credit and securitization have been useful tools to make credit available to those who might not otherwise qualify.

Unfortunately, many of the borrowers who took advantage of subprime loans have been unable to afford the mortgages they received. As interest rates have risen and property values decreased, foreclosures have occurred at alarming rates and delinquencies continue to climb. Many borrowers were duped into mortgages they could not repay, or simply made poor financial decisions. The consequences are grim. Millions may lose their homes. Even borrowers with good credit are having more difficulty finding lenders willing to grant those mortgages. Many mortgage lenders are going bankrupt. Credit standards are tightening. Investors are losing money on subprime mortgage bonds. Economists predict that the effect of these lending practices on the economy will be felt for years to come.

SUBPRIME LENDING

Traditionally, 15 and 30 year fully amortizing conventional loan products have decreased from 62% of total originations in 2003 to just 33% by the end of 2006, while the origination of loans to subprime borrower , and origination of interest only and option-ARM loans to prime or near-prime borrower, have increased.[27]

Subprime mortgages are mortgages granted to customers of poor solvency and which therefore present greater risk of default than those to "normal" customers. These mortgages are thus qualified when they are granted to persons with a problematic credit history or to those unable to provide all the necessary documents (proof of income sources, for example) or in those cases where the amount of the mortgage represents a very high percentage of the price of the home being financed (more than 85%) or the monthly payment represents more than 55% of available earnings, etc.

The majority of subprime loans are not originated by traditional banks regulated by the Office of Comptroller of Currency for Federal banks or the California Department of Financial Institutions for state chartered banks. Subprime lending originated by banks, last year, only amounted to 10% of total subprime originations. The vast majority of subprime originations are made by non-depository institutions and brokers. The various lending institutions and brokers operate under different regulatory and supervisory regimes with varying intensities of enforcement effort. That fragmentation makes monitoring brokers and lenders difficult for regulators and investors alike.

Twenty years ago, the subprime mortgage market barely existed. There were a few lenders and brokers who offered these loans, but for the most part, borrowers with credit problems simply could not get a mortgage. This left millions of Americans unable to purchase a home or forced them to sell if they got into financial straits.

Homeownership has hit record-high levels in recent years largely due to a sustained period of record-low interest rates. But many experts also feel that the expansion of subprime lending has contributed to the gains in homeownership.

The growth of the subprime market can be attributed to several factors, including federal deregulation of the mortgage rates, the expanding use of

---

[27] Testimony of Emory W. Rushton, Senior Deputy Comptroller, Office of Comptroller of Currency, Before United States Senate Committee on Banking, Housing, and Urban Affairs

credit scores and technological advances. In addition, as prime mortgage lending became more competitive, banks and other traditional mortgage lenders sought higher profits in the subprime market.

As they are more risky, sub-prime mortgages usually carry a higher interest rate. Normally, customers often pay a differential of between 2% and 3% more than the rate on a standard or prime mortgage.

Subprime mortgages emerged on the financial landscape more than two decades ago, but did not begin to expand significantly until the mid-1990s. The expansion was fueled by innovations--including the development of credit scoring--that made it easier for lenders to assess and price risks. In addition, regulatory changes and the ongoing growth of the secondary mortgage market increased the ability of lenders, who once typically held mortgages on their books until the loans were repaid, to sell many mortgages to various intermediaries, or "securitizers." The securitizers in turn pooled large numbers of mortgages and sold the rights to the resulting cash flows to investors, often as components of structured securities. This "originate-to-distribute" model gave lenders (and, thus, mortgage borrowers) greater access to capital markets, lowered transaction costs, and allowed risk to be shared more widely. The resulting increase in the supply of mortgage credit likely contributed to the rise in the homeownership rate from 64 percent in 1994 to about 68 percent now--with minority households and households from lower-income census tracts recording some of the largest gains in percentage terms.

However, for all its considerable benefits, the broadening of access to mortgage credit that has occurred during the past decade also had important negative aspects. Not surprisingly, given their weaker credit histories and financial conditions, subprime borrowers default on their loans more frequently than prime borrowers. The consequences of default may be severe for homeowners, who face the possibility of foreclosure, the loss of accumulated home equity, and reduced access to credit. In addition, clusters of foreclosures can lead to declines in the values of nearby properties and do great damage to neighborhoods.

In 1994, the subprime mortgage lending was only $35 billion.[28] By 2003, the market had grown to $330 billion. Nationally, in 2003 the subprime market was 9 percent of the total mortgage market, but in California,

---

[28] Subprime Mortgage Lending and the Capital Markets, FRBSF Economic Letter. Dec 28, 2001.

subprime lending was 13.3% of the market.[29] That share may be growing. In 2004, the prime mortgage market was sluggish, but subprime lending more than doubled in California to $197 billion.

Between 2001 and 2006 ARMs as a share of total subprime loans increased from 73 percent to more than 91 percent. The share of no-documentation or low-documentation loans increased from 28 percent to more than 50 percent and the percentage of borrowers who took out interest only payment loans increased from zero to more than 22 percent. Furthermore, ARM loans account for 44 percent of new foreclosures in the second quarter of 2007.While consumer groups applaud the fact that more families have access to credit, they have consistently expressed concerns that the subprime industry is selling people higher-priced loans when they could qualify for prime loans.

Although there is no single source that tracks covered loan volume in California, anecdotal evidence indicates that it is a small percentage of the overall mortgage market.

Not surprisingly, foreclosure rates are higher for subprime borrowers. In mid-2004, 4.6 percent of subprime loans were in foreclosure compared to 0.5 percent for prime loans. Consumer groups worry that when interest rates rise, too many subprime borrowers will find themselves saddled with loans they cannot afford and the foreclosure rates will climb even higher.

In the drive to extend credit into new markets and increase profit margins, the lending community turned to the secondary market in order to mitigate credit risk and increase the levels of subprime lending. Suddenly, loans that had been held by a bank were being sold to Wall Street in the form of securities guided by complex financial arrangements and agreements.

Most important to the growth of the subprime market, however was the creation of a secondary market for subprime loans. In the early 1990s, Wall Street's acceptance of mortgage-backed securities comprised of pools of subprime loans greatly increased. A few years ago, Fannie Mae and Freddie Mac began purchasing these loans as well. These market-based activities have provided lenders with the funds needed to make new mortgages, thus bringing additional capital into the subprime arena.

---

[29] Assembly Banking and Finance Committee Informational Hearing, *Covered and Subprime Loans in California: Are Consumers Getting the Protection They Need?* Background Briefing Paper. 2005

SECONDARY MARKET

In recent history, banks funded mortgage loans through their customer's deposits with mortgage credit dictated by the volume of bank deposits. Furthermore, banks kept loans on their books. Today, banks and other non-depository lenders have the option to sell their loan on the secondary market. Some lenders issue their own securities based of loans they originate or purchase.

Mortgage-backed securities (MBS) are securities sold to investors like stocks and bonds. MBS are created when originators or financial intermediaries pool large volumes of mortgage loans and sell securities backed by the monthly payments made by borrowers on the underlying mortgage loans. When a homeowner, whose loan is secured in an investment pool, makes his or her monthly payment, the payment combined with the payments of other loans goes into the pool and forms the basis of cash flows for investors. Investors choose their position in mortgage pool based on priority of payments from the pool in the event of a default. The pools typically have several investment grade tranches, ranging from AAA ratings down to subprime rated traunches that would absorb the most losses in the event of default but offer the most return. Bonds are also structured as tranches that collect only interest on the underlying mortgage obligation, or trauches that received payments from the principle payments on the mortgage.

At this time, the US mortgage market amounts to 10,000 billion dollars, of which sub-prime mortgages represent 13% of the total market and 9% of nominal gross domestic product (GDP) of the United States.[30] Most of these sub-prime mortgage loans are granted by financial institutions that are not deposit-taking entities and therefore are subject to lower regulatory and supervision requirements compared with those for other banks and deposit institutions. Once the customer uses the loan to buy a house, the debt is noted in the balance sheet of the institution granting the loan. However, in order to boost their business, these institutions relieve themselves of these mortgages and sell them to commercial banks or investment banks. The new holders, in turn, package the mortgages in blocks and issue securitization bonds (CDO, or Collateralized Debt Obligations) using the sub-prime mortgages as security or collateral. That is to say, based on subprime mortgages, they create a new kind of asset that is more easily negotiable in the markets and it is this bond that carries the risk in the operation. To the extent that the holders of the mortgages

---

[30] "Sub-prime Mortgage Crisis in United States Centre of Attention." *La Caixa.*, The Spanish Economy Monthly Report. September 2007.

keep paying off their debt every month, these funds are used to pay those who have bought these bonds.

The MBS market is the largest fixed income market in the United States. At the end of 2006, approximately $6.5 trillion of securitize mortgage-related debt was outstanding compared to $4.3 trillion of U.S. Treasury securities and $5.4 trillion of corporate debt.[31]

CDOs are a global phenomenon extending far beyond national boundaries or domestic capitol controls. JPMorgan estimate that $1.5 trillion in CDOs exist globally with $500 billion in structured finance CDOs meaning those made up of bonds back by subprime mortgages.[32]

Those buying CDOs are usually investment funds, insurance companies, liquid asset holders, traders, etc. who obtain higher yields from these assets than the market average although, naturally, running greater risk. This new product is broken down according to the credit risk assumed and a qualification or credit rating is assigned by the rating agencies.

The key elements to a typical securitization include the following:

- **Issuer** - A bankruptcy-remote special purpose entity (SPE) formed to facilitate a securitization and to issue securities to investors.
- **Lender** - An entity that underwrites and funds loans that are eventually sold to the SPE for inclusion in the securitization. Lenders are compensated by cash for the purchase of the loan and by fees. In some cases, the lender might contract with mortgage brokers. Lenders can be banks or non-banks.
- **Mortgage Broker** - Acts as a facilitator between a borrower and the lender. The mortgage broker receives fee income upon the loan's closing.
- **Servicer** - The entity responsible for collecting loan payments from borrowers and for remitting these payments to the issuer for distribution to the investors. The servicer is typically compensated with fees based on the volume of loans serviced. The servicer is generally obligated to maximize the payments from the borrowers to the issuer, and is responsible for handling delinquent loans and foreclosures.
- **Investors** - The purchasers of the various securities issued by a securitization. Investors provide funding for the loans and assume varying degrees of credit risk, based on the terms of the securities they purchase.

---

[31] Securities Industry and Financial Markets Association, *Research Quarterly*, February 2007, page 22.
[32] Anderson, Jenny and Heather Timmons. "Why a U.S. Subprime Mortgage Crisis Is Felt Around the World." *The New York Times*, August 31, 2007.

- **Rating Agency** - Assigns an initial rating to the various securities issued by the issuer and updates these ratings based on subsequent performance and perceived risk. Rating agency criteria influence the initial structure of the securities.
- **Trustee** - A third party appointed to represent the investors' interests in a securitization. The trustee ensures that the securitization operates as set forth in the securitization documents, which may include determinations about the servicer's compliance with established servicing criteria.
- **Securitization Documents** - The documents create the securitization and specify how it operates. One of the securitization documents is the Pooling and Servicing Agreement (PSA), which is a contract that defines how loans will be combined in a securitization, the administration and servicing of the loans, representations and warranties, and permissible loss mitigation
  strategies that the servicer can perform in event of loan default.
- **Underwriter** - Administers the issuance of the securities to investors.
- **Credit Enhancement Provider** - Securitization transactions may include credit enhancement (designed to decrease the credit risk of the structure) provided by an independent third party in the form of letters of credit or guarantees.

OBSTACLES TO LOAN MODIFICATIONS

The ability to offer workout options are predicated on the assumption that the borrower contacts his or her institution before becoming seriously delinquent on his or her loan or that the lender reaches out to contact borrowers who have missed a payment or who the lender believes are likely to run into trouble upon an interest rate reset. The ability to engage in workouts listed above also assumes that the institution which holds the loan is able to negotiate freely with the borrower to develop a workout option in the best interests of both. This latter assumption is valid when the originating lender retains the loan in its portfolio, but can be less accurate when the loan has been securitized, because the terms of the securitization governing documents may place restrictions on the servicer's flexibility to engage in loan modifications

When difficulty arises in making payments on a securitized loan, the borrower generally will not be dealing with the local banker with whom there might be an established relationship. Instead, the borrower will be dealing with a servicer. The servicer has responsibilities defined in the securitization documents that are substantially different than those of a lender. The servicer and the trustee are responsible for taking actions that are in the best interest of the investors who purchased portions of the securitization. Protecting the investors means determining the best alternative that would bring the maximum recovery on a defaulted loan on a present-value basis. If the servicer determines that a workout or modification of the loan achieves that goal, then there is an alignment of the investor/servicer/borrower relationship. However, if liquidation of the collateral (through a foreclosure or other means) results in the highest net present value of cash flows, the servicer may be bound by the terms of the securitization to pursue this approach to the benefit of the investor despite the resulting detriment to the borrower.

Even if a modification to the loan looks like the right approach, other factors might limit the servicer's options. Most securitizations are established as Real Estate Mortgage Investment Conduits (REMICs). The REMIC structure provides considerable tax benefits, (i.e., only the investors are subject to tax, not the conduit itself) but also includes provisions that could limit the flexibility of a servicer to modify a borrower's loan terms in a proactive manner. To qualify for tax-advantaged status, the pool of loans securitized in a REMIC must generally be treated as a static pool, which usually precludes modifying loans in the pool. An exception to this general prohibition allows for modifications when default is reasonably foreseeable. Once a determination is made that default is reasonably foreseeable, most securitization agreements provide significant flexibility for the servicer to modify terms of the loan. This allows for modification of terms when a loan has defaulted, but may prohibit changes to loans that are current.

The Internal Revenue Service (IRS) leaves it to servicers to determine what "reasonably foreseeable" means as it relates to default, which makes these determinations dependent upon the facts and circumstances of each mortgage. In many cases, servicers would likely need to seek legal determinations from outside counsel, especially with respect to whether a default was reasonably foreseeable, in order to modify loans in the pool. Some securitization documents indicate that once a loan is delinquent for a certain amount of time, for example, 60 days, modifications of the terms may be allowed, subject to REMIC laws. In some deals, the servicer must certify with a legal opinion that a modification of loan terms would not result in an adverse REMIC event. Therefore, while some flexibility is available, the specifics are often unclear. Further clarification regarding permissible modification activities under REMIC laws would improve the servicer's ability to work through problems with the borrower.

Aside from the restraints imposed on modifications by the REMIC structure, the personal service agreement (PSA) can also impose barriers to loan modification. The language in each PSA is different and each establishes the rules about how a particular securitization operates or what needs to be done to change those rules. Many PSAs contain more than 200 pages of dense legal verbiage. The PSA provides a blueprint as to how cash flows and losses are allocated and distributed to the various parties, and establishes the rules that the servicer must abide by in managing this critical function in the transaction. The PSA sets forth whether and how a servicer can modify the underlying loans in a securitization. The documents will also identify the other parties in the transaction who might have an important role in this decision.

If the PSAs terms and conditions regarding modifications prove to be overly restrictive, changing the PSA can be very difficult and may require extraordinary actions, such as obtaining the consent of two-thirds or all of the investors. In some deals, the PSA is quite explicit in allowing the servicer flexibility in modifying delinquent loans, while in other transactions the language is vague.

Even if the servicer can arrange a modification of terms, the servicer may still be limited in the ability to take a proactive approach to modifying a loan. If a servicer foresees problems on the horizon for a group of borrowers that is currently paying as agreed, the servicer might not be able to modify the terms of the loan until the borrower enters into the "imminent default" category. For example, following Hurricane Katrina, some banks granted blanket payment moratoria for borrowers with homes in the Gulf Coast region, but many servicers were limited in their ability to grant similar blanket moratoria for mortgages that were securitized. Instead, these servicers had to make modifications on a case-by-case basis based on the facts and circumstances of each borrower. In situations like this, waiting for the borrower to fall behind in payments may not be the most prudent course of action for any of the parties involved. If solutions could be reached to forestall a problem, the result would be greater flexibility for servicers and possibly loss mitigation.

While the servicer has an important role in the decisions relating to the underlying borrower, there are other parties involved in the transaction whose views also carry significant weight. In most older deals (and some more recent), the servicer must obtain the consent and approval of the rating agency and bond insurer before considering loan modifications in amounts greater than 5 percent of the total transaction. Yet, excessive modifications might be viewed as a negative factor when ratings are reviewed by the ratings agencies.

Financial guarantors and other credit enhancement providers have become more involved in the structured finance market as well, often providing insurance on the deeply subordinated tranches of securitizations to facilitate the sale of these more risky positions. In this role, a guarantor steps in and absorbs losses should the underlying collateral begin to deteriorate. Therefore, the guarantor has a vested interest in the decisions made by the servicer in dealing with distressed borrowers. In some transactions, the servicer is required to gain the prior written consent of the credit enhancement provider for any modification, waiver, or amendment that would cause the aggregate number of outstanding mortgage loans which have been modified, waived or amended to exceed 5 percent of the original pool balance. Whether the credit enhancement provider, servicer, and borrower share the same interest will depend on the facts and circumstances of the specific situation. If their interests are not aligned, however, the credit enhancement provider's demands will no doubt have a large effect on the ultimate outcome.

The accounting rules also play an important role in the decisions made by the various parties. Securitization is often used as a balance sheet management strategy, whereby assets sold into a securitization are removed from the seller's books, thus freeing up resources such as capital. Lenders must meet strict accounting requirements before they can remove assets from their books, to show that they no longer "control" these assets, and that the risks and rewards associated with the loans have been transferred to the investors.

Overall, the ability to securitize pools of such mortgages certainly helped to make mortgage loans available and has reduced the cost of credit for borrowers. However, the securitization structure also has introduced a number of new participants and complexities into the loan relationship, which reduces flexibility for addressing the problems of distressed borrowers.

OPTIONS FOR HOMEBUYERS FACING FORECLOSURE

- **Reinstatement-**This means bringing the mortgage current. This is rare, unless you get a tax refund, a bonus check, or some other windfall that could catch you up on owed mortgage payments.
- **Partial Reinstatement-**Pay off a portion of what is owed.
- **Forbearance-**Lender agrees to take less than the full payment.

- **Repayment Plan-** Outstanding debt is paid off over the course of several months or a year so a large payment can be broken down into smaller ones.

- **Loan Modification-**This changes the terms of loan—a later pay-off date or a change in the interest rate.

- **Refinance-**You may need decent credit to qualify, but this can get you a new loan with a better fee schedule or interest rate.

If a borrower can't afford to make payments at all, then they have three options for liquidation:

- **Short Sell-**A short sell is selling your house for less than the amount you owe. Lenders consider this a settlement and may forgive your remaining debt.

- **Deed in lieu of Foreclosure-**This is a voluntary transfer of your property to your lender.

- **Assumption-**This option lets someone else assume your mortgage for you.

RECENT ACTIONS

The national Hope Campaign provides free, twenty-four hour, bilingual counseling for people that are in fear of losing their homes. The number is 1-800-HOPE. In addition, the United States Department of Housing and Urban Development has a list of regional counseling services. Although picking up the phone will not put money in the bank, it can reduce the probability of a foreclosure. A 2004 study by Freddie Mac indicated that retention options could reduce the possibility of foreclosure by 60–80 percent, depending on the type of loan.

Countrywide Financial Corp., the largest U.S. home-mortgage lender by volume, said it will refinance or restructure up to $16 billion in loans by the end of next year for homeowners facing higher payments because of interest-rate resetting.

Countrywide also recently announced it's partnering with the Neighborhood Assistance Corporation of America (NACA), a community and advocacy group that that has often been at odds with Countrywide's lending policies. Borrowers wanting to rework loans through NACA are required to go through the organization's comprehensive approval process. They fill in an application on NACA’s website. Then they must attend a home buyer's workshop of about four hours long held at any of the organization's 33 offices in 19 states. The workshop covers mundane, but misunderstood, aspects of mortgage borrowing, such as what a settlement statement means. After that, borrowers make an appointment for one-on-one counseling sessions of about 90 minutes to two hours. The counselors help prepare realistic budgets, looking at incomes and expenses including car payments and child-care costs.

Wells Fargo, of San Francisco, offered some 80,000 repayment plans and made 25,000 "workouts" - including loan modifications — aimed at helping borrowers keep their homes.

The Housing Finance Agencies of Maryland, Massachusetts, New York and Ohio have all started refinance programs to assist distressed borrowers with long term, fully underwritten prime mortgage products. These programs are not give-aways of state funds, but rather loan guarntee programs where the state steps in to gaurantee the payment of the loan. Each state has contributed one hudred million dollars or more to this effort.

In response to the subprime fallout, federal regulators (Office of Comptroller of Currency, Office of Thrift Supervision, Federal Reserve Board, Federal Deposit Insurance Corporation, and National Credit Union Administration) issued guidance on nontraditional mortgage product risks. The guidance applies to both prime and nonprime loans and covers federally-regulated financial institutions, their subsidiaries and affiliates, and federally-insured financial institutions.

Key components of the federal guidance include the following:

1. Financial institutions' analyses of borrowers' repayment capacity should include an evaluation of ability to pay the fully indexed rate, not just the initial low introductory rate. Analyses of repayment capacity should avoid over-reliance on credit scores as a substitute for income verification.

2. Institutions should avoid the use of loan terms and underwriting practices that will heighten the need for a borrower to rely on the sale or refinancing of the property once amortization begins.

3. Higher pricing of loans with elevated risks should not replace the need for sound underwriting.

4. Second mortgages with minimal or no owner equity should not have a payment structure that allows for delayed or negative amortization unless the risk is mitigated.

5. Institutions with high concentrations of nontraditional products should have good risk management practices in place and capital levels commensurate with the risk, and;

6. Institutions that offer nontraditional mortgage products should make the potential consumer of these products aware of all possible risks and should provide this information to potential borrowers in a clear, balanced, and timely manner. Payment shock, negative amortization, prepayment penalties, and the cost of reduced documentation loans should be explained. Monthly statements on payment-option adjustable rate mortgages should explain the consequences of each payment option.

7. In issuing the guidance, the federal regulators urged states to work quickly to apply similar guidance to state-regulated entities engaged in mortgage lending and brokering. In November 2006, CSBS and AARMR issued guidance substantially similar to the federal guidance, but deleted sections of the federal guidance that were inapplicable to nondepository institutions (i.e., sections dealing with capital reserve requirements).

8. Subsequent to the issuance of this guidance State Senator Mike Machado introduced SB 385, which was also co-authored by the Assembly Banking Chair, Assemblymember Ted Lieu, in order to clearly give state regulators the authority to enforce the guidance on their licensees. SB 385 was signed by the governor October 5, 2007.

On April 17, 2007 the federal regulators also issued guidnace to lenders concerning their efforst to work with troubled borrowers:

"The federal financial institutions regulatory agencies encourage financial institutions to work constructively with residential borrowers who are financially unable to make their contractual payment obligations on their home loans. Prudent workout arrangements that are consistent with safe and sound lending practices are generally in the long-term best interest of both the financial institution and the borrower.

Many residential borrowers may face significant payment increases when their adjustable rate mortgage (ARM) loans reset in the coming months. These borrowers may not have sufficient financial capacity to service a higher debt load, especially if they were qualified based on a low introductory payment. The agencies have long encouraged borrowers who are unable to meet their contractual obligations to contact their lender or servicer to discuss possible payment alternatives at the earliest indication of such problems.

The agencies encourage financial institutions to consider prudent workout arrangements that increase the potential for financially stressed residential borrowers to keep their homes. However, there may be instances when workout arrangements are not economically feasible or appropriate. Financial institutions should follow prudent underwriting practices in determining whether to consider a workout arrangement. Such arrangements can vary widely based on the borrower's financial capacity. For example, an institution might consider modifying loan terms, including converting loans with variable rates into fixed- rate products to provide financially stressed borrowers with predictable payment requirements. Financial institutions may receive favorable Community Reinvestment Act (CRA) consideration for programs that transition low and moderate income borrowers from higher cost loans to lower cost loans, provided the loans are made in a safe and sound manner."

On May 2, 2007 United States Senator Chris Dodd held a Homeownership Preservation Summit that reached a series of principles with lenders and services on efforts to assist trouble borrowers. Those principles are:

1) Early contact and evaluation of borrowers prior to loan reset.

2) Modify loans to create long-term affordability.

3) Establish dedicated teams or resources in order to handle modifications in an efficient and timely manner.

4) For those who are eligible, low cost financing options should be offered.

5) Lenders should work with GSEs to make credit available to borrowers through new products and expanded programs that will help borrowers out of resetting subprime ARMS.

6) Maximize success, minimize damage.

7) Systems should be developed so that parties can track progress and establish accountability.

IMPACTS OF FORECLOSURES

A recent report released by the Congressional Joint Economic Committee (CJEC) has highlighted some dismal impacts as a result of the foreclosure crisis:

- Approximately $71 billion in housing wealth directly destroyed through the process of foreclosure.

- More than $32 billion in housing wealth indirectly destroyed by the spillover effect of foreclosures which reduces value of neighboring properties.

- States and local governments will lose more than $917 million in property tax revenue as a result of the destruction of housing wealth caused by subprime foreclosures.

Additionally, CJEC has found that as a result of foreclosures, California could lose $110,921,021 in property tax revenue. They also estimate almost 200,000 foreclosures in California over the next five quarters. In another study regarding the typical cost of foreclosure to municipalities, the City of Chicago was used as an example.[33] In a review of the impact of foreclosure son Chicago it was found that the cost per property in some cases exceeded $30,000. Municipalities face increased expenditures due to foreclosures because they require direct expenditures for increased policing and fire suppression, demolition contracts, building inspections, legal fees and fees associated with managing the foreclosure process.

[33] Apgar, William & Mark Duda. "Collateral Damage: The Municipal Impact of Today's Mortgage Foreclosure Boom" Homeownership Preservation Foundation. 2005

APPENDIX I

FORECLOSURE TIMELINE[34]:

Day 1
It's the first of the month, and the mortgage payment is due. The borrower misses the payment.

Day 16 to day 30
A late charge is assessed on payment.
The company that processes the borrower's payments (called the mortgage servicer) starts attempting to make contact to find out what happened.

Day 45 to day 60
The servicer sends a "demand" or "breach" letter to the borrower pointing out that terms of the mortgage have been violated. The borrower is given 30 days to resolve the situation by paying the delinquent amount.

Day 90 to day 105
The servicer refers the loan to its foreclosure department and hires a local attorney or other firm to initiate foreclosure proceedings. Depending on the state where the home is located, the servicer's representative may record a formal notice of foreclosure at the local courthouse, publish details of the debt in the local newspaper, attend hearings on the case and make appropriate court filings.

Day 150 to day 415
The house is sold at a foreclosure sale or auction. The wide time range is due to different state requirements. Borrowers in states with judicial foreclosures, or those in which lenders have to retake property titles via the court system, can get almost a year to straighten out their affairs before the sale. Those in nonjudicial states have as little as two months.

[34] Courtesy of Bankrate.com

APPENDIX II

SUBPRIME CRISIS HISTORICAL TIMELINE

DECEMBER 2006

• *December 28:* Ownit Mortgage Solutions files for bankruptcy.

FEBRUARY 2007

• *February 7:* The Senate Banking Committee holds the first hearing of the 110th Congress addressing legislative solutions to predatory lending in the subprime sector.

• *February 12:* ResMae Mortgage files for bankruptcy.

• *February 20:* Nova Star Financial reports a surprise loss.

MARCH 2007

• *March 2:* The Federal Reserve announces draft regulations to tighten lending standards. Lenders would be required to grant loans on a borrower's ability to pay the fully indexed interest rate that would apply after the low, initial fixed-rate period of two or three years. New regulations are met with skepticism in Congress.

• *March 2:* Fremont General stops making subprime loans and puts its subprime business up for sale.

• *March 8:* New Century Financial, the second largest subprime lender in 2006, stops making loans.

• *March 20:* People's Choice files for bankruptcy.

• *March 22:* The Senate Banking Committee holds a hearing to investigate the sharp increase in defaults and foreclosures, questioning banking regulators, a Federal Reserve representative, industry executives and two homeowners. Both Democrats and Republicans criticize banking regulators for failing to respond more quickly to curb the growth in risky home loans to people with weak credit.

• *March 27:* At a Joint Economic Committee hearing, Ben Bernanke, Chairman of the Board of Governors of the Federal Reserve System, says housing market weakness "does not appear to have spilled over to a significant extent." More Bernanke: "At this juncture, however, the impact on the broader economy and financial markets of the problems in the subprime market seems likely to be contained. In particular, mortgages to prime borrowers and fixed-rate mortgages to all classes of borrowers continue to perform well, with low rates of delinquency."

APRIL 2007

• *April 2:* New Century Financial files for bankruptcy.

• *April 6:* American Home Mortgage writes down the value of risky mortgages rated one step above subprime.

• *April 11:* The JEC, chaired by Senator Charles Schumer, releases a report analyzing the subprime mortgage foreclosure problem and its economic impact on the most vulnerable communities. The report, entitled "Sheltering Neighborhoods from the Subprime Foreclosure Storm," argues that foreclosure prevention is cost-effective and presents policy suggestions for curbing future subprime foreclosures.

• *April 12:* Senator Schumer calls on Federal Government to intervene on behalf of homeowners in response to a National Association of Realtors report showing falling home prices due to rising foreclosures and a Los Angeles Times story in which the White House blamed homeowners for signing up for deceptive subprime mortgages.

• *April 12:* According to the Los Angeles Times, Tony Fratto, Spokesman for the White House, said "individuals need to Legend: In the Markets In Congress In the Administration JOINT ECONOMIC COMMITTEE Senator Charles E. Schumer, Chairman August 2007 make smart decisions in taking on debt, and there has to be some responsibility for making those decisions." He also said that any federal action would be unwelcome and would encourage "risky behavior."

• *April 18:* Senator Dodd hosts the Homeownership Preservation Summit, bringing together some of the largest subprime lenders, securitizers, and servicers, as well as consumer and civil rights groups, to discuss ideas and develop solutions to the subprime mortgage market crisis. Following the summit, Senator Dodd states, "I am not overly anxious to legislate… We think there may be enough laws on the books."

• *April 18*: Freddie Mac announces plans to refinance up to $20 billion of loans held by subprime borrowers who would be unable to afford their adjustable-rate mortgages at the reset rate.

• *April 24:* The National Association of Realtors announces that sales of existing homes fell 8.4% in March from February, the sharpest month-to-month drop in 18 years.

MAY 2007

• *May 3:* Senator Schumer introduces the first comprehensive plan to help homeowners avoid foreclosures. The plan includes a request for $300 million in federal funds for community non-profits to help homeowners refinance current mortgages through personalized financial counseling. Schumer calls on banks and lenders to also provide funding for nonprofit counselors. Senator Schumer, along with Senators Brown and Casey also introduce the "Borrower's Protection Act of 2007," which proposes federal regulation for mortgage brokers in order to avoid future defaults on subprime loans. The bill seeks to regulate mortgage brokers and originators under the Truth in Lending Act (TILA) by establishing on behalf of consumers a fiduciary duty and other standards of care. In addition, the bill outlines standards for brokers and originators to assess a borrower's ability to repay a mortgage and holds lenders accountable for brokers and appraisers.

• *May 4:* The House Financial Services Committee passes the "Expanding American Home Ownership Act". The bill would allow Fannie Mae and Freddie Mac to purchase and securitize larger mortgages (up to $625,500 or the region's median home price) in high-cost areas of the U.S. where the median price exceeds $417,000 (the current loan limit). The bill would also authorize zero down payment loans and direct the Department of Housing and Urban Development (HUD) to serve higher risk borrowers who would otherwise turn to predatory and high priced mortgage loan alternatives.

• *May 9*: The Federal Open Market Committee meets and leaves rates unchanged. The FOMC states in their minutes, "The correction of the housing sector was likely to continue to weigh heavily on economic activity through most of this year, somewhat longer than previously expected." However, the FOMC continued to refer to the housing crisis as a "correction".

• *May 17:* At the Federal Reserve Bank of Chicago's Forty-Third Annual Conference on Bank Structure and Competition, Chairman Bernanke reiterates his March statement by saying the Fed does not foresee a broader economic impact from the growing number of mortgage defaults.

• *May 25:* The National Association of Realtors reports that sales of existing homes fell by 2.6 percent in April to a seasonally adjusted annual rate of 5.99 million units, the slowest sales pace since June 2003. The number of unsold homes left on the market reached a record total of 4.2 million.

JUNE 2007

• *June 4:* Housing and Urban Development (HUD) Secretary Alfonso Jackson endorses counseling and financial education as the best way to tackle the subprime foreclosure boom in a speech at the National Press Club.

• *June 5:* At an International Monetary Conference in Cape Town South Africa, Chairman Bernanke endorses the basis of a proposal made by Schumer to increase federal funds for community non-profits engaged in helping families in unsuitable subprime loans avoid losing their homes to foreclosure.

• *June 6:* ZipRealty Inc., a national real-estate brokerage firm, announces that the number of homes listed for sale in 18 major U.S. metropolitan areas at the end of May was up 5.1% from April. This is a striking deviation from the general trend as tracked by the Credit Suisse Group, which says on a national basis; inventories of listed homes have typically been little changed in May during the past two decades.

• *June 12:* RealtyTrac announces U.S. foreclosure filings surged 90 percent in May from May 2006. Foreclosure filings were up 19 percent from April. There were 176,137 notices of default, scheduled auctions and bank repossessions in May. The median price for a U.S. home dropped 1.8 percent the first three months of 2007. According to Freddie Mac, typically, more than half of all home sales occur in the April to June period.

• *June 14:* Goldman Sachs reports flat profit from a year ago due to mortgage market problems.

• *June 22:* Bear Stearns pledges up to $3.2 billion to bail out one of its hedge funds because of bad bets on subprime mortgages.

• *June 26:* Senator Schumer convenes housing experts to examine how to protect homebuyers from subprime lending and other mortgage industry abuses in a Banking Subcommittee hearing. The hearing focuses on the mortgage origination process, abuses in mortgage lending industry, responsible solutions to protect consumers in home-buying process and the impact of these proposed solutions on the market as a whole. The hearing also examines the Borrower's Protection Act of 2007 (S. 1299), which seeks to address many of the abuses that have taken place in the mortgage process by creating new regulations and requirements for various mortgage originators.

JULY 2007

• *July 10:* Standard and Poor's and Moody's downgrade bonds backed by subprime mortgages. Fitch follows suit.

• *July 10:* The Senate Appropriations Committee approves $100 million of the requested $300 million for HUD Housing Counseling programs in the Transportation, Housing, and Urban Development, and Related Agencies FY08 Appropriations Bill. With these funds, non-profit agencies are able to provide individual counseling by working one-on one with borrowers stuck in unaffordable subprime loans.

• *July 18:* Bear Stearns announces its two hedge funds that invested heavily in the subprime market are essentially worthless, having lost over 90% of their value, equal to over $1.4 billion.

• *July 17*: The Federal Reserve announces a pilot program to monitor brokers, joining the Board of Governors of the Federal Reserve with the Office of Thrift Supervision, the Federal Trade Commission, and state agencies represented by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators, to conduct targeted consumer-protection compliance reviews of underwriting standards, oversight, and risk-management practices within non-depository lenders with significant subprime mortgage operations.

• *July 18:* Commerce Department announces housing starts are down 19.4 percent over the last 12 months. Also announced is a 7.5 percent plunge in permits to build new homes, the largest monthly decline since January 1995. Permits are 25.2 percent below their level a year ago, reflecting continued pessimism among builders over the near-term outlook for new homebuilding.

• *July 18 and 19:* Chairman Bernanke testifies in front of the House Financial Services Committee and the Senate Banking Committee in his Second Monetary Report to Congress in 2007.

• *July 19:* The Dow Jones industrials close above 14,000 for the first time.

• *July 18 and 19:* In two days of testimony in Congress, Chairman Bernanke said there will be "significant losses" due to subprime mortgages, but that such losses are "bumps" in "market innovations" (referring to hedge fund investments in subprime mortgages). Bernanke reiterated that problems in the subprime mortgage market have not spilled over into the greater system. Bernanke also said the problems "'likely will get worse before they get better." He forecasts that the economy is poised for moderate growth, but continuing problems in the housing market prompt the Fed to slightly reduce its growth expectations.

• *July 25:* The JEC examines the impact of the subprime lending crisis on Cleveland, Ohio, one of the hardest hit communities in the nation. The hearing reveals the individual faces of the subprime mortgage crisis. Local residents and city council members testify.

• *July 30:* IKB Deutsche Industriebank, a German bank, is bailed out because of bad bets on U.S. mortgage-backed securities.

• *July 31*: Home prices continue to fall, marking the 18th consecutive decline, beginning in December 2005, in the growth rate of housing prices, according to the monthly S&P/Case-Shiller's Home Prices Indices, which tracks housing prices in metropolitan areas and is considered a leading measure of U.S. single-family home prices. The 10-City Composite index showed an annual decline of 3.4% (it's biggest since 1991) and the 20-City Composite reported an annual decline of 2.8%.

AUGUST 2007

• *August 1*: Two hedge funds managed by Bear Stearns that invested heavily in subprime mortgages declare bankruptcy. Investors in the funds file suit against Bear Stearns, alleging that the investment bank mislead them about the extent of the funds' exposure.

• *August 6:* American Home Mortgage files for bankruptcy.

• *August 7:* The Federal Open Market Committee leaves the overnight federal funds rate at 5.25%, referring to tightening in the credit markets and ongoing housing market crisis as a "correction". Despite financial market turmoil, the FOMC forecasts that "the economy seems likely to continue to expand at a moderate pace over coming quarters, supported by solid growth in the employment and incomes and a robust global economy."

• *August 7:* Senators Schumer and Dodd separately write to James B.

Lockhart III, director of the Office of Federal Housing Enterprise Oversight (OFHEO), urging him to consider temporarily raising the limit on purchases of home loans by Fannie Mae and Freddie Mac in response to increasing concerns of a credit crunch spilling into the broader mortgage market.

• *August 7:* Senator Clinton introduces a plan to address mortgage lending abuses, including new regulations on brokers, strong state licensing standards, and federal registration for brokers. The plan also proposes a $1 billion fund to assist state programs that help at-risk borrowers avoid foreclosure.

• *August 8*: Senator Schumer writes to Federal regulators, urging them to devise an action plan to deal with the current liquidity crunch in the mortgage markets that threatens to spread across the economy as a whole. Schumer expresses his concerns that regulators are underestimating the spillover effects of the housing market crisis. "Nobody, including me, wants or expects the Federal regulators to step in and lend a hand to the private sector players who took risky gambles in the subprime market," says Schumer. "But when millions of Americans who have good credit now face the real possibility of not being able to purchase a home because of spillovers from the subprime market, we need the regulators to play a leadership role to preserve market liquidity and minimize the damage."

• *August 8:* Treasury Secretary Hank Paulson says, "Borrowers weren't quite as disciplined as they should be... Lenders clearly weren't as disciplined as they should be. We've seen some excesses. We've seen it in the subprime area, and that will be with us for a while."

• *August 9:* American International Group, one of the biggest U.S. mortgage lenders, warns that mortgage defaults are spreading beyond the subprime sector. With delinquencies becoming more common among borrowers in the category just above subprime.

• *August 9:* BNP Paribas, a French bank, suspends three of its funds because of exposure to U.S. mortgages.

• *August 9:* President Bush addressing the housing market crisis, saying, "The fundamentals of our economy are strong…I'm told there is enough liquidity in the system to enable markets to correct." Bush also said, "The conditions for the marketplace working through these issues are good. My hope is that the market, if it functions normally, will be able to yield a soft landing."

• *August 9 and 10:* European Central Bank and Federal Reserve intervene in markets by pumping billions of dollars of liquidity into the markets.

• *August 10:* John Edwards responds to President Bush's comments, calling on the Administration to act to moderate the housing crisis. Edward's a plan to protect homeowners and fight predatory lending includes strong national legislation to regulate mortgage abuses and prohibit predatory mortgage lending based on North Carolina's state law and a Home Rescue Fund to work with local non-profits, government agencies and community financial institutions to help struggling homeowners renegotiate or refinance their mortgages.

• *August 10:* In regards to lifting the caps on Fannie Mae and Freddie Mac, President Bush said he would like to see Congress gets GSEs "reformed, get them streamlined, get them focused, and then I will consider other options".

• *August 10:* The federal regulator for Fannie Mae denies the mortgage finance company's request to grow its investment portfolio, but did not close the door on the possibility of lifting the cap in the future.

• *August 13*: Aegis Mortgage files for bankruptcy.

• *August 15:* Rep Barney Frank announces plans to hold hearings in the House Financial Services Committee investigating credit rating agencies role in the subprime mortgage crisis.

• *August 16:* Countrywide Financial, the nation's largest mortgage lender, draws down $11.5 billion from its credit lines.

• *August 16:* All three major stock indexes were 10% lower than their July peaks – a marker indicating a correction of the stock market, due to tightening in the credit markets.

• *August 17:* The Federal Reserve cuts the discount rate by half a point. Stocks rally.

• *August 22:* RealtyTrac Inc announces foreclosures were up 93% in July 2007 from July 2006. The national foreclosure rate in July was one filing for every 693 households. There were 179,599 filings reported last month, up from 92,845 a year ago.

• *August 22:* In letters to more than 40 major market players, and federal financial regulators including Chairman Bernanke and Secretary Paulson, Senator Schumer cautions that regulators' efforts to bring liquidity to tightened credit markets have so far overlooked the harrowing situation in the underlying mortgage market that stoked the credit crunch in the first place. Schumer urged banks, lenders, and loan servicers to direct resources to the non-profits on the frontlines of the mortgage crisis in the same vain as the Senate Appropriations Committee, which has set aside $100 million for nonprofits that work with homeowners to prevent foreclosure.

APPENDIX III

PENDING FEDERAL LEGISLATION

1. **H.R. 3838**-To temporarily increase the portfolio caps applicable to Freddie Mac and Fannie Mae, to provide the necessary financing to curb foreclosures by facilitating the refinancing of at-risk.
2. **H.R. 2061**-Predatory Mortgage Lending Practices Reduction Act- To protect home buyers from predatory lending practices.
3. **H.R. 3535**-Homebuyer's Protection Act of 2007- To amend the Truth in Lending Act to require escrow accounts for the payment of property taxes and insurance for all subprime loans, and to expand the coverage of the appraisal requirements under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, and for other purposes.
4. **H.R.3777**-Protecting Access to Safe Mortgages Act- To temporarily raise the portfolio caps applicable to Freddie Mac and Fannie Mae, to provide the necessary financing to curb foreclosures by facilitating the refinancing of at-risk subprime borrowers into safe, prime loans, to preserve liquidity in the mortgage lending markets, and for other purposes.
5. **S. 2036**-Protecting Access to Safe Mortgages Act - A bill to temporarily raise conforming loan limits in high cost areas and portfolio caps applicable to Freddie Mac and Fannie Mae, to provide the necessary financing to curb foreclosures by facilitating the refinancing of at-risk subprime borrowers into safe, prime loans, to preserve liquidity in the mortgage lending markets, and for other purposes.
6. **H.R. 3012**-Fair Mortgage Practices Act of 2007 - To amend the Truth in Lending Act to provide for the establishment of fair mortgage practices, generally, and for subprime mortgages in particular, to provide for a national system for licensing or registering residential mortgage loan originators, and for other purposes.
7. **H.R. 3133**-Financial Literacy for Homeowners Act - To authorize the Secretary of the Treasury to make grants to States, units of general local government, and nonprofit organizations for counseling and education programs for the prevention of predatory lending and to establish a toll-free telephone number for complaints regarding predatory lending, and for other purposes.
8. **S. 1222**-STOP FRAUD Act - A bill to stop mortgage transactions which operate to promote fraud, risk, abuse, and under-development, and for other purposes.
9. **H.R. 3666**-Foreclosure Prevention and Homeownership Protection Act - To establish a bipartisan commission to perform a comprehensive examination of the current foreclosure and mortgage lending crisis and

to make recommendations for legislative and regulatory changes to address such problems.

10. **H.R. 3019**-Expand and Preserve Home Ownership Through Counseling Act - To establish an Office of Housing Counseling to carry out and coordinate the responsibilities of the Department of Housing and Urban Development regarding counseling on homeownership and rental housing issues, to make grants to entities for providing such counseling, to launch a national housing counseling advertising campaign, and for other purposes.
11. **H.R 1852**-Expanding American Homeownership Act of 2007 - To modernize and update the National Housing Act and enable the Federal Housing Administration to use risk-based pricing to more effectively reach underserved borrowers, and for other purposes.
12. **H.R. 1427**-Federal Housing Finance Reform Act of 2007 - To reform the regulation of certain housing-related Government-sponsored enterprises, and for other purposes.
13. **H.R. 3074**-Transportation, Housing and Urban Development, and Related Agencies Appropriations Act- Making appropriations for the Departments of Transportation, and Housing and Urban Development, and related agencies for the fiscal year ending September 30, 2008, and for other purposes.
14. **H.R. 3915-** To amend the Truth in Lending Act to reform consumer mortgage practices and provide accountability for such practices, to establish licensing and registration requirements for residential mortgage originators, to provide certain minimum standards for consumer mortgage loans, and for other purposes.

APPENDIX IV

GLOSSARY & COMMON MORTGAGE RELATED TERMS

- **7/23 and 5/25 Mortgages**
  Mortgages with a one time rate adjustment after seven years and five years respectively.
- **3/1, 5/1, 7/1 and 10/1 ARMs**
  Adjustable rate mortgages in which rate is fixed for three year, five year, seven year and 10-year periods, respectively, but may adjust annually after that.
- **Acceleration**
  The right of the mortgagee (lender) to demand the immediate repayment of the mortgage loan balance upon the default of the mortgagor (borrower), or by using the right vested in the Due on Sale Clause.
- **Adjustable Rate Mortgage (ARM)**
  A mortgage in which the interest rate is adjusted periodically based on a pre-selected index. Also sometimes known as a renegotiable rate mortgage, or variable rate mortgage.
- **Adjustment Date**
  The date that the interest rate changes on an adjustable rate mortgage (ARM).
- **Adjustment Interval**
  On an adjustable rate mortgage, the time between changes in the interest rate and/or monthly payment, typically one, three or five years depending on the index.
- **Adjustment Period**
  The period elapsing between adjustment dates for an adjustable rate mortgage (ARM).
- **Amortization**
  Loan payment divided into equal periodic payments calculated to pay off the debt at the end of a fixed period, including accrued interest on the outstanding balance.
- **Annual Percentage Rate (APR)**
  The measurement of the full cost of a loan including interest and loan fees expressed as a yearly percentage rate. Because all lenders apply the same rules in calculating the annual percentage rate, it provides consumers with a good basis for comparing the cost of different loans.
- **Balloon Mortgage**
  A loan which is amortized for a longer period than the term of the

loan. Usually this refers to a thirty year amortization and a five or seven year term. At the end of the term of the loan, the remaining outstanding principal on the loan is due. This final payment is known as a balloon payment.

- **Blanket Mortgage**
  A mortgage covering at least two pieces of real estate as security for the same mortgage.
- **Broker**
  An individual in the business of assisting in arranging funding or negotiating contracts for a client but who does not loan the money himself. Brokers usually charge a fee or receive a commission for their services.
- **Buy Down**
  When the lender and/or the home builder subsidized the mortgage by lowering the interest rate during the first few years of the loan. While the payments are initially low, they will increase when the subsidy expires.
- **Caps** (interest)
  Consumer safeguards which limit the amount of change to the interest rate for an adjustable rate mortgage.
- **Caps** (payment)
  Consumer safeguards which limit the amount of change to the monthly payments for an adjustable rate mortgage.
- **Change Frequency**
  The frequency (in months) of payment and/or interest rate changes in an adjustable rate mortgage (ARM).
- **COFI**
  An adjustable-rate mortgage with a rate that adjusts based on a cost-of-funds index, often the 11th District Cost of Funds.
- **Conventional Loan**
  A mortgage not insured by FHA or guaranteed by VA.
- **Conversion Clause**
  A provision in an ARM allowing the loan to be converted to a fixed-rate at some point during the term. Usually conversion is allowed at the end of the first adjustment period. The conversion feature may cost extra.
- **Debt-to-Income Ratio**
  The ratio, expressed as a percentage, which results when a borrower's monthly payment obligation on long term debts is divided by his or her gross monthly income. See housing expenses-to-income ratio.
- **Default**
  Failure to meet legal obligations in a contract, specifically, failure to make the monthly payments on a mortgage.

- **Deferred Interest**
  When a mortgage is written with a monthly payment that is less than required to satisfy the note rate, the unpaid interest is deferred by adding it to the loan balance. See *negative amortization.*
- **Delinquency**
  Failure to make payments on time. This can lead to foreclosure.
- **Equity**
  The difference between the fair market value and current indebtedness also referred to as the owner's interest. The value an owner has in real estate over and above the obligation against the property.
- **Escrow**
  An account held by the lender into which the home buyer pays money for tax or insurance payments. Also earnest deposits held pending loan closing.
- **Federal Home Loan Mortgage Corporation**(FHLMC) also called "Freddie Mac"
  A government sponsored entity that purchases conventional mortgage from insured depository institutions and HUD-approved mortgage bankers.
- **Federal National Mortgage Association** (FNMA) also know as "Fannie Mae"
  A government sponsored entity that purchases and sells conventional residential mortgages as well as those insured by FHA or guaranteed by VA.
- **FHA Loan**
  A loan insured by the Federal Housing Administration open to all qualified home purchasers. While there are limits to the size of FHA loans, they are generous enough to handle moderately priced homes almost anywhere in the country.
- **First Mortgage**
  The primary lien against a property.
- **Fixed Installment**
  The monthly payment due on a mortgage loan including payment of both principal and interest.
- **Fixed Rate Mortgage**
  The mortgage interest rate will remain the same on these mortgages throughout the term of the mortgage for the original borrower.
- **Fully Amortized ARM**
  An adjustable rate mortgage (ARM) with a monthly payment that is sufficient to amortize the remaining balance, at the interest accrual rate, over the amortization term.
- **Foreclosure**
  A legal process by which the lender or the seller forces a sale of a mortgaged property because the borrower has not met the terms of

the mortgage. Also known as a repossession of property.

- **Government National Mortgage Association (GNMA)**
  Also known as "Ginnie Mae." Provides sources of funds for residential mortgages, insured or guaranteed by FHA or VA.
- **Graduated Payment Mortgage** (GPM)
  A type of flexible payment mortgage where the payments increase for a specified period of time and then level off. This type of mortgage has negative amortization built into it.
- **Growing Equity Mortgage (GEM)**
  A fixed rate mortgage that provides scheduled payment increases over an established period of time. The increased amount of the monthly payment is applied directly toward reducing the remaining balance of the mortgage.
- **Impound**
  The portion of a borrower's monthly payments held by the lender or servicer to pay for taxes, hazard insurance, mortgage insurance, lease payments, and other items as they become due. Also known as reserves.
- **Initial Interest Rate**
  This refers to the original interest rate of the mortgage at the time of closing. This rate changes for an adjustable rate mortgage (ARM). It's also known as "start rate" or "teaser."
- **Interest**
  The fee charged for borrowing money.
- **Interest Accrual Rate**
  The percentage rate at which interest accrues on the mortgage. In most cases, it is also the rate used to calculate the monthly payments.
- **Interest Rate Buydown Plan**
  An arrangement that allows the property seller to deposit money to an account. That money is then released each month to reduce the mortgagor's monthly payments during the early years of a mortgage.
- **Interest Rate Ceiling**
  For an adjustable rate mortgage (ARM), the maximum interest rate, as specified in the mortgage note.
- **Interest Rate Floor**
  For an adjustable rate mortgage (ARM), the minimum interest rate, as specified in the mortgage note.
- **Investor**
  A money source for a lender.
- **Jumbo Loan**
  A loan which is larger than the limits set by the *Federal National Mortgage Association* and the *Federal Home Loan Mortgage Corporation.* Because jumbo loans cannot be funded by these two

agencies, they usually carry a higher interest rate.

- **Lien**
  A claim upon a piece of property for the payment or satisfaction of a debt or obligation.
- **Lifetime Payment Cap**
  For an adjustable rate mortgage (ARM), a limit on the amount that payments can increase or decrease over the life of the mortgage.
- **Lifetime Rate Cap**
  For an adjustable rate mortgage (ARM), a limit on the amount that the interest rate can increase or decrease over the life of the loan.
- **Loan**
  A sum of borrowed money (principal) that is generally repaid with interest.
- **Margin**
  The amount a lender adds to the index on an adjustable rate mortgage to establish the adjusted interest rate.
- **Monthly Fixed Installment**
  The portion of the total monthly payment that is applied toward principal and interest. When a mortgage negatively amortizes, the monthly fixed installment does not include any amount for principal reduction and doesn't cover all of the interest. The loan balance therefore increases instead of decreasing.
- **Mortgage**
  A legal document that pledges a property to the lender as security for payment of a debt.
- **Mortgage Banker**
  A company that originates mortgages for resale in the secondary mortgage market.
- **Mortgage Broker**
  An individual or company that charges a service fee to bring borrowers and lenders together for the purpose of loan origination.
- **Negative Amortization**
  When your monthly payments are not large enough to pay all the interest due on the loan. This unpaid interest is added to the unpaid balance of the loan. The home buyer ends up owing more than the original amount of the loan.
- **One Year Adjustable Rate Mortgage**
  Mortgage where the annual rate changes yearly. The rate is usually based on movements of a published index plus a specified margin, chosen by the lender.
- **Payment Change Date**
  The date when a new monthly payment amount takes effect on an adjustable rate mortgage (ARM) or a graduated-payment mortgage (GPM). Generally, the payment change date occurs in the month immediately after the adjustment date.

- **Periodic Payment Cap**
  A limit on the amount that payments can increase or decrease during any one adjustment period.
- **Periodic Rate Cap**
  A limit on the amount that the interest rate can increase or decrease during any one adjustment period, regardless of how high or low the index might be.
- **Points** (Loan Discount Points)
  Prepaid interest assessed at closing by the lender. Each point is equal to 1 percent of the loan amount (e.g., two points on a $100,000 mortgage would cost $2,000).
- **Preapproval**
  The process of determining how much money you will be eligible to borrow before you apply for a loan.
- **Primary Mortgage Market**
  Lenders, such as savings and loan associations, commercial banks, and mortgage companies, who make mortgage loans directly to borrowers. These lenders sometimes sell their mortgages to the secondary mortgage markets such as *FNMA* or *GNMA*, etc…
- **Principal**
  The amount borrowed or remaining unpaid. The part of the monthly payment that reduces the remaining balance of a mortgage.
- **Principal Balance**
  The outstanding balance of principal on a mortgage not including interest or any other charges.
- **Principal, Interest, Taxes, and Insurance (PITI)**
  The four components of a monthly mortgage payment. Principal refers to the part of the monthly payment that reduces the remaining balance of the mortgage. Interest is the fee charged for borrowing money. Taxes and insurance refer to the monthly cost of property taxes and homeowners insurance, whether these amounts are paid into an escrow account each month or not.
- **Private Mortgage Insurance** (PMI)
  In the event that you do not have a 20 percent down payment, lenders will allow a smaller down payment - as low as 3 percent in some cases. With the smaller down payment loans, however, borrowers are usually required to carry private mortgage insurance. Private mortgage insurance will usually require an initial premium payment and may require an additional monthly fee depending on your loan's structure.
- **Refinance**
  Obtaining a new mortgage loan on a property already owned often to replace existing loans on the property.
- **Reverse Annuity Mortgage** (RAM)

A form of mortgage in which the lender makes periodic payments to the borrower using the borrower's equity in the home as collateral for and repayment of the loan.

- **Second Mortgage**
  A mortgage made subsequent to another mortgage and subordinate to the first one.
- **Secondary Mortgage Market**
  The place where primary mortgage lenders sell the mortgages they make to obtain more funds to originate more new loans. It provides liquidity for the lenders.
- **Servicer**
  An organization that collects principal and interest payments from borrowers and manages borrower escrow accounts. The servicer often services mortgages that have been purchased by an investor in the secondary mortgage market.
- **Step Rate Mortgage**
  A mortgage that allows for the interest rate to increase according to a specified schedule (i.e., seven years), resulting in increased payments as well. At the end of the specified period, the rate and payments will remain constant for the remainder of the loan.
- **Third Party Origination**
  When a lender uses another party to completely or partially originate, process, underwrite, close, fund, or package the mortgages it plans to deliver to the secondary mortgage market.
- **Two Step Mortgage**
  A mortgage in which the borrower receives a-below-market interest rate for a specified number of years (most often seven or 10), and then receives a new interest rate adjusted (within certain limits) to market conditions at that time. The lender sometimes has the option to call the loan due with 30 days notice at the end of seven or 10 years. Also called "Super Seven" or "Premier" mortgage.
- **Underwriting**
  The decision whether to make a loan to a potential home buyer based on credit, employment, assets, and other factors and the matching of this risk to an appropriate rate and term or loan amount.
- **Wraparound Mortgage**

Results when an existing assumable loan is combined with a new loan, resulting in an interest rate somewhere between the old rate and the current market rate. The payments are made to a second lender or the previous homeowner, who then forwards the payments to the first lender after taking the additional amount off the top.

Assembly Banking and Finance Committee
&
Assembly Higher Education Committee
Joint Informational Hearing

"Impact of Credit Crisis on Student Lending Market"

California State Capitol
June 9, 2008
2:00 p.m., Room 437

Joint Informational hearing of

Assembly Banking & Finance Committee
&
Assembly Higher Education Committee

Impact of Credit Crunch on Student Loans

The global credit crisis that started early 2007 has garnered the most attention for its impact on the home mortgage market. A prompt realization of the credit risk concerning some investment vehicles and fast deteriorating home prices have led to one of the most severe market shake-ups in recent memory. The seizure of the credit markets has made the securitization of several investment vehicles very difficult, and at times impossible. In those cases where financing is flowing in the capital markets, a steep premium is attached to those credit deals. This credit crisis has now spilled over into the student lending market. The collapse of the auction rate securities (ARS) market, a previously obscure financial market for most people, has impacted municipal bonds and the student loan market. The structure of student loan markets will be discussed in more detail later. Additionally, the subprime lending crisis has had an overlooked, and direct effect on the student loans as a borrower with a foreclosure in the last five years is ineligible for a federal PLUS loan[35]. Due to this credit crisis, private student loans will be underwritten with more restrictive terms such as requiring increased FICO scores. It is estimated that these changes alone will result in 100,000 families becoming ineligible for both PLUS and private student loans.[36]

Student lending is funded via private loan programs, the Federal Financial Education Loan Program (FFELP), or the William D. Ford Federal Direct Loan Program (Direct Loan) provided by the federal government. Direct Loans are funded from public capital originating with the U.S. Treasury. They are distributed through a channel that begins with the U.S. Treasury Department and from there passes through the USDE, then to the college or university and then to the student. Private loans and FFELP loans have been stifled, to varying degrees, by shut down in securitizations for private loans, and a 57% reduction in securitizations of FFELP loans and the cost of those funds increasing 137 basis points.[37]

---

[35] Testimony by Mark Kantrowitz, Publisher, FinAid.org. Hearing of the US Senate Committee on Banking, Housing, and Urban Affairs Turmoil in U.S. Credit Markets: Impact on the Cost and Availability of Student Loans. April 15, 2008
[36] Ibid.
[37] Ibid

There are 5,966 institutions of higher education eligible to participate in the Title IV loan programs. Of that number, 4,105 institutions actively participate in the FFEL program, while 1,150 institutions actively participate in the DL program. However, since February 2008 to today, more than 288 institutions have begun the process to switch to the DL program. This compares with nine institutions switching during the same time period in 2007. Although there has been concern expressed in the community that the DL program would be unable to handle a sudden shift in loan volume, ED has assured institutions that it should be able to double its loan volume. The process for an institution to switch from the FFEL to the DL program might be difficult to accomplish in a very short period of time if a school were to suddenly determine that its students had difficulty accessing loans.

A recent *New York Times* article, "Student Loans Start to Bypass 2-Year Colleges," highlighted the exodus student loan programs at two-year colleges. Lenders are pulling out of this market based on analysis of higher default rates, low numbers of borrowers and small loan amounts that combined to make loans to these institutions less profitable. This is occurring even with 95% of the value of these loans guaranteed by the federal government. California's two-year colleges have been burdened with budget reductions and other cost cutting measures due to multiple state budget deficits. According to the College Board, 40% of the nation's undergraduates attend two-year colleges, with a third of their graduates taking out loans. Two-year colleges are often the gateway for students, often facing financial difficulties, to enter the higher education system.

Four non-profit state loan agencies, Pennsylvania Higher Education Assistance Agency (PHEAA), Massachusetts Education Financing Authority (MEFA), Michigan Higher Education Student Loan Authority (MHESLA) and Brazos (TX) have suspended all FFEL program originations. NorthStar Guarantee had suspended all activity in the FFEL program but has subsequently resumed making Stafford and PLUS loans, excluding consolidation loans.

The lenders who have exited all or part of the FFEL program account for over 12 percent of Stafford and PLUS loan origination volume and 83 percent of FFEL consolidation loan volume. These lenders originated more than $7 billion in Stafford and PLUS loans and more than $39.3 billion in consolidation loans in FY 07. All of the top ten and 38 of the top 100 consolidation lenders have stopped making consolidation loans, and 27 of the top 100 originators have stopped making Stafford and PLUS loans.
In addition, a number of institutions are reporting anecdotally on email

lists that some FFEL lenders have informed them that they will no longer offer loans to the institution's students, usually because the volume of loans from that college or university is too low.

According to the National Association of College and University Business Officers, as of May 22, 2008, eighty-nine education lenders have exited or suspended their participation in all or part of the FFEL program. Seventy-two lenders have suspended participation in the entire FFEL program, 17 lenders have suspended participation in the consolidation loan program only, and 26 lenders have suspended their private student loan programs. This reduction in lending has occurred in spite of Asset Backed Securities (ABS) associated with student loans being AAA rated. Around 7.5 million borrowers took out $91.8 billion in FFELP loans during the current school year at 4,500 institutions.[38]

Student Lending Marketplace.

The majority of student loans are originated via the FFELP or the Direct Loan program with colleges and universities generally participating in either one or the other.

- Under the FFELP the loan is originated by a private lending institution but guaranteed by the federal government. Furthermore, these loans contain interest rates caps with subsidies to the lenders and guarantors that ensure the student borrower is able to get the most cost effective loan possible.
- The Direct Loan program is a loan that is made by and repaid to the federal USDE. These two lending programs are not available at every educational institutions.

These programs offer two types of undergraduate loans:

- Subsidized Stafford Loans: These are needs-based loans that cover the difference between a student's resources and the cost of attending a college or university, up to $13,500. The federal government pays the interest while the student is attending the college or university and subsidizes the interest throughout the life of the loan.

- Unsubsidized Stafford Loans: Not based on financial need, these loans generally cover the difference between the subsidized Stafford Loan and the total cost of attending college. Loans are made by private lending institutions and repayment is guaranteed by the

[38] Robert Tomsho. Tough Assignment: Find College Loans, *Wall Street Journal*. June 1, 2008

federal government. The federal government sets the interest rates and fees.

It is estimated that three quarters of postsecondary schools participate in the FFELP, while only 25% participate in the Direct Loan program. The differences in participation for these programs vary due to differences in subsidies and support offered for depending on the loan program. For example, more generous subsidies are offered to lenders in the FFEL program, and schools received administrative assistance that is not available through the Direct Loan program. Furthermore, the Direct Loan limits have not kept pace with the cost of education; however, one could also argue that neither grants nor loans are able to keep pace with increasing costs of education in general.

Another loan program, designed for credit worthy parents of dependent students, are PLUS Loans. These are not needs-based and are federally guaranteed. Federal student loans to parents: Usually these are PLUS loans (formerly standing for "Parent Loan for Undergraduate Students"). Unlike loans made to students, parents can borrow much more — usually enough to cover any gap in the cost of education. However, there is no grace period as payments start immediately. Parents are responsible for repayment on these loans, not the student. The parents have signed the master promissory note to pay and, if they do not do so, it is their credit rating that suffers. As mentioned in the opening of this document, the foreclosure crisis has had a direct impact on these types of loans as foreclosures have a sever impact on credit ratings, and can completely eliminate eligibility to receive these types of loans.
Another option for students is access to the private student loan market. These are loans that are not guaranteed by a government agency and are made to students by banks or finance companies. Advocates of private student loans suggest that they combine the best elements of the different government loans into one: They generally offer higher loan limits than direct-to-student federal loans, ensuring the student is not left with a budget gap. However, unlike to-the-parent government loans, they generally offer a grace period with no payments due until after graduation. This grace period ranges as high as 12 months after graduation, though most private lenders offer six months.

Private loans generally come in two types: school-channel and direct-to-consumer. School-channel loans offer borrowers lower interest rates but generally take longer to process. School-channel loans are 'certified' by the school, which means the school signs off on the borrowing amount, and the funds for school-channel loans are disbursed directly to the school. Direct-to-consumer private loans are not certified by the school; schools don't

interact with a direct-to-consumer private loan at all. The student simply supplies enrollment verification to the lender, and the loan proceeds are disbursed directly to the student. While direct-to-consumer loans generally carry higher interest rates than school-channel loans, they do allow families to get access to funds very quickly — in some cases, in a matter of days. Some argue that this convenience is off-set by the risk of student over-borrowing and/or use of funds for inappropriate purposes, since there is no third-party certification that the amount of the loan is appropriate for the education finance needs of the student in question. Direct-to-consumer private loans are the fastest growing segment of education finance and, as such, a number of providers are introducing products. Loan providers range from large education finance companies to specialty companies that focus exclusively on this niche. Such loans will often be distinguished by the indication that "no FAFSA is required" or "Funds disbursed directly to you."
Lenders that participate in the federal program may also offer private loans.

Capital Markets & Student Loans:
Not-for-profit lenders and state-based student loan secondary market organizations and non-traditional lenders (e.g., Sallie Mae) use a variety of strategies to raise capital in the marketplace, which is, in turn, offered as student loans. All of these types of organizations may participate in both the FFEL program and the private loan market, with varying levels of participation by each affiliated organization. Many traditional deposit banks (e.g., Chase, Bank of America, Wachovia, and Citibank) have participated in the FFEL program and offer private loans. In FY 06, traditional banks held nearly 24 percent of outstanding volume while non-banks held over 76 percent of volume.

Like mortgage lending, student lending is also funded and operated through complex secondary market transactions and investment vehicles. Secondary markets include Sallie Mae, commercial banks, state guaranty agencies, non-profits and non-depository banking entities. These secondary market participants either keep the loans on their books or fund them through the issuance of ARS or ABS. In selling the loans to the secondary market, banks free up their capital and are able to make additional loans to students. Many of the not-for-profit lenders also buy loans from the banks on the secondary markets, which means that if the not-for-profit lenders are facing a short-term liquidity problem, the banks may face a long-term liquidity problem when the secondary market is not available to buy their loans.

Sallie Mae is the largest purchaser of secondary market student loans in the market. However, the recent market turmoil has caused Sallie Mae to scale back its overall market participation with a complete exit from the loan consolidation market. Sallie Mae was created in 1972 via congressional action as a Government Sponsored Enterprise (GSE), much like Fannie Mae and Freddie Mac, to provide a secondary market to encourage the origination of loans to students who were considered a credit risk. In 2004, Congress terminated its charter and it became a private company.

Approximately, 85% of FFELP loans have been financed through issuance of ABS, however since September 30, 2007, no loan originated has been funded through securitization[39]. In the first quarter of 2008 only $8.4 billion of student loan ABS was issued, compared to $21.7 billion in the first quarter of 2007.[40] According to statistics from Sallie Mae, the total outstanding amount of student loans from both FFELP and the private market is $405 billion. The ARS market, in 2007 held $80 billion with $230 billion held in the ABS market. Sallie Mae does most of its funding through the ABS market.

In the standard ABS financing, student loans are transferred from lenders into a bankruptcy remote securitization trust that then issues securities to investors. In these trusts, the underlying loan is the collateral for repayment of the investment, and with a FFELP guarantee up to 97% of the loan, these securities are relatively stable and safe investments. The ABS backed by the loans are divided up into tranches based on quality of the underlying asset ranging and rated by credit rating agencies from AAA to AA. ABS backed by loans from the FFELP are usually rated AAA due to the large federal guarantee in the event of default. Investors in these securities receive various floating rates of interest based on the rating and maturity of the security. The recent market turmoil has lead to investor demanded rate spreads that are too expensive to make newly originated loans profitable.

As mentioned previously the other sector of financing for student loans is the ARS market. ARSs are long-term bonds bearing interest rates that are set during an auction but can be held at intervals as short as one week. During the auction, those bondholders who wish to sell their bonds can do so if sufficient buyers bid. Generally speaking, the more market interest there is in purchasing an auction rate security, the lower the rate the issuer must pay bondholders. The less market interest, the higher the rate the

---

[39] Testimony of Tom Deutsch, American Securitization Forum. Hearing of the US Senate Committee on Banking, Housing, and Urban Affairs Turmoil in U.S. Credit Markets: Impact on the Cost and Availability of Student Loans. April 15, 2008

[40] Ibid.

issuer must pay. If there are insufficient buyers to purchase the auction rate securities that holders wish to sell, the bondholders must keep their bonds (turning a liquid investment into a less liquid one), and the issuer must pay a rate (the "failed auction rate") that is specified in the bond documents. The failed auction rate is typically much higher than the rates the market has traditionally accepted, which places financial pressure on the issuer. Historically, investment banks would step in to purchase any otherwise un-purchased auction rate securities. However, the liquidity crunch that has affected nearly all market participants has left them unable to support the volume of bonds that investors want to sell. Early this year over 700 auctions failed in a single week. In addition to being issued by student loan finance authorities, they are issued by municipalities, non-profit hospitals, and housing finance agencies.

The crisis in the ABS and ARS markets has been exacerbated, according to many players in the student loan market, by the College Cost Reduction and Access Act of 2007.

College Cost Reduction and Access Act of 2007.

Many lenders have pointed to other changes in the student lending market that have reduced the attractiveness of these loans for investors. The largest of those changes was the passage of the HR 2669 (Miller), the College Cost Reduction and Access Act of 2007 (CCRAA), which reduced both borrower interest rates and reduced the subsidy rates that the government would pay to lenders. Furthermore, the Congressional Budget Office estimated the total reduction in lender subsidies, resulting from CCRAA, would exceed $40 billion over 10 years , a reduction that some lenders have felt would make it virtually impossible to continue to offer loans in a such a market.

CCRAA cut the subsidy rates on loans in order to free up money for an increase in Pell Grants, starting with a $490 increase for the first two years, rising to $1,090 for the 2012-2012 school year and as a response to troubling developments involving lenders and student aid officers steering students into questionable loans. Key provisions relating to students loans are as follows:

- The bill gradually cuts interest rates on subsidized Stafford loans for undergraduate students in half, according to the following schedule:
    - 6.8 percent for loans first disbursed July 1, 2006 to July 1, 2008

    - 6 percent for loans first disbursed July 1, 2008 to July 1, 2009
    - 5.6 percent for loans first disbursed July 1, 2009 to July 1, 2010
    - 4.5 percent for loans first disbursed July 1, 2010 to July 1, 2011
    - 3.4 percent for loans first disbursed July 1, 2011 to July 1, 2012

- Loan payments will be limited to 15 percent of a borrower's discretionary income or 15 percent of the amount that a borrower's (and spouse's if applicable) adjusted gross income exceeds 150 percent of the poverty line, divided by 12. Unpaid interest and principal are capitalized and any outstanding loan balance is forgiven after 25 years of repayment.

- PLUS Loans made on behalf of a dependent student and Direct Consolidation Loans that contain PLUS loans are not eligible for the income-based repayment program.

- Holders of these loans must apply the borrower's payments first to interest, second to fees, and then toward the principal of the loan.

- Any interest due and not covered by the borrower shall be paid by the Secretary of Education for up to three years except for periods that a borrower is in deferment due to economic hardship.

- The lender shall also capitalize the interest due when the borrower stops participating in the income-based repayment program, or begins making payments larger than what is specified under income-based repayment.

- Principal due and not paid under income-base repayment shall be deferred.

- Borrowers may remain in income-based repayment more than 10 years.

- When borrowers leave the program the maximum payment required on the loan shall not exceed the monthly amount based on a 10-year repayment period when the borrower first joined income-based repayment. The time the borrower is permitted to repay the loan may exceed 10 years.

- The Department must repay or cancel any outstanding loan principal and interest for borrowers after 25 years of repayment.

- Borrowers currently repaying loans according to income-contingent repayment or income-sensitive repayment plans will have the choice to continue in their current plans or may participate in the program created by this bill.

- The USDE must establish procedures to annually determine borrowers' eligibility for the program, including verification of a borrower's income and the amount of their loans.

- Reductions to Lenders in the FFELP program.

    - Eliminate the "Exceptional Performer" status that allows lenders that meet certain requirements established by the Secretary of Education to receive higher insurance rates on defaulted loans

    - Reduce the insurance paid by the federal government to lenders on defaulted loans from 98 percent to 97 percent of unpaid principal balances through October 1, 2012 at which point the insurance will be reduced to 95 percent

    - Reduce the amount that guarantors may keep through collections on defaulted loans from 23 percent to 16 percent

    - Reduce the special allowance payments (SAP) from the Department to lenders based on their tax status. For-profit lenders would receive a 55 basis point SAP reduction and non-for-profit lenders would receive a 40 basis point SAP reduction. To ensure that only nonprofit lenders benefit from the increased subsidization, nonprofit lenders that are owned in-whole or in-part by a for-profit entity would not be eligible for the reduced subsidy reductions. Nonprofit lenders that are purchased by for-profit entities would also lose their higher subsidization rates on the date of the sale.

- Increase the loan fee paid to the Department by lenders - that cannot be passed on to borrowers - from 0.5 percent to 1 percent of the principal amount of each newly originated loan made on or after October 1, 2007
- Decrease the account maintenance fees paid by the Department to guarantors from .10 percent to .06 percent on newly originated loans
- The definition of economic hardship is also changed under from 100 percent of the poverty line for a family of 2 to 150 percent of the poverty line applicable to the family size.

Recent Developments:

The *lender-of-last-resort* (LLR) is a proposed solution to the current crisis, but this program directly involves guaranty agencies, not institutions of higher education.

Specifically, current law requires guaranty agencies to develop policies and operating procedures to ensure that a borrower in the geographic area serviced by that guaranty agency is able to obtain a loan. The agency can make the loan or direct the borrower to a designated lender. The Secretary of USDE is authorized to advance loan capital to the guaranty agency if it is needed in order to enable the agency to make loans under these provisions.

The federal guarantee on these loans is 100 percent, which is three percent higher than what lenders would receive if they made a loan under FFELP. Otherwise, the terms and conditions on these loans are the same as loans made under current law. The USDE issued guidance to guaranty agencies on LLR services in the FFEL program. The original intent of the LLR provisions was to deal with situations when individual students were not able to get loans, rather than to serve as a large-scale lending platform. On Wednesday, May 21, 2008, the USDE released the implementation details of H.R. 5715, the Ensuring Continued Access to Student Loans Act of 2008, which was signed into law by President Bush on May 7, 2008. In a Dear Colleague letter, the Department discuses the following four steps of its plan to ensure access to student loans:

1. As authorized by HR 5715, the Department will purchase loans from the FFEL program lenders for the 2008-2009 academic year and offer lenders access to short-term liquidity;

2. The Department pledges to continue working with the FFEL program community in the short-term to explore programs that might re-engage the capital markets;

3. The Department will make available, if needed, an enhanced lender-of-last resort program; and

4. The Department has the capability of doubling the capacity of the Direct Loan program, should it be needed.

Sallie Mae, the nation's largest originator of federally-guaranteed student loans, announced that they will continue to originate loans following previous reports that the student loan organization might withdraw from the federal program. This federal response is fluid and is changing moment by moment, even at the time of this writing. Time will tell if efforts to boost market liquidity will have an impact.

California's Nexus with Federal Loan Programs:

The state's guarantor of FFELP student loans is the California Student Aid Commission (CSAC) established in 1955. CSAC guarantees principle and interest on federal student loans. EdFund was created on January 1997 as a non-profit corporation to act as an auxiliary for CSAC. Today, CSAC may be best known for administering the $800 million Cal Grant Program.

As the second largest provider of guarantee services in the nation, EdFund processed over $9 billion in loan guarantees in fiscal year 2006-07, and has the capacity to scale its operations to process LLR loan volume, as needed. CSAC and EdFund operate a single line of business as guarantors of loans as they do not engage in direct lending.

On May 30, 2008, the Assembly Budget Subcommittee #2 approved language to ensure that CSAC is able to exercise all options as a lender of last resort and that EdFund must follow directives of CSAC in utilizing its authority to provide greater market liquidity for student loans.

On May 16, 2008, CSAC filed a detailed report with the USDE regarding their proposed participation in the LLR program as required by 34 CFR 682.401(c)

Conclusion:

All participants in the student loan market are hopeful that the latest plans to inject liquidity in the marketplace will ensure that student loans are available as needed. However, the changes that have occurred over the last year have raised many questions about the future of the student lending market. Due to liquidity concerns, the lending environment is beginning to change direction to a focus that may require increased role for state guarantor agencies. Furthermore, as the facts on the ground change moment to moment it is unclear whether the LLR program will become the predominant standard method of issuing student loans and not the exception as in the past.

Further, questions remain as to whether this the rapid change in student loans resulted from the credit crisis or the subsidy cuts contained in CCRAA. The National Association of Student Financial Aid Administrators released a white paper, *The Student Loan Credit Crunch*, on April 29, 2008 to that discussed the impacts of the credit crunch on student loans. In addressing the issue of originations of this crisis they wrote the following: *Some lenders attribute their current troubles to subsidy cuts made by the College Cost Reduction and Access Act (CCRAA) signed into law on September 27, 2007. However, NASFAA agrees with the opinions expressed by a number of lenders in their testimony during several congressional hearings: While the subsidy cuts in the CCRAA may have exacerbated the problems in the capital market, this alone has not created the current credit crunch.*

California State Assembly
Banking and Finance Committee

Informational Hearing

"The Mortgage Crisis Today: Better or Worse?"
Regulation Z

Monday, August 4, 2008
2:00 pm
State Capitol, Room 444

California State Assembly Banking and Finance Committee

The Mortgage Crisis Today: Better or Worse?
&
The Impact of Changes to Federal Reserve Regulation Z

On November 1, 2007, the Assembly Banking and Finance Committee conducted an informational hearing "Subprime Mortgage Crisis in California, A Community Hearing to Examine Solutions and Mitigation Efforts," that examined the mortgage crisis through the testimony of consumer advocates, community leaders and industry experts. At the time of that hearing it was clear that the subprime mortgage crisis was only the beginning of larger problem that would go on to shake up capital markets worldwide. Insufficient risk calculation, as well as, the abuse of certain mortgage loan features led to a downward spiral of both credit and confidence. Years of insufficient underwriting standards combined with a bubble in home price appreciation created the perfect combination of financial disaster. Mortgages offered to borrowers who often had no ability to repay the loan combined with over inflated property values were packaged into securities and sold on the secondary market where the inherent risk of these products was overlooked or even ignored. These securities garnered high rates of return, a gold mine in a market that was flush with liquidity and those willing to spend it. This encouraged a cycle were the rates of return were so great on these products that Wall Street demanded more investment in mortgages, which in turn led many mortgage lenders to churn out subprime mortgages with little or no secondary review. At the time of the November, 2007 hearing several large subprime lenders had filed for bankruptcy or were in the process of being absorbed by larger financial institutions in order to avoid a complete collapse of the mortgage market.

In California, lenders filed 72,571 "notices of default" on borrowers in the third quarter of 2007, eclipsing a record of 61,541 set in 1996, according to DataQuick Information Systems. In Stockton, California in the 3rd quarter of 2007 1 in every 27 home had received some time of foreclosure filing. Today that statistic, for the second quarter of 2008 was 1 in 25 homes. Additionally, foreclosure filings were reported on 739,714 U.S. properties during the second quarter of 2008, a nearly 14 percent increase from the previous quarter and a 121 percent increase from the second quarter of 2007. That means that 1 in every 171 U.S. households received a foreclosure filing. The California cities of Stockton and Riverside-San Bernardino take the No. 1 and No. 2 spots with the most foreclosure activity nationwide, with 10 of California's metropolitan areas in the top twenty nationwide (Stockton at No. 1, San Bernadino/Riverside at No. 2, Bakersfield at No. 4, Sacramento at No. 5, Oakland at No. 8, Fresno at No. 9, San Diego at No. 11, Orange at No. 15, Ventura at No. 16 and Los Angeles at No. 19.)

A large percentage of foreclosure filings are notices of default (NODs). However, not all NODs lead to a foreclosure sale and due the legally mandated timelines for the foreclosure process it can take up to a year to determine how many NODs have actually led to a home loss, though the data reflects that more than half of NODs lead to a foreclosure sale. For example, Foreclosureradar.com looked back to NODs filed in June of 2007 and found that 60% of those resulted in the property sold at auction.

Is the crisis getting better? The expert consensus is that the worst of the crisis is not over. Home prices continue a rapid decline as the housing market is oversupplied with homes, many of which are foreclosed properties. Credit standards have tightened as the availability of easy credit has dwindled. Now, even borrowers with good credit are facing some difficulties getting financing for a home.

Additionally, more loans continue to default as we now see new classes of loans in the Alt-A loan market face growing pressure and stress. Many subprime and Alt-A loans that are currently avoiding large payment increases due to lower interest rates will potentially face higher payment potential when rates normalize in the next few years.

Alt-A home loans are issued to borrowers with good credit ratings who often lack adequate income documentation to satisfy the requirements for a conventional prime loan.   As of April 2008, an estimated 16.3% of the Alt-A loans issued in 2006 and 2007 were under water, in that the debt exceeds the value of the property, and the number of under water loans is expected to grow. These loans are at high risk of default and foreclosure even in the face of some lender's willingness to reduce interest rates or otherwise modify terms. Fourteen months after origination, 4.21 percent of Alt-A loans made in 2006 face 90-plus-day delinquencies. The 90-day default rate was 1.59 percent for 2005 Alt-A loans and 0.91 percent for 2004 originations after 14 months of existence. The figures exclude exotic loans such as pay-option adjustable rate loans (POARMs) which allow borrowers, within certain specified parameters, to choose a payment amount each month. The large proportion of Alt-A loans used to finance second homes and investment properties further increases the risk that borrowers will default and allow the property to be foreclosed.

Over the next two years, up to 5 million homeowners are at risk of default, representing only half of the total borrowers who have negative equity positions.[41] Additionally, home prices are expected to fall by another 10%, making the total from peak to floor decline 25% with the bottom being reached in the third quarter of 2009.[42] Another analysis finds that up to 2.7 million subprime loans will go into foreclosure by the end of 2012 with a total of 6.5 million loans of multiple varieties going into foreclosure over the next five years, with a peak of 2.8 million between 2008 and 2009.[43] The total dollar amount of losses related to residential mortgages will be $525 billion.[44]

Recently, the Hope Now coalition of mortgage lenders, servicers, investors and community advocacy groups, designed to streamline assistance with loan modifications to trouble borrowers released its report for the month of June. More than 76,000 borrowers had their loans modified in June, up 9% from May. Another 105,000 homeowners were given repayment plans, which are less effective over the long term, which made up 58% of all mortgage workouts in June. This attempts have still not stemmed the tide of foreclosures as Hope Now reported that 82,039 people lost their homes, up 12% from May. For California, it is estimated that in the second half of 2008 up to 83,829 homes will fall into foreclosure.[45]

The statistics and outlook for the next two years is certainly grim. Rising foreclosures distress local communities and hamstring government finance. Hundreds of local governments throughout California face budget deficits that are related to the housing crisis.

The purpose of this hearing is to examine and review the recently proposed and adopted changes to the Federal Reserve Regulation Z, as well as, examine the events that have taken place since this committee last convened a hearing on the mortgage crisis.

LOAN MODIFICATIONS.

In September of 2007, the commissioner of the Department of Corporations (DOC) designed a voluntary survey to query the loan

[41] *Update on U.S. Household Finances.* Moody's Economy.com. July 2008
[42] Ibid.
[43] *Foreclosure trends- A Sobering Reality.* Credit Suisse. Fixed Income Research. April 23, 2008.
[44] *Update on U.S. Household Finances.* Moody's Economy.com. July 2008
[45] Isaac, Rani. *Foreclosures in California: The Current Housing Crisis is More Severe Than Previous Corrections*. California Research Bureau. May 2008

modification efforts of loan servicers. DFI also engaged in a survey of state chartered banks and credit unions. Subsequent to this survey effort, Governor Schwarzenegger and DOC commissioner DuFauchard announced an agreement with five of the largest loan servicers to streamline the modification process. The agreement was reached with four lenders representing 25 percent of the sub-prime loan market in California with the agreement consisting of three basic principles providing that mortgage lenders will:

- Reach out proactively to borrowers well before their loans reset;
- Streamline the processes by which they determine whether borrowers may reasonably be expected to be able to make the reset payment; and
- For people who are in their homes and making timely payments now at the starter rate, but who lenders determine cannot make the reset payment, keep them at that starter rate for a sustainable period of time.

Additionally, DOC continued to collect data from their licensees who service mortgage loans to determine the pace and scope of loan modification efforts. DOC has collected and reported this data on a monthly basis with the Commissioner pledging to collect this data for a long as necessary. Additional observations made by the Commissioner, together with survey data, are available on the department's web site, at http://www.corp.ca.gov/press/news/SubprimeLending.asp

In early December 2007, Treasury Secretary Henry Paulson announced an agreement to streamline and establish standards for loan modification and in some cases freezing the interest rate on some loans for five years. This agreement (http://www.americansecuritization.com/uploadedFiles/FinalASFStatementonStreamlinedServicingProcedures.pdf) was reached in conjunction with the American Securitization Forum (ASF), an organization that represents companies that issue mortgage backed securities, as well as investors, loan servicers and rating agencies. The ASF modification parameters sorts subprime borrowers whose rates are about to reset into three categories:

1) Those who are current on their loans, have decent credit scores and equity in their homes, and are likely to be eligible for refinancing. The plan "encourages" servicers to refinance these loans without prepayment penalties, but there are no guarantees.

2) Those who are current on their loans but are not eligible to refinance because of poor credit scores or zero to 3 percent equity in their homes. This is the group that could be fast-tracked into a five-year freeze at the loan's introductory rate, to prevent their monthly payments from shooting up.

3) Those who are delinquent on their loans even at the introductory rate and do not qualify for refinancing. This group could very well end up in foreclosure or have to "short sell" their home if no other option can be worked out.

The ASF plan also called for voluntary data collection by its members on loan modifications and workout arrangements.

In February 2008, the State Foreclosure Prevention Working Group (SFPWG), released its first of two reports, summarizing data collected by a working group comprised of the Conference of State Bank Supervisors and representatives
of the Attorneys General of 11 states, including California. The SFPWG's first report summarized data provided by 13 servicers, representing approximately 58% of the subprime servicing market, for the month of October 2007. Its second report, released in April 2008, included data from the same servicers, for loans made from October 2007 through January 2008. The SFPWG's reports can be found at http://www.csbs.org/Content/NavigationMenu/Home/StForeclosureMain.htm

In February 2008, the HOPE NOW Alliance released its first set of national data, and has subsequently added state-specific data. The HOPE NOW Alliance is an industry-led group that has grown to include virtually all of the large, federally-regulated financial institutions that service residential mortgage loans, as well as many of the large state-regulated institutions. To date, it has released state-specific and national data on foreclosure starts, foreclosure sales completed, repayment plans established, loan modifications completed, and repayment plan inventory for all four quarters of 2007 and the first quarter of 2008 (the same time period reflected in Commissioner DuFauchard's data). HOPE NOW's most recent data release includes data from 21 servicers, representing 66% of all outstanding residential mortgage loans and 85% of outstanding subprime residential mortgage loans. The HOPE NOW data can be found at http://www.hopenow.com/media/press_release.php.

LEGISLATIVE RESPONSES.

In September 2006, the five federal banking agencies (OCC, OTS, FRB, FDIC, and NCUA) issued guidance on nontraditional mortgage product risks. The guidance applies to both prime and nonprime loans and covers federally-regulated financial institutions, their subsidiaries and affiliates, and federally-insured financial institutions. Nontraditional loans are those that allow borrowers to defer repayment of principal, and in some cases, interest. They are also known as alternative or exotic mortgages. Borrowers who obtain these loans are given the opportunity to make relatively low payments during an initial low interest rate period in exchange for agreeing to make much higher payments during a later amortization period. Nontraditional loans are not unique to the subprime market; they are sold in the prime, alt-A, and subprime markets. Common loan types covered by the federal guidance include payment option mortgages and interest-only mortgages (readers are directed to the background paper for Senate Banking & Finance Committee's January 31, 2007 hearing for the definitions and common terms of these loan products).

Key components of the federal guidance include the following:

1) Financial institutions' analyses of borrowers' repayment capacity should include an evaluation of ability to pay the fully indexed rate, not just the initial low introductory rate. Analyses of repayment capacity should avoid over-reliance on credit scores as a substitute for income verification;

2) Institutions should avoid the use of loan terms and underwriting practices that will heighten the need for a borrower to rely on the sale or refinancing of the property once amortization begins;

3) Higher pricing of loans with elevated risks should not replace the need for sound underwriting;

4) Second mortgages with minimal or no owner equity should not have a payment structure that allows for delayed or negative amortization unless the risk is mitigated;

5) Institutions with high concentrations of nontraditional products should have good risk management practices in place and capital levels commensurate with the risk; and,

6) Institutions that offer nontraditional mortgage products should make the potential consumer of these products aware of all possible risks and should provide this information to potential borrowers in a clear, balanced, and timely manner. Payment shock, negative amortization, prepayment penalties, and the cost of reduced documentation loans should be explained. Monthly statements on payment-option adjustable rate mortgages should explain the consequences of each payment option.

In issuing the guidance, the federal regulators urged states to work quickly to apply similar guidance to state-regulated entities engaged in mortgage lending and brokering. Last year, this committee passed SB 385 (Machado) Chapter 301, Statutes of 2007 which implemented the Guidance for state licensed entities. Subsequent to the enactment of this legislation, the Department of Real Estate and Department of Corporations passed regulations to implement the guidance on their licensees. The imposition of the Guidance was a good first step as recognized by the Federal Reserve Board:

The guidance issued by the federal banking agencies has helped to promote safety and soundness and protect consumers in the subprime market. Guidance, however, is not necessarily implemented uniformly by all originators Guidance also does not provide individual consumers who have suffered harm because of abusive lending practices and opportunity for redress.[46]

With the convening of session earlier this year, the Legislature responded to this crisis with numerous bills addressing the current crisis and addressing mortgage issues on a going forward basis. The legislature introduced 15 bills designed to address this crisis though strengthening regulations and consumer protections.

AB 69 (Lieu) clarifies that DOC has ability to request loan modification data from its licensees. This bill is pending on the Senate floor.

AB 180 (Bass) revises the law related to foreclosure consultants to ensure that those facing foreclosure do not become further victimized by scams or outrageous fees. Provide for a registration process for persons acting as foreclosure consultants. This bill is pending before Senate Appropriations.

AB 529 (Torrico) requires lenders to notify borrowers of an impending interest rate reset of an adjustable rate mortgage. This bill is currently on

[46]Official staff commentary of the Federal Reserve Board on publication of final rule amending Regulation Z.

Senate third reading.

AB 1830 (Lieu) Provides California regulators with authority to enforce provisions of federal law relative to mortgages. Currently in Senate Appropriations Committee.

AB 1837 (Garcia) bans payment of compensation for originating a subprime loan or nontraditional loan with an interest rate above the wholesale par rate for which the consumer qualifies. Currently in Assembly Banking and Finance.

AB 2161 (Swanson), requires the Department of Corporations, Department of Financial Institutions and Department of Real Estate to compile a report concerning consumer complaints relating to mortgage lenders. This bill is currently pending in Senate Appropriations.

AB 2187 (Caballero) requires each notice of default and foreclosure to include a homeowner bill of rights that provides a list of their legal rights and responsibilities in the foreclosure process. This bill was held on suspense in Assembly Appropriations Committee.

AB 2880 (Wolk) specifies, among other things, that that mortgage brokers have a fiduciary responsibility to their clients, and requires licensees to maintain a surety bond with their regulator. This bill was held on suspense in Assembly Appropriations Committee.

AB 2359 (Jones) would prohibit a broker, trustee, or mortgagee, or his or her agent, beneficiary, or assigns from requiring as a condition of an agreement regarding a high-cost covered loan, subprime loan, or nontraditional mortgage, as defined, that a borrower or an applicant for the loan waive any rights, duties, remedies, obligations forums, or procedures of California law with respect to a residential mortgage or mortgage foreclosure. Held in Senate Banking, Finance and Insurance.

AB 2509 (Galgiani), would establish the Homeownership Preservation Mortgage Guarantee Program, as specified, administered by the Business, Transportation & Housing Agency. Held in Senate Banking, Finance and Insurance.

AB 2740 (Brownley) provides that a loan servicer, or a bank, credit union, or finance lender that services loans secured by residential real property, owes a duty of good faith and fair dealing to a borrower. The bill would regulate the fees and charges that may be imposed by loan servicers or mortgage loan servicers. The bill would also establish various other prohibited acts and requirements applicable to the servicing of residential mortgage loans. Held in Senate Banking, Finance and Insurance.

SB 1053 (Machado) requires every real estate broker licensed by DRE who makes, brokers, or services mortgages to notify DRE about those activities on an annual basis; Requires supervising real estate brokers (those in charge of mortgage brokerage businesses) to submit detailed compliance reviews of their books and records to DRE annually, along with business activity reports detailing the loans their businesses brokered, made, and serviced during the prior year. Held in Assembly Banking and Finance Committee.

SB 1054 (Machado): Gives the Department of Real Estate (DRE) the ability to ban individuals who have been found guilty of violating the Real Estate Law from real estate-related employment for up to three years. Held in Assembly Banking and Finance Committee.

SB 1137 (Perata): This bill enacts several changes to the procedures that must be followed before the holder of a mortgage may issue a notice of default or notice of trustee sale, requires the holder of a mortgage to mail a specified notice to the tenant(s) of a property on which foreclosure proceedings have begun, and imposes penalties on property owners who fail to adequately maintain foreclosed properties, as specified. Chapter 69, Statutes of 2008

SB 1604 (Machado): Under finance lenders law, requires that applicants show a minimum tangible net worth of $25,000 for "brokers," $50,000 for "a broker engaged in the business of negotiating or performing acts in connecting with residential mortgage loans," and $250,000 for finance lenders (of residential mortgage loans), and require that licensees maintain the applicable net worth at all times; Maintains surety bond generally at $25,000, but increases to $50,000 for finance lenders (of residential mortgage loans); Requires any person seeking employment with a finance lender or broker to complete a specified employment. Currently in Assembly Appropriations Committee.

Thus far, the only bill to reach the Governor has been SB 1137 (Perata) which contained an urgency clause. SB 1137 represents the Legislature's efforts to mitigate the current impacts of the housing crisis by requiring increased contact between lenders/servicers and borrowers before the property enters the foreclosure process. Specifically, this bill requires that the mortgagee or trustee contact the borrower, or attempt to make contact, at least 30 days prior to mailing a NOD. Furthermore, it requires that the owners maintain vacant properties or face $1,000 per day fine. It also provides the owner 30 days to correct a violation once notification has been received from the local government. Finally, it provided enhanced protections for renters by allowing for additional time for renters in foreclosed properties.

Another key component of this legislative package is AB 1830 (Lieu). AB 1830 has been amended several times in order to strike a compromise between consumer and industry advocates. The goal of AB 1830 is to provide consumer protections for higher priced loans building upon the recent announcement of changes to the Truth in Lending Act (TILA). Key components of AB 1830 have included the regulation and restriction of prepayment penalties, limits on the use of yield spread premiums, and establishing rights for individual borrowers.

FEDERAL RESPONSE:

On January 9, 2008 the Federal Reserve Board (Board) published proposed rules that would amend Regulation Z (Reg Z), which implements TILA and the Home Ownership and Equity Protection Act (HOEPA). The proposal included new restrictions or requirements for mortgage lending and servicing designed to protect consumers from abusive mortgage product features and deceptive acts. This proposal creates a new class of loans for coverage called "higher-priced loans." These loans are considered to be those that have most dominated the subprime marketplace. Whereas, previous efforts, such as the Interagency Guidance on Subprime Lending defined subprime lending in terms of borrower characteristics, the changes to regulation Z focus on the features of the actual loan products. In the Board staff comments on the final Reg Z changes the commentary acknowledged that the best way to identify the subprime market is through "loan price, rather than by borrower characteristics."

The Board received 4700 comments on the proposal from community banks, mortgage brokers, bank holding companies, secondary market participants, credit unions, state and national financial services trade associations, realtors, realtor trade groups, individual consumers, state and federal regulators, and national community groups and consumer organizations.

The specific of the proposal and final rule follow.

Higher-priced loan Definition.

The proposal defined higher-priced mortgage loans as a consumer credit transaction secured by the consumer's principal dwelling for which the APR on the loan exceeds the yield on comparable Treasury securities by at least three percentage points for first-lien loans, or five percentage points for subordinate-lien loans. This definition excludes reverse mortgages, construction-only loans and bridge loans.

After taking into consideration numerous arguments during the comment period the Board decided to adopt a definition that is similar to the proposal, but different in the particulars. Instead of tying the definition to the yield on Treasury securities, the final definition will use the average offer rates for the lowest-risk prime mortgages, termed "average prime offer rates." The Board identified two main difficulties with using Treasury yields to set APR thresholds into law. First, the spread between mortgage rates and Treasuries changes in both the short term and long term. Second, it is difficult to determine the comparable Treasury security for a given mortgage loan.

The final threshold will be 1.5 percentage point above the average prime offer rate on comparable transactions for first-lien loans, and 3.5 percentage points for subordinate-lien loans.

It is possible that the selected thresholds for the definition of higher-priced loans could spill over and capture part of the Alt-A market. In the staff commentary to the final proposal (12 CFR Part 226, Truth in Lending: Final Rule. Federal Register, Wednesday July 30, 2008) the Board concluded:

If the selected thresholds cover more than the subprime market, then they likely extend into what has been known as the alt-A market. The alt-A market is generally understood to be for borrowers who typically have higher credit scores than subprime borrowers but still pose more risk than prime borrowers because they make small down payments or do not document their incomes, or for other reasons. The definition of this market is not precise, however. The Board judges that the benefits of extending §226.35's restrictions into some part of the alt-A market to ensure overage of the entire subprime market outweigh the costs. This market segment also saw undue relaxation of underwriting standards, one reason that its share of residential mortgage originations grew sixfold from 2003 to 2006 (from two percent of originations to 13 percent). To the extent § 226.35 covers the higher-priced end of the alt-A market, where risks in that segment are highest, the regulation will likely benefit consumers more than it would cost them.

Ability to Repay.

The proposal prohibited creditors from extending credit without regard of the borrower's ability to repay from sources other than collateral. The ability to repay also require that the borrower must be able to repay the loan plus applicable real estate taxes and hazard insurance premiums. The proposal requires that creditors verify income and assets using reliable third party documentation. The proposed rule included a "pattern and practice" standard to determine when a violation has occurred.

The Board found that the most risky types of loans often were made to borrowers without any consideration of their ability to repay the loan over its entire life cycle. For example, on a 2/28 ARM the borrower was qualified to pay the loan on the first two years of the fixed rate but no consideration was given to repayment ability after the interest rate adjustment at the end of year two.

The final rule is substantially similar to the proposal. The major difference is the final rule removed the "pattern and practice" language. The Board commented:

The Board believes that removing ‘‘pattern or practice’’ is necessary to ensure a remedy for consumers who are given unaffordable loans and to deter irresponsible lending, which injures not just individual borrowers but also their neighbors and communities. The Board further believes that the presumption of compliance the Board is adopting will provide more certainty to creditors than either ‘‘pattern or practice’’ or the proposed safe harbor. The presumption will better aid creditors with compliance planning, and it will better help them mitigate litigation risk.

Prepayment Penalties (PPPs).

One of the most controversial and least understood features of subprime lending has been PPPs. PPPs are typically a feature of subprime mortgage loans that require that a borrower pay a percentage amount of their loan should they pay-off (refinance) the loan within a certain time-frame. On average, a PPP is around 3% of the outstanding balance of the loan. With the high cost of homes in California this can range from $2500-$6,000. According to First American LoanPerfomance data, three-quarters of securitized subprime loan pools originated from 2003 through the first half of 2007 had a PPP. Furthermore, approximately 55% of subprime 2/28

ARMS originated from 2000-2005 prepaid while the PPP was in effect.

As recent media accounts have portrayed, these penalties are a source of much controversy. Media reports abound with stories of borrowers "trapped" into ARMs with rates set to rise above what they can afford, but they are unable to refinance due to the prepayment penalty.

On the other side of this debate, some contend that PPPs can actually provide for an interest rate reduction for the borrower because loans with this feature command more value on the secondary market. For a borrower who is educated on their mortgage loan options, a PPP may make perfect sense for them to reduce their interest rate. However, far too many stories reveal that most borrowers do not understand the trade off they are making, nor is the imposition of the penalty properly explained in context of the interest rate. Furthermore, due to the secondary market appetite for these provisions, the incentive to offer a loan with a prepayment penalty may have altered some lender's concerns with risk.

The Board's proposal only allowed PPPs if:

- The penalty period does not exceed five years from loan consummation.
- The borrower's debt to income ratio, at consummation does not exceed 50%.
- The penalty period expires 60 days prior to an interest rate reset.
- The penalty does not apply if there is a refinancing by the same creditor or its affiliate.

The Board's final proposal was stronger than many had predicted. In their commentary on the final proposal the Board concluded:

The Board concludes that prepayment penalties' injuries outweigh their benefits in the case of higher-priced mortgage loans and HOEPA loans designed with planned or potential payment increases after just a few years. For other types of higher priced and HOEPA loans, however, the Board concludes that the injuries and benefits are much closer to being in equipoise. Thus… the final rule prohibits penalties in the first case and limits them to two years in the second.

The final rule bans PPPs for higher priced loans if the payment can change with the first four years after consummation. With most adjustable rate loans ranging from two to three years, this provision effectively bans PPP for ARMS. Additionally, for loans that do not have a payment change the PPP is limited to the just the first two years after consummation.

Escrows for Taxes and Insurance.

While escrows are common in the prime mortgage market, the opposite is true in the subprime market where a majority of borrowers do not have escrow accounts for taxes and insurance. Creditors who do not offer escrows can quote lower monthly payments than those creditors who do offer escrows. Furthermore, the lack of escrows provides for additional problems as it can take advantage of borrowers who are shopping for the lowest monthly payment. A loan with an escrow account built in will inherently cost more per month than one without. In the Board's staff commentary on the final change regarding escrows they found:

The lack of escrows in the subprime market increases the risk that consumers will base borrowing decisions on unrealistically low assessments of their mortgage-related obligations.

The proposed rule required creditors to establish an escrow account for property taxes and homeowners insurance on higher-priced loans secured by the first lien on the principle dwelling. The creditor may allow the consumer to cancel the escrow account 12 months after consummation. The final rule adopts the proposal.

Creditor Payments to Mortgage Brokers.

The Board had proposed to prohibit a creditor from paying a mortgage broker, in a covered transaction, more than the consumer agreed to in writing that the broker would receive.

This was the Board's attempt to regulation what are known as yield spread premiums. YSPs are points paid by the lender to the broker for originating a loan at an above par rate, meaning slighting higher than that for which the borrower may qualify. A YSP is financed over a particular time period during the loan. This practice, in recent years, has come under increasing scrutiny due to the appearance that it is an enticement for brokers to steer borrowers into more costly loans than they could otherwise get. Industry has responded that YSPs serve as a way for borrowers to pay no money toward closing cost as the YSP is used to refund the broker their payment for cost associated with the transaction. This view is a subject of dispute among several parties.

The Board attempted to design model language for an agreement and disclosures. The Board conducted tests and interviews with consumers and based on the results of those tests decided to abandon the proposal. The Board concluded that the proposed agreement and disclosures would actually confuse consumers and undermine their decision-making ability. The Board committed to revisiting this issue at a future date.

Coercion of Appraisers.

The Board proposed to prohibit creditors and mortgage brokers and their affiliates from coercing, including, or otherwise encouraging appraisers to misstate or misrepresent the value of a consumer's principle dwelling. The Board adopted the rule as proposed with some limited changes regarding examples of prohibited conduct.

Servicing Abuses.

The Board proposed to prohibit certain practices of servicers. The proposal provided that no servicer shall:

- Fail to credit a consumer's periodic payment as of the date received.
- Impose a late fee or delinquency charge where the late fee or delinquency charge is due only to a consumer's failure to include in a current payment a late fee or delinquency charge imposed on earlier payments.
- Fail to provide a current schedule of service fees and charges within a reasonable time of request.
- Fail to provide an accurate payoff statement within a reasonable time of request.

The final rule adopted most of the proposal except for the fee schedule language. Some consumer groups argued that the fee disclosure would not help because borrowers can not shop for servicers. Additionally, some industry groups argued that the disclosure of fees would be difficult due to the use of third party providers and the possibility that the listing of all potential fees could take numerous pages. The Board chooses not to act on this part at this time but may reexamine the issue of servicer fees in upcoming reviews of Reg Z.

Advertising Restrictions.

The Board proposed new advertising rules for open-end home equity plans (HELOCs) and closed end loans. The new disclosure for HELOCs require that their terms be disclosed in a clear and conspicuous manner with clear disclosure of an initial promotional term associated with the loan. Specifically, the advertising must disclose the following in a clear and conspicuous manner:

- The period of time during which the promotional rate or promotional payment will apply;
- In the case of a promotional rate, any annual percentage rate that will apply under the plan; and,
- In the case of a promotional payment, the amount and time periods of any payments that will apply under the plan.
- In variable-rate transactions, payments determined based on application of an index and margin to an assumed balance would be required to be disclosed based on a reasonably current index and margin.

For closed end loans, the Board also proposed advertising changes to ensure that rates and promotional rates are disclosures clearly. The Board also proposed changes for Prohibited Acts or Practices relating to mortgage advertisements. The Board proposed to prohibit the following seven acts or practices:

- The use of the term ‘‘fixed’’ to refer to rates or payments of closed-end home loans, unless certain conditions are satisfied;
- Comparison advertisements between actual and hypothetical rates and payments, unless certain conditions are satisfied;
- Falsely advertising a loan as government supported or endorsed;
- Displaying the name of the consumer’s current lender without disclosing that the advertising mortgage lender is not affiliated with such current lender;
- Claiming debt elimination when one debt merely replaces another debt;

- The use of the term ‘‘counselor’’ or ‘‘financial advisor’’ by for-profit brokers or lenders; and

- Foreign language advertisements that provide required disclosures only in English.

The final rule concerning advertising is substantially similar to the proposal.

Consumer Disclosures.

The Board proposed a requirement that creditors deliver required loan disclosures three business days after application and before the consumer has paid any fee, other than a fee for obtaining the consumer's credit report. The Board concluded that current requirements were not enough to ensure that borrowers had the opportunity to fully review their loan documents. When borrowers receive their documents at the closing table, they may feel trapped in the transaction or falsely believe that they have reached a point of no return.

The final rule is substantially similar to the proposal.

Operative Dates.

Finally, the final changes to Reg Z will go into effect October 1, 2009, with an exception regarding the escrow requirement for higher priced loans. The implementation of the rule concerning escrow accounts is effective April 1, 2010.

HR 3221: American Housing Rescue and Foreclosure Prevention Act of 2008

The American Housing Rescue and Foreclosure Prevention Act (H.R. 3221) was signed into law by President Bush on July 30, 2008. The legislation combines a number of bills including measures to modernize the Federal Housing Administration (FHA) and reform the Fannie Mae and Freddie Mac. These changes are intended to provide crucial liquidity to the mortgage markets, and also strengthen regulation and oversight for the future.

In addition, HR 3221 will help families facing foreclosure keep their homes, help other families avoid foreclosures in the future, and help the recovery of communities harmed by empty homes caught in the foreclosure process.

The subsequent discussion will examine each part of HR 3221.

The “Federal Housing Finance Regulatory Reform Act of 2008"

This title strengthens and modernizes the regulation of the housing government sponsored enterprises – Fannie Mae and Freddie Mac (the enterprises) and the Federal Home Loan Banks (FHLBs) – and expands the housing mission of these GSEs. In addition, it creates a new program at Federal Housing Administration (FHA) that will help at least 400,000 families save their homes from foreclosure by providing for new FHA loans after lenders take deep discounts.

Safety and Soundness Regulation of the Housing GSEs

The "Federal Housing Finance Regulatory Reform Act of 2008" establishes a new, independent, regulator for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. The legislation endows this regulator with broad new authority, equivalent to the authority of other federal financial regulators, to ensure the safe and sound operations of the GSEs, including the power to:

- establish capital standards;
- establish prudential management standards, including internal controls, audits, risk management, and management of the portfolio;
- enforce its orders through cease and desist authority, civil money penalties, and the authority to remove officers and directors;
- restrict asset growth and capital distributions for undercapitalized institutions;
- put a regulated entity into receivership; and,
- review and approve (subject to notice and comment) new product offerings of the enterprises.

Mission Improvement

The new legislation also significantly enhances the affordable housing component of the GSEs’ mission, and expands the number of families that the enterprises can serve by raising the loan limits in high cost areas above the standard conforming limit to 115 percent of median house price up to 150 percent of the conforming loan limit.

Currently, this would be $625,500, and would be adjusted for inflation. For the enterprises, the legislation tightens targeting requirements of the affordable housing goals, and rewrites those goals to ensure that the enterprises provide liquidity to both ownership and rental housing markets for low and very-low income families. The legislation requires the enterprises to serve a variety of underserved markets, such as rural areas, manufactured housing, and the preservation market. The legislation improves reporting requirements for affordable housing activities, including the expansion of the public use database, and strengthens the new regulator's ability to enforce compliance with the housing goals.

Finally, the legislation creates a new Housing Trust Fund and a Capital Magnet Fund, financed by annual contributions from the enterprises, which will be used for the construction of affordable rental housing.

For the FHLBs, the legislation requires new affordable housing goals similar to those that apply to the enterprises for FHLB mortgage purchase programs. The legislation also requires the FHLBs to create a public use database for such programs. Treasury-certified Community Development Financial Institutions (CDFIs) are made eligible to join FHLBs. Finally, community financial institution members of the FHLBs may use FHLB advances for community development purposes.

Treasury Emergency Authority

The legislation contains several temporary provisions requested by Secretary of the Treasury Paulson designed to shore up the confidence of the financial markets in the GSEs and the FHLBs, including the authority for Treasury to purchase debt securities issued by the GSEs and the authority for Treasury to purchase common stock of the enterprises with the agreement of the companies. This authority expires on December 31, 2009. Before exercising these temporary powers, the Treasury would have to determine that actions taken under this authority are necessary to:

- protect the taxpayer;
- provide stability to the financial markets; and,
- prevent disruptions in the availability of mortgages.

The Treasury would set the terms and conditions regarding any use of the temporary authority, including requiring that repayments to the government receive priority or preference. In addition, the emergency authority gives the Director of the Federal Housing Finance Agency (FHFA) the authority over executive compensation, whether or not the government exercises its temporary authority to purchase debt or stock.

Finally, the legislation requires the new Director to consult with Governors of the Federal Reserve when developing regulations or guidance regarding capital, portfolios, and prudential management standards, taking into consideration the risks posed by the regulated entities to the financial system. This requirement also expires on December 31, 2009.

Mortgage Broker and Originator Licensing

The "Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act) is intended to create greater accountability and transparency by establishing a uniform licensing and registration system for all loan originators, including mortgage brokers and loan officers. Under this provision, all loan originators at federally-regulated institutions will have to be registered through the nationwide system, and all other loan originators will be required to be licensed by the state or through a HUD-backup system if a state does not establish a licensing system. To meet the requirements under this provision, within 12 months, states will have to develop licensing requirements to ensure that applicants meet minimum standards including educational requirements, background checks, and testing. If a state does not establish a licensing system that meets the minimum requirements, HUD is directed to establish a licensing system for loan originators in the state. Under this provision, borrowers and lending institutions will be able to access information about all loan originators, including their background and history as a loan originator.

Summary of the "HOPE for Homeowners Act of 2008"

The "HOPE for Homeowners Act of 2008" creates a new, temporary, voluntary program within FHA to back FHA-insured mortgages to distressed borrowers. The new mortgages offered by FHA-approved lenders will refinance the loans of distressed owner-occupants at risk of losing their homes to foreclosure at significant discounts. In exchange, homeowners will share future appreciation with FHA.

The program is built on five principles:

1) Long-term affordability. The program is built on the idea, expressed by Federal Reserve Chairman Bernanke, that creating new equity for troubled homeowners is likely to be a more effective way to avoid foreclosures. New loans will be based on a family's ability to repay the

loan, ensuring affordability and sustainable homeownership.

2) No investor or lender bailout. Investors and/or lenders will have to take significant losses in order to benefit from the proceeds of the loans refinanced with government insurance. However, these losses would be less than the losses associated with foreclosure.

3) No windfall for borrowers. Borrowers will share their new equity and future appreciation equally with FHA. Borrowers will pay for the FHA insurance.

4) Voluntary participation. This will be a voluntary program. No lenders, servicers, or investors will be compelled to participate.

5) Restore confidence, liquidity, and transparency. Credit markets are fearful and frozen in part because banks and other financial institutions do not know what their subprime mortgages and related securities are worth. The uncertainty is forcing lenders to hoard capital and stop the lending necessary for economic growth. This program will help restore confidence and get markets flowing again.

The new program will be overseen by a Board made up of the Secretary of HUD, the Secretary of the Treasury, the Chairman of the Federal Reserve Board, and the Chairman of the Federal Deposit Insurance Corporation (FDIC). The Board will have the authority to develop standards within the framework of the legislation.

Only owner-occupants who are unable to afford their mortgage payments are eligible for the program. No investors or investor properties will qualify. Homeowners must certify, under penalty of law, that they have not intentionally defaulted on their loan to qualify for the program and must have a mortgage debt-to-income ratio greater than 31 percent as of March 1, 2008. Lenders must document and verify borrowers' income with the IRS.

The size of the new FHA-insured loan will be the lesser of the amount the borrower can afford to repay, as determined by the current affordability requirements of FHA, or 90 percent of the current value of the home. Loans must be 30-year, fixed rate loans.

In order to avoid a windfall to the borrower created by the new 90% loan-to-value FHA-insured mortgage, the borrower must share the newly-created equity and future appreciation equally with FHA. This obligation will continue until the borrower sells the home or refinances the FHA-insured mortgage. Moreover, the homeowner's access to the newly created equity will be phased-in over 5 years.

In order to protect against adverse selection, the program prohibits the Secretary from paying an insurance claim whenever the representations and warranties required to be made by lenders are violated, or in cases in which a borrower has an early payment default and misses the first payment. The Act provides the Board the authority to establish other protections against adverse selection, such as requiring "seasoning" for certain higher risk loans before they can be insured under the program. Appraisers of property insured by FHA must be certified by the state where the property is located, or by a nationally recognized professional appraisal organization, and have "demonstrated verifiable education" in FHA appraisal requirements. Before participating in this program, all subordinate liens must be extinguished. This will have to be done through negotiation with the first lien holder.

The legislation provides servicers with an incentive to participate in the program by offering a safe harbor against legal liability. The program is authorized to insure up to $300 billion in mortgages and is expected to serve approximately 400,000 homeowners.

The program will begin October 1, 2008 and sunset on September 30, 2011. CBO say the program will net nearly $250 million for taxpayers. The program is paid for by using part of the Affordable Housing Trust Fund; the GSE bill provides a further $2 billion cushion for the government by establishing a reserve fund at Treasury over ten years. If the program costs less than projected, the unused funds are returned to the Affordable Housing Trust Fund. If the program more than pays for itself (as was the case during the Roosevelt Administration), any excess savings are dedicated to reducing the national debt.

Summary of the "Foreclosure Prevention Act of 2008"

The Foreclosure Prevention Act contains the following provisions:

- **Assisting Communities Devastated by Foreclosures.** Homes that have been foreclosed upon and are sitting unoccupied lead to declines in neighboring house values, increased crime and significant disinvestment. To ensure that communities can mitigate these harmful effects of foreclosures, $3.92 billion is provided to communities hardest hit by foreclosures and delinquencies. These supplemental Community Development Block Grant Funds will be used to purchase foreclosed homes, at a discount, and rehabilitate or redevelop the homes to stabilize neighborhoods and stem the significant losses in house values of neighboring homes.

- **Providing Pre-Foreclosure Counseling for Families in Need.** To help families avoid foreclosure, this legislation provides $150 million in additional funding for housing counseling. These funds will be distributed by the Neighborhood Reinvestment Corporation by the end of 2008 to ensure families can quickly get the help they need. As many as 250,000 additional families are expected to connect with their mortgage servicer or lender to explore options that will keep them in their homes as a result of these counseling funds. In addition, $30 million is provided to help provide legal services to distressed borrowers.

- **Enhancing Mortgage Disclosure.** To ensure that consumers are provided with timely and meaningful disclosures in connection with mortgages, the legislation expands the types of home loans subject to early disclosures (within three days of application) under the Truth In Lending Act (TILA) to include all mortgages, including refinances and home equity loans. The legislation requires that disclosures be provided no later than 7 days prior to closing so borrowers can shop for another loan if not satisfied with the terms. The bill requires a new disclosure that informs borrowers of the maximum monthly payments possible under their loan, and also doubles the range of statutory damages for TILA violations to $400 to $4000.

- **Housing Assistance for Veterans.** To assist returning soldiers avoid foreclosure, this bill lengthens the time a lender must wait before starting foreclosure from three months to nine months after a soldier returns from service and also provides returning soldiers with one year relief from increases in mortgage interest rates. In addition, the Department of Defense is required to establish a counseling program to ensure veterans and active service members can access assistance if facing financial difficulties. Also included is a provision that increases the VA loan guarantee amount, so that veterans have additional homeownership opportunities. The legislation contains provisions to do the following: increase benefits paid to veterans with disabilities such as blindness for the purpose of adapting their housing; provide a moving benefit to servicemen and women who are forced to move out of rental housing because the owner of the housing was foreclosed on; provide that veterans benefits received in a lump sum are treated the same for the purposes of eligibility for housing assistance as monthly benefits; and to allow the Veterans Administration to provide for improvements and structural alterations to homes of veterans with service-connected disabilities.

MORTGAGE CRISIS HISTORICAL TIMELINE

JULY 2008

July 30: President signs the American Housing Rescue and Foreclosure Prevention Act (H.R. 3221). The centerpiece of the legislation is a program that will allow homeowners facing foreclosure to refinance into lower-cost, government -insured mortgages they can afford to repay.

July 14: The Federal Reserve Board approves a final rule for home mortgage loans to better protect consumers and facilitate responsible lending. The rule prohibits unfair, abusive or deceptive home mortgage lending practices and restricts certain other mortgage practices.

July 10: Foreclosure filings for June 2008 have jumped 53 percent from this time last year. According to Realty Trac, foreclosure filings were reported on 252,363 homes last month the second straight month in which more than a quarter of a million properties received foreclosure filings.

July 10: With market fears that Fannie Mae and Freddie Mac will continue to lose money in a declining housing market, the stock prices of the two Government Sponsored Enterprises have dropped 76 and 83 percent respectively. News reports have begun to indicate that the Bush administration has begun planning for the more serious possibility that one or both of these mortgage giants could falter.

July 8: The Federal Reserve and the Securities and Exchange Commission announced that they have entered into an information-sharing agreement in order to execute their respective regulatory duties.

July 2: According to the American Bankers Association, the share of delinquencies for home equity lines of credit has nearly doubled in the last year. 1.1 percent of all home equity loans were delinquent in the first quarter; up from just 0.6 for the same period in 2007.

JUNE 2008

June 25: Home prices nationwide are down 15.3 percent from a year ago. The Case-Shiller Index, using numbers from April has shown that home prices in 20 major housing markets are now back down to their 2004 levels.

June 25: The State of Illinois is suing mortgage giant Countrywide. The lawsuit charges that Countrywide sold misleading, intentionally risky loans to people who couldn't otherwise qualify for comparable loans.

June 21: According to data from the Census Bureau, Americans are renting houses and apartments at the highest level since 2002. The drop in households headed by homeowners was the sharpest decline in over 20 years. This report shows that much of the homeownership growth during the Bush administration has vanished, in part due to the subprime mortgage crisis.

June 20: 406 people have been arrested since January as part of the FBI's crackdown on mortgage fraud. According to the Justice Department, those indicted during Operation Malicious Mortgage were responsible for up to $1 billion in losses.

June 20: Two Bear Stearns executives, Matthew Tannin and Ralph Cioffi, were charged with nine counts of fraud for misleading investors and lenders prior to the bank's collapse. The managers failed to disclose the imminent collapse of their funds to individual investors. While their funds plunged in value, Tannin and Cioffi painted a rosy picture to allay fears from worried investors. They are the first executives from Wall Street investment banks to be criminally charged over the credit crisis.

June 16: According to the New York Times, Wall Street's largest banks wrote down a staggering $107.2 billion worth of assets over the last year – fueled by staggering losses in subprime mortgage backed securities. These losses wiped out nearly half of the gains this sector enjoyed during the previous three years.

June 13: During the month of May, over 73,000 American families lost their homes. According to Realty Trac, the foreclosure explosion marked a 158% increase from May 2007. This gloomy data, coupled with a 14.1% decrease in national home prices over the past year, proves that the rug continues to be pulled out from under the American homeowner.

June 12: Conflicts of interest and limited disclosure prompted the Securities and Exchange Commission (S.E.C.) to propose stricter rules for the credit rating industry. The S.E.C. has pushed for greater openness in the credit rating industry after the three major firms all failed to identify the risks in subprime mortgage backed securities.

June 9: The Federal Housing Administration (F.H.A.) announced that it expects $4.6 billion in losses from high default rates on home loans. The F.H.A.'s clients primarily consist of first-time buyers, minorities, and low-income owners, who were hurt by the weak economic conditions and subsequently defaulted. The expected loss is the highest since 2004. Brian Montgomery, the F.H.A. commissioner, said: "Unless we take action to mitigate these losses, F.H.A. will soon either have to shut down or rely on appropriations to operate."

June 7: In May, the US unemployment rate had its highest jump in 22 years. According the Labor Department, the rate spiked to 5.5%, marking the 5th straight month of job losses and the highest unemployment figure in 3.5 years. Many experts fear the US is spiraling into a recession.

June 5: For the first time in history, more than one million homes are now in foreclosure. According to a Mortgage Bankers Association report, the number of homes in foreclosure now is 1.1 million - up from the 938,000 homes that were in foreclosure at the end of last year. This marks the first time that more than one million homes have been in foreclosure Also in the report were indications that the foreclosure crisis is worsening; 448,000 homes began the foreclosure process during the first quarter, up from 382,000 that began the process in the last quarter of 2007. According to the MBA, loans at subprime rates are to blame for 39% of the foreclosures

MAY 2008

May 27: First quarter data revealed that US home prices plummeted 14.1% from their prices last year. The S&P/Case-Shiller index recorded the fastest rate of decline in the history of the index. This evidence indicated that the mortgage crisis is only worsening. David Blitzer, the chairman of S&P's index committee, warned, "There are very few silver linings that one can see in the data. Most of the nation appears to remain on a downward path."

May 22: Moody's, which provides credit ratings, began investigating whether internal computer errors caused the company to assign high ratings to poor securities. The announcement raised many questions about the reliability of Moody's ratings, which are heavily relied upon by investors of all sizes. Following the announcement, its shares fell 15.9%.

May 21: The Mortgage Bankers Association released its weekly report of mortgage application volume, which shows that applications dropped by 7.8% during the week ending May 16. This week's survey is exactly five years after the peak in the housing boom, mortgage applications now stand at one-third of the volume at the high point in May 2003.

*May 14***:** According to Reality Trac, the number of foreclosure filings hit a record in April, with filings spiking 65% compared with the same month a year earlier. April saw the largest number of foreclosure filings since data tracking began in January 2005. This marked a 4% increase from March, indicating that the housing crisis is showing no signs of letting up. Furthermore, the report showed that home prices nationwide have plunged 7.7% in this year alone.

May 12: Real estate analyzer First American Core Logic revealed that the rise in mortgage delinquencies currently being experienced will continue to grow during the next six to twelve months. In their forecast, First American released an index of foreclosure risk, which increased 16% from the same period last year. These projected delinquencies are expected to increase as declining home prices and difficult economic conditions persist.

May 12: MBIA announced a $2.4 billion loss during the first quarter of 2008. The company exposed itself to more and more risk as mortgage defaults rose from the subprime crisis. In contrast, MBIA posted a profit of $199 million for the first quarter of last year.

May 9: AIG, one of the world's largest insurance companies, experienced its worst three months in its 89-year history, losing $7.81 billion and $3.09 a share. The plunge was four times worse than Wall Street's expectations.

May 7: Fannie Mae reported a $2.2 billion loss during the first quarter. Over the same period a year ago, Fannie reported a $961 million profit. As defaults and foreclosures in the housing market have mounted, the government has increasingly depended on Fannie Mae and Freddie Mac. On top of the $2.2 billion loss, Fannie is projecting losses to continue into the next several quarters. The report showed the amount of unrealized losses on mortgage investments has nearly doubled from the last quarter of 2007, increasing from $4.8 billion to $9.3 billion.

*May 7***:** UBS reported that it sold $15 billion worth of subprime mortgage debt to the wealth management firm BlackRock at a 32% discount. The Swiss bank also announced it would cut 5,500 jobs by the middle of 2009.

May 6: House Speaker Nancy Pelosi issued a report entitled, "Stabilizing Housing Is Key to America's Economic Recovery." In this report, Speaker Pelosi chronicled the millions of foreclosures, declining home values, and trillions of dollars lost in household wealth.

May 5: Federal, state, and local agencies have stepped up efforts in their investigation of the subprime crisis, with a special focus on Wall Street. Investigations into the valuation of UBS' mortgage-security holdings and last summer's collapse of hedge funds at Bear Stearns are already underway. The task force has expanded since the FBI began it in January as details on companies' lending practices have emerged. Countrywide alone is facing scrutiny from federal prosecutors in California and Illinois, the United States Trustee, and the S.E.C.

May 1: The Board of Governors of the Federal Reserve lowered the Fed funds rate by 25 basis points. This marked the 7th rate cut since September - reflecting the economy fragility. In a statement, the Fed acknowledged the economy is weak, "household and business spending has been subdued and labor markets have softened further. Despite the lowering of this key interest rate, financial markets remain under considerable stress." The Fed also cited "tight credit conditions and the deepening housing contraction" as justification for the rate cut. Critics warned that low interest rates will only cause more inflation

APRIL 2008

April 29: First quarter data prepared by Realty Trac revealed a 112% jump in foreclosure filings compared with the same period last year. In this year alone, more than 155,000 families have lost their homes to foreclosure. Nationwide, one in every 194 U.S. homes received a foreclosure filing this quarter, with Nevada hit the hardest, where 1 of every 54 households received filings. Foreclosure filings only worsened towards the end of the quarter, with a 5% jump in foreclosure filings from February to March. It appears the housing crisis will only worsen, with experts warning that foreclosures will peak in the 3rd or 4th quarter.

April 29: Countrywide recorded a nearly $900 million loss in the first quarter as housing market woes torpedoed the lender's bottom line. The loss, which comes out to $1.60 per share, was a far cry from the expected profit of 2 cents a share. Despite Countrywide's poor earnings, the firm's top two executives will receive a combined payout of $19 million in stock through the impending buyout from Bank of America. President David Sambol will receive an additional $28 million in cash.

April 22: UBS released a report in which it detailed the "blind drive for revenue" that pushed the bank to take imprudent risks. The investment bank has written off nearly $38 billion since the subprime crisis began, $19 billion of which came in the first quarter of 2008.

April 21: The profits of the nation's second-largest bank, Bank of America, sunk by 77% during the first quarter. The company was forced to set aside $4.8 billion for its home equity, small business and homebuilder divisions, signaling the deepening impact of the mortgage crisis.

April 18: Citigroup announced quarterly losses of $5.1 billion. Citi's banking division lead the sea of red ink as it contains all of Citi's liabilities in the subprime lending crisis. The downward trend continued from the previous quarter, when Citigroup reported its largest quarterly drop in its company's history at $9.83 billion. The bank was forced to raise capital totaling over $30 billion, much of it from sovereign wealth funds, in late 2007.

April 17: Merrill Lynch announced losses of $1.96 billion in the first quarter of 2008 - compared with a $2.16 billion profit over the same period in 2007. Merrill's loss in profits was coupled with another announcement that it will cut 2,900 jobs—10% of its workforce. The firm has written-down $27.4 billion over the last three quarters.

April 15: Realty Trac announced that foreclosure actions in the U.S. shot up 57% during the month of March. Foreclosure papers were filed for 234,685 homes last month. Since last year, banks have repossessed 129% more homes than the year before.

MARCH 2008

March 31: The Treasury Department released its plan to overhaul financial regulatory agencies. This blueprint was a response to the failure of these agencies to recognize the warning signs of the mortgage lending crisis. The proposal gives the Federal Reserve more authority over Wall Street Firms, but does not apply stricter rules to markets for risk and hedging, which are largely unregulated. It also recommends merging the S.E.C. with the Commodity Futures Trading Commission. The plan was quickly met with criticism. Senator Dodd, Chairman of the Senate Banking Committee said, "It fails to realize that the Fed helped create this crisis by ignoring the red flags as far back as five years ago. It does not make sense to give a bigger shovel to the very people who helped dig us into this hole."

March 31: Janet Yellen, the president of the Federal Reserve Bank of San Francisco, urged the government to provide more financial education for minority and low-income borrowers. Yellen said they will be hardest hit by the housing crisis and the least informed. She warned that leaving low-income borrowers uninformed and devoid of resources could lower property values, increase crime, and deplete government revenues.

March 27: A five-month investigation by the Justice Department into New Century Financial, one of the nation's biggest subprime lenders, revealed that accountants are largely to blame for the mortgage crisis. According to the report, New Century's "significant improper and imprudent practices" were enabled by the lack of oversight from auditors.

March 25: The S&P/Case-Shiller index reported that home prices dropped once again in the month of January. January's drop represents the 19th straight month that home prices dropped and the largest single-month drop in the 20 year history of the report.

March 24: JPMorgan Chase announced it would raise its offer for embattled Bear Stearns Co to $10 a share from the previous bid of $2/share. Even by quintupling the price JPMorgan is willing to pay, Bear Stearns is valued 90% lower that it was when its stock reaches its $170 high last year.

March 20: Citigroup announced that it will be cutting another 2,000 jobs. This is on top of the 4,200 layoffs already announced by Citigroup in January. Over the past year, more than 60,000 jobs have been cut throughout the financial sector, in large part due to contracting subprime mortgage lending divisions.

March 19: Federal regulators finally acted to allow Fannie Mae and Freddy Mac to buy more mortgages, easing pressures on the cash strapped mortgage market.

March 18: On the heels of the collapse of Bear Stearns, Wachovia has released a report showing that Merrill Lynch is the most at risk major broker behind Bear Stearns due to their vulnerability from subprime securities.

March 16: Investment bank Bear Stearns announced that it will sell itself to JPMorgan Chase for $2 a share – a 93% discount on the current stock price. This fire sale comes as worldwide markets showed concern that Bear Stearns was close to folding under the pressure of their subprime liabilities.

March 7: Employers cut 63,000 jobs in February, the largest single month decline in the workforce in almost five years. Also, December and January numbers were revised to reflect dimmer employment markets than previously reported.

March 6: Numbers released by the Mortgage Bankers Association showed that by the end of 2007, 2.04% of all mortgages were in the foreclosure process. This marks the highest level of foreclosure ever recorded in the Mortgages Bankers Association's report.

March 5: Chairman of the Federal Reserve Ben Bernanke urged mortgage lenders to forgive some of the debt held by homeowners on the brink of foreclosure. This position is in stark contrast to the Bush administration who has consistently opposed debt forgiveness

March 4: The Treasury Department announced that the administration's "Hope Now" program designed to assist homeowners struggling to repay subprime mortgages has helped 45,000 people in its first month. Meanwhile, industry experts question whether the program centered on extending repayment periods is doing enough to alleviate the core issues of the foreclosure crisis.

March 3: The Commerce Departments revealed that construction spending plummeted by 1.7% in the month of January. This is the single biggest single month drop in the sector in 14 years.

February 29: A report from market analysts at UBS shows that losses within the financial sector from subprime mortgage back securities could reach $600 billion. This new report on expected losses marks a 50% rise from previous estimations made just months ago.

FEBRUARY 2008

February 25: In January, the median home price fell and, for the sixth straight month, existing home sales dropped. The 0.4% drop in sales along with the 4.6% drop in price have been spurred by lenders making it more difficult for families to take out mortgages, making it more costly to receive a loan.

February 19: Credit Suisse, the second largest Swiss bank announced it would write down $1 billion in subprime losses. Up to this point, Credit Suisse had been one of the few major international financial institutions who hadn't been affected by the subprime collapse.

February 15: The nation's fourth largest bond insurer, FGIC announced it would seek to split its company into two. After receiving a tarnished credit rating from all of the major ratings agencies, FGIC hopes to protect its municipal bond sector from the subprime backed securities which has caused the ratings drop.

February 13: The bipartisan economic stimulus package is signed into law. With this measure, taxpayers can expect $300-$1200 tax rebate checks to arrive in the second half of 2008. This $162 billion package was passed due to the looming threat of recession spurred by the subprime mortgage crisis.

February 12: Bank of America, Citigroup, Countrywide, JPMorgan Chase, Washington Mutual, and Wells Fargo announced a joint venture to assist mortgage borrowers struggling underneath the burdens of rising monthly payments. "Project Lifeline", as it will be called, will be in addition to the Bush administration backed "Hope Now" which has come under fire from critics who say it wasn't a large enough step towards helping American homeowners.

JANUARY 2008

January 30: Standard and Poor's announced it would be cutting the credit ratings of $534 billion in subprime mortgage backed securities. Downgrades of these securities could lead to another $265 billion in losses for the financial industry.

January 30: UBS, the world's largest wealth manager, announced the need to write down another $4 in subprime-related losses. This new write-down brings the total for UBS subprime losses over $18.4 billion. Subprime related losses pushed the company its worst year of performance in its institutional history.

January 29: The Wall Street Journal reported that federal investigators have begun inquiries into possible criminal actions taken by 14 companies due to their role in the securitization of subprime mortgages.

January 29: The House of Representatives passed an economic stimulus package with $146 billion in targeted tax relief.

January 29: The number of houses in foreclosure rose 79 percent in 2007, according to Reality Trac. December also marked the fifth straight month where 200,000 or more foreclosure filings were made.

January 28: New home sales dropped 26.4% in 2007, according to a Commerce Department report. In addition, the median price of new homes fell by 10.4% from December 2006 - the biggest 12 month decline in 37 years.

January 17: Lehman Brothers said it would no longer continue the practice of wholesale mortgage lending. As a pioneer in issuing mortgage backed securities, Lehman Brothers also announced it would cut 1,300 jobs. These job cuts come on top of 2,500 other jobs eliminated since June 2007.

January 15: Citigroup the largest bank in the U.S. announced that its mortgage portfolio dropped in value by $18.1 Billion. This news led

Citigroup to its first quarterly loss in 16 years.

January 11: Merrill Lynch, the nation's third largest securities firm, announced it would need to write down more than double its initial projection related to subprime mortgage losses**.** Initial projections showed Merrill Lynch would lose around $7 Billion; however, it now appears that number could reach $15 Billion.

January 11: Bank of America, the nation's second largest banking institution, announced that it would buy Countrywide Financial, the nation's largest mortgage lender. This acquisition ended days of speculation that Countrywide, due to its role in the proliferation of subprime mortgages, would be forced to declare bankruptcy.

January 10: Countrywide Financial reported that late mortgage payments and foreclosures reached the highest level ever recorded this past December. The foreclosure rate on Countrywide's mortgages grew from just 0.7% a year ago to 1.44% last month. On the announcement of this news, shares in Countrywide dropped to their lowest price in over a decade.

January 4: The Labor department announced that the unemployment rate skyrocketed from 4.7% to 5% in December. These numbers were fueled by the loss of 28,500 jobs in residential construction and 7,000 jobs lost in the mortgage lending industry throughout 2007. The fall to 5% made December's unemployment jump the largest unemployment increase since the days after Sept. 11, 2001.

DECEMBER 2007

December 20: Reeling from the subprime mortgage crisis, investment bank Bear Stearns announced the first quarterly loss in the institution's eight-decade history. With this announcement from Bear Stearns, Wall Street's losses had reached a combined $40 Billion from the subprime mortgage crisis.

December 19: Morgan Stanley announced it would be writing down an additional $9.4 billion in losses on subprime linked investments. The company also announced it would be selling a $5 billion dollar stake to a foreign investment fund.

December 18: The Commerce Department reported that housing construction was down 3.7 percent for the month of November to a seasonally adjusted rate of 1.187 million units. This marked a 24.2 percent drop in new home construction in the 12 month period and the lowest level of home construction in more than 16 years.

December 17: Treasury Secretary Henry Paulson announced he favors temporarily allowing Fannie Mae and Freddie Mac to purchase home loans in excess of $417,000.
This allows Fannie Mae and Freddie Mac to provide home loans in more areas throughout the country.

December 14: The US Senate passed legislation giving needed tax relief to those at risk of foreclosure on their subprime mortgages**.** The Mortgage Forgiveness Debt Relief Act both extends the tax deductions on mortgage insurance premiums and eliminates taxes accrued by receiving debt forgiveness. Previous to this legislation, debt forgiveness was treated as income and taxed accordingly, further crippling struggling American families.

December 11: The Federal Reserve Board announced only a 25 basis-point cut in the discount rate

December 11: Washington Mutual announced that it expected its fourth quarter loan losses would reach $1.6 Billion. In addition, it expected that 3,000 Washington Mutual employees would be laid off as a result of investments in subprime mortgage-backed securities.

December 10: Swiss bank UBS announced it would write down an additional $10 Billion in subprime losses **–**possibly resulting in a net loss for all of 2007. UBS also announced it has solicited a cash infusion of $11.5 Billion from GIC, Singapore's sovereign wealth fund, and an unknown Middle Eastern investor.

December 10: Fannie Mae and Freddie Mac announce that they are changing their criteria for purchasing delinquent home loans. The two government-sponsored entities, which together own or guarantee approximately two-fifths of U.S. home mortgage debt, have recently set aside billions of dollars to compensate for bad home loans. Their profits have declined at a time when home prices are falling and defaults are soaring on high-risk mortgages.

December 6: Standing between Treasury Secretary Henry Paulson and Housing and Urban Development Secretary Alphonso Jackson, President Bush announces measures to help many struggling homeowners. President Bush touts the HOPE NOW Alliance as an example of government uniting members of the private sector to address voluntarily the housing crisis

without taxpayer subsidies or government mandates. The President calls upon Congress to, among other actions, reform both the Federal Housing Administration and the Government Sponsored Enterprises Freddie Mac and
Fannie Mae.

December 5: The *Wall Street Journal* reports that New York Attorney General Andrew M. Cuomo sent out subpoenas to major Wall Street firms including Merrill Lynch, Morgan Stanley, Deutsche Bank, Bear Sterns, and Lehman Brothers over the late summer to explore further their role in the packaging and selling of subprime mortgages.

November 2007

November 29: According to Realty Trac, there were 222,451 foreclosure filings last month. It is a 94 percent increase from October 2006 and represents one foreclosure filing for every 555 households in the nation. The 2 percent increase from
September 2007 indicates that the subprime crisis is only getting worse.

November 29: According to a government report released today, there were 516,000 new homes for sale at the end of October. It would take 8.5 months to clear that inventory at the current sales pace.

November 29: Treasury Secretary Henry Paulson meets with leading banking regulators and industry representatives, including loan servicing companies responsible for collecting and distributing loan payments, to discuss a subprime plan
aimed at controlling resetting interest rates for subprime borrowers. No official details are announced.

November 29: Federal Reserve Chairman Ben Bernanke, speaking to a group of business executives in Charlotte, N.C., indicates that the economy may need another general rate cut. He expects consumers to suffer from the deepening housing slump.

November 29: California Governor Arnold Schwarzenegger rolls out a $1.2-million education campaign to help borrowers
and lenders restructure loans before a home is lost to foreclosure. Speaking at a press conference in Riverside, CA, Governor Schwarzenegger says that hundreds of thousands of monthly mortgage payments in the state are expected to soar by hundreds of dollars over the next few years.

November 28: The National Association of Realtors reports that sales of existing single-family homes and condominiums dropped by 1.2% in October to a seasonally adjusted annual rate of 4.97 million units. The median price of a home sold in October declined to $207,800, a drop of 5.1 percent from October 2006. It is the single largest one year decline on record.

November 28: With the subprime housing credit crisis spreading, the Commerce Department reports that orders to factories for big-ticket manufactured goods declined by 0.4% in October. It was the third consecutive decline, the longest slump in nearly four years.

November 21: Shares of Countrywide, the largest U.S. Mortgage Lender, close below $10 for the first time in more than five years.

November 19: Fannie Mae shares are down 7.3% to $37.70 on reports from Credit Suisse that the government sponsored entity may report a loss of between $1 billion to $5 billion on its subprime AAA portfolio.

November 15: The U.S. House of Representatives approves H.R. 3915, "The Mortgage Reform and Anti-Predatory Lending Act of 2007," by a vote of 291 to 127. The historic bipartisan legislation reins in the abusive lending practices that contributed to the current mortgage crisis.

November 15: Barclays Group PLC takes a $2.7 billion write-down for losses on securities linked to the U.S. subprime mortgage market collapse.

November 14: According to Realty Trac, foreclosure filings rose in 77 of the largest 100 metropolitan areas from the prior quarter. Overall, residential foreclosure filings nearly doubled in the third quarter from a year earlier.

November 14: HSBC Holdings PLC, Europe's biggest bank, reports that it took a $3.4 billion impairment charge at its U.S. consumer finance division, HSBC Finance Corp.

November 8: Testifying before the Joint Economic Committee, Federal Reserve Chairman Ben Bernanke expresses his concern over the subprime housing crisis and floats the idea of providing governmental guarantees against defaults on so-called "jumbo" loans, those above the $417,000 limit on mortgages that can be backed by Fannie Mae or Freddie Mac.

November 6: David Trone, a securities analyst at Fox-Pitt Kelton, downgrades Morgan Stanley amid speculation that the brokerage firm will suffer losses of $6 billion due to the reduced value of credit investments. In his report, Trone writes: "We suggest an outright avoidance until either management discloses more specific exposure data and it proves smaller than we thought, or they actually take write-downs big enough to get beyond this."

November 4: On top of the $5.9 billion write-down reported in early October, Citigroup says it will take an additional $8 billion to $11 billion write-down related to subprime mortgages. In a memo to employees announcing his resignation, C.E.O. Charles O. Prince III writes: "It is my judgment that the size of these charges makes stepping down the only honorable course for me." Mr. Prince leaves with $105.2 million in cash and stock – in addition to the $53.1 million in compensation he took home over the past four years.

OCTOBER 2007

October 31: In a nearly unanimous decision, the Federal Reserve Board lowers the federal funds rate by one-quarter percentage point to 4.50%.

October 30: Shareholders sue Merrill Lynch & Co for issuing false and misleading statements regarding its expo sure to risk mortgage investments. The lawsuit seeks class-action status on behalf of purchasers of Merrill stock between February 26 and October 23, 2007.

October 30: Reports from the S&P/Case-Shiller index indicate that housing prices have again fallen at record rates. In the largest drop since June 1991, the 10 city index declined 5 percent in August 2007 as compared to the same month during the previous year.

October 29: John Robbins, former chairman of the Mortgage Bankers Association, says approximately a half of million U.S. mortgage borrowers each year for the next few years risk foreclosure. He expects that 1 million borrowers will lose favor with their lenders each year and that 500,000 of them will not be able to save their home loans.

October 24: Merrill Lynch writes down $7.9 billion due to exposure to collateralized debt obligations, complex debt instruments, and subprime mortgages. As a result, the firm takes a $2.3 billion loss, the largest in the firm's history.

October 17: The Commerce Department reports that U.S. home construction starts fell 10.2% last month to their lowest level in more than 14 years. Building permit activity, an indicator of future construction plans, declined 7.3%, the largest drop since January 1995.

October 17: The Federal Reserve's "Beige Book," a survey of businesses, indicates that the housing crisis is intensifying and that businesses are concerned that other areas of the economy are likely to suffer as a result.

October 16: The National Association of Home Builders reports that its housing market index, which tracks builders' perceptions of conditions and expectations for home sales over the next six months, dropped to 18, its lowest level since the inception of the index in 1985. The housing market index has declined for eight straight months. Builder confidence increased in the Midwest by two points, but the region still has the lowest overall rate in the nation.

October 15: Strongly urged to act by the Treasury Department, Citigroup, JPMorgan Chase, and Bank of America announce the creation of a new entity, called a Master Liquidity Enhancement Conduit, to raise $200 billion in order to purchase securities that are otherwise likely to be dumped on the market and further depress the housing debt crisis.

October 15: Citigroup acknowledges that its risk management models failed its customers and shareholders during this summer's credit crisis, leading to the company's 57 percent drop in third-quarter profit. Citigroup was forced to write off $3.55 billion and set aside $2.24 billion to cover anticipated losses stemming from failing mortgages and consumer loans.

October 15: Federal Reserve Chairman Ben Bernanke says that the housing crisis is far from over and will create a "significant drag" on domestic economic growth into next year.

October 10: The National Association for Realtors revises down its outlook for home sales. It lowers its prediction for existing home sales for the year from 5.92 million to 5.78 million. Although demand for applications to purchase homes and refinance existing mortgages rose during the preceding week, consumers continue to have trouble getting loans approved. New home sales are projected to fall to 805,000 this year and to 752,000 next year.

October 10: The Bush administration announces a new mortgage industry coalition to help homeowners stay in their homes. Treasury Secretary Henry M. Paulson Jr. estimates that the new initiative, dubbed Hope Now, will assist 2 million homeowners whose initial mortgage rates are resetting to higher and often unaffordable rates. The coalition includes 11 of the largest mortgage service companies, which represent 60 percent of all mortgages in the nation. They will be joined by mortgage counseling agencies, investors, and large trade organizations.

October 9: The U.S. Securities and Exchange Commission (SEC) announces its intention to review potential conflicts of interest in the credit rating agencies due to questionable practices associated with the ratings given to mortgage-backed securities that have contributed to the spreading housing crisis. SEC Chairman Christopher Cox says: "We have underway right now the beginnings of examinations that are focused on conflicts of interest, and books and records examinations, and whether the agencies are following their own procedures."

October 4: The credit ratings agency, Moody's Investors Service, reports that subprime mortgage bonds originated in the first half of 2007 include loans that are going delinquent at the fastest recorded rate. The Moody's report predicts that accelerating delinquencies from 2007 bonds are likely to surpass the number of delinquencies in 2006, which hit a peal not seen since 2000.

October 3: Residential foreclosures in New York City hit 698 during the third quarter. It represents a 64% increase from the same period last year. Yet the spike in New York pales in comparison to the third quarter increases in Los Angeles (247%) and Miami (168%). Miami's foreclosure rate per household is 116% higher than Los Angeles and 852% higher than New York City.

October 1: Former Federal Reserve Chairman Alan Greenspan says the housing crisis is far from over. "As in similar situations of inventory excess, I would expect home prices declines to continue until the rate of inventory liquidation reaches its peak." Greenspan adds that the consumer and broader economy will suffer as a result.

October 1: UBS reports its first quarterly loss in nine years. The largest wealth manager in the world plans to write down $3.4 billion in its fixed-income portfolio and other departments and to cut 1,500 jobs in its investment bank. The loss is attributed to the spreading credit crisis stemming from the emerging housing depression.

SEPTEMBER 2007

September 27: Luminent Mortgage Capital, a home-loan investment company, downgrades its second-quarter profit as the company struggles to gain access to credit and bankers seize assets.

September 27: The Commerce Department reports that sales of single-family homes decreased by 8.3% last month, the lowest level in seven years. The median price of a new home declined by 7.5% to $225,000 in August 2007 as compared to the same month a year ago.

September 25: The National Association of Realtors releases new housing statistics that reveal sales of existing single-family homes dropped by 4.3 percent in August, compared to July. It is the sixth straight decrease, pushing sales to the lowest point in five years. The fall in sales pushes the inventory of unsold homes to a record 4.58 million in August.

September 25: According to the S&P/Case-Shiller's Home Prices Indices, which track housing prices in metropolitan areas, home prices continue to fall at an increasing rate. The 10-City Composite index shows an annual decline of 4.5 percent– the largest in 16 years.

September 21: HSBC Holdings announces its plans to close its U.S. subprime unit, Decision One Mortgage, and record an impairment charge of about $880 million. HSBC states that it no longer believes the mortgage business is sustainable. Approximately 750 U.S. employees are expected to be affected by the decision.

September 20: Testifying before the House Financial Services Committee, Federal Reserve Chairman Ben Bernanke says that the credit crisis has created "significant market stress" and that the Fed is "committed to preventing problems from recurring, while still preserving responsible subprime lending." Treasury Secretary Henry Paulson adds that the administration is considering raising the Fannie Mae and Freddie Mac loan limits so that they can temporarily buy, bundle, and sell as securities any loans exceeding $417,000. But Secretary Paulson emphasizes that any changes to include so-called jumbo loans must include stricter regulations for oversight.

September 19: The Office of Federal Housing Enterprise Oversight (OFHEO), the regulator of Fannie Mae and Freddie Mac, agrees to relax restrictions on the mortgage finance companies' investment holdings, enabling Fannie Mae and Freddie Mac to buy $20 billion more in subprime mortgages. But OFHEO Director James Lockhart reaffirms the administration's stance that he will not allow "any major increases in the (investment) portfolio levels."

September 19: The Commerce Department reports that construction of new homes fell by 2.6 percent in August to the slowest pace in 12 years.

September 18: Realty Trac Inc. announces that home foreclosure filings surged to 243,000 in August, up 115 percent from August 2006 and 36 percent from July, marking the highest number of foreclosure filings since Realty Trac began tracking monthly filings. The foreclosure filing rate nationally is now one in every 510 homes.

September 18: The mortgage lending crisis intensifies as Impact Mortgage Holdings Inc. says it will quit most lending activities, while Accredited Home Lenders Holding Co. posts a major quarterly loss and says its survival remains in doubt.

September 18: Federal Reserve cuts target federal funds rate by a half point to 4.75 percent. It is the first rate reduction in four years and the steepest in nearly five years. The Fed openly admits that the housing downturn is much more severe than initially anticipated. In response to the rate cut, the Dow Jones industrial average jumps 200 points and closes up 335 points at 13, 739.39.

September 18: The U.S. House of Representatives overwhelmingly passes H.R. 1852, the "Expanding American Homeownership Act of 2007," which expands funding for housing counseling, authorizes lower down payments for borrowers who can afford mortgage payments, and directs the Federal Housing Administration to offer mortgage loans to higher risk – but qualified – borrowers.

September 17: Merrill Lynch & Co. Inc.'s $1.3 billion bet on subprime lending takes a turn for the worse when the world's largest brokerage confirms job cuts at its First Franklin Financial Corp. unit. Merrill Lynch declines to say how many jobs are being cut. Recently filed reports with U.S. banking regulators show that Merrill Lynch Bank & Trust Co., where a lot of the First Franklin franchise is housed, lost $111 million through the first half of 2007.

September 17: NovaStar Financial Inc gives up its real estate investment trust, effectively abandoning the lending business, because it cannot pay a $157 million dividend.

September 14: Merrill Lynch & Co., the biggest underwriter of collateralized debt obligations, signals that the subprime mortgage crisis may hurt third-quarter earnings. The New York-based firm reports that it made ``fair value adjustments'' for potential losses to date on unspecified holdings and financing commitments.

September 12: According to the quarterly Anderson Forecast by the University of California at Los Angeles, the spreading housing crisis will push the national economy to the brink of recession but growth in other sectors of the economy could lead to a moderate recovery by 2009. David Shulman, senior economist for the forecast, lowers his forecast for housing starts to an annual rate of 1 million to 1.1 million, down from a range of 1.2 million to 1.3 million.

September 12: Speaking to representatives of leading financial firms, Treasury Secretary Henry Paulson says that the turbulence that has hit financial markets will take some time to be resolved, especially in the area of subprime mortgages. He urges the large firms to work with the administration to help ensure that subprime homeowners get assistance in dealing with sharply rising mortgage payments as their initial low adjustable rate mortgages now reset to higher levels.

September 6: Concerned by the exploding subprime mortgage crisis, Federal Reserve Governor Randall Kroszner says fallout may spread beyond housing market into general economy.

September 6: The Mortgage Bankers Association releases a quarterly report showing that the delinquency rate (the number of people who are behind in their payments but have not yet entered the foreclosure process) for mortgage loans on one-to four-unit residential properties was 5.12 percent of all loans outstanding in the second quarter of 2007, up 28 basis points from the first quarter of 2007, and up 73 basis points from one year ago. The delinquency rate for subprime loans was up from 13.77 in the first quarter to 14.82 percent in the second quarter. The delinquency rate for prime loans rose from 2.58 percent to 2.73 percent. Compared to this time last year, the seriously delinquent rate is 23 basis points higher for prime loans and 304 basis points higher for subprime loans.

September 5: The National Association of Realtors releases statistics on pending sales for existing homes. The figures reveal a 16.1 percent decline in July from a year ago and a 12.2 percent decline from the prior month. The July 89.9 level is the second lowest in the history of the index and its lowest since the September 11th terrorist attacks that severely disrupted the national economy.

September 5: The Federal Reserve releases its Beige Book, a largely anecdotal report on the economy based on interviews with business leaders throughout the country. Counter to investor sentiment, the findings do not indicate that the housing crisis is expanding into the general economy. The Dow Jones industrial average drops nearly 200 points.

September 4: The six banking regulators, including the Federal Reserve, call on mortgage companies to work with struggling homeowners likely to lose their homes as their adjustable rate mortgage interest rates escalate. Citing the benefit to both lenders and borrowers, Fed Governor Randall Kroszner says: "Keeping families in their homes is a matter of great importance to the Federal Reserve."

AUGUST 2007

August 31: President Bush holds a press conference to highlight the growing problems in the subprime mortgage market. He says the "government has a role to play" in the growing crisis and calls upon the Federal Housing Administration to help subprime borrowers refinance into loans insured by the federal agency. The modest FHA program is expected to assist 60,000 delinquent borrowers. President Bush announces an additional program expected to help another 20,000 homeowners by reducing insurance premiums for those who pose less of a credit risk.

August 27: National Association of Realtors reports that existing home sales declined by 0.2 percent in July, leaving the level of sales 9.0 percent below the level 12 months prior.

August 22: Realty Trac Inc announces foreclosures were up 93% in July 2007 from July 2006. The national foreclosure rate in July was one filing for every 693 households. There were 179,599 filings reported last month, up from 92,845 a year ago.

August 17: The Federal Reserve cuts the discount rate by half a point. Stocks rally.

August 16: Countrywide Financial, the nation's largest mortgage lender, draws down $11.5 billion from its credit lines.

August 16: All three major stock indexes were 10% lower than their July peaks – a marker indicating a correction of the stock market, due to tightening in the credit markets.

August 13: Aegis Mortgage files for bankruptcy.

August 9 and 10: European Central Bank and Federal Reserve intervenes in markets by pumping billions of dollars of liquidity into the markets.

August 9: American International Group, one of the biggest U.S. mortgage lenders, warns that mortgage defaults are spreading beyond the subprime sector. With delinquencies becoming more common among borrowers in the category just above subprime.

August 9: BNP Paribas, a French bank, suspends three of its funds because of exposure to U.S. mortgages.

August 6: American Home Mortgage files for bankruptcy.

August 1: Two hedge funds managed by Bear Stearns that invested heavily in subprime mortgages declare bankruptcy. Investors in the funds file suit against Bear Stearns, alleging that the investment bank mislead them about the extent of the funds' exposure.

JULY 2007

July 31: Home prices continue to fall, marking the 18th consecutive decline, beginning in December 2005, in the growth rate of housing prices, according to the monthly S&P/Case-Shiller's Home Prices Indices, which tracks housing prices in metropolitan areas and is considered a leading measure of U.S. single-family home prices. The 10-City Composite index showed an annual decline of 3.4% (it's biggest since 1991) and the 20-City Composite reported an annual decline of 2.8%.

July 30: IKB Deutsche Industrie bank, a German bank, is bailed out because of bad bets on U.S. mortgage-backed securities.

July 25: The JEC examines the impact of the subprime lending crisis on Cleveland, Ohio, one of the hardest hit communities in the nation. The hearing reveals the individual faces of the subprime mortgage crisis. Local residents and city council members testify.

July 19: The Dow Jones industrials close above 14,000 for the first time.

July 18 and 19: In two days of testimony in Congress, Chairman Bernanke said there will be "significant losses" due to subprime mortgages, but that such losses are "bumps" in "market innovations" (referring to hedge fund investments in subprime mortgages). Bernanke reiterated that problems in the subprime mortgage market have not spilled over into the greater system. Bernanke also said the problems "'likely will get worse before they get better." He forecasts that the economy is poised for moderate growth, but continuing problems in the housing market prompt the Fed to slightly reduce its growth expectations.

July 18 and 19: Chairman Bernanke testifies in front of the House Financial Services Committee and the Senate Banking Committee in his Second Monetary Report to Congress in 2007.

July 18: Commerce Department announces housing starts are down 19.4 percent over the last 12 months. Also announced is a 7.5 percent plunge in permits to build new homes, the largest monthly decline since January 1995. Permits are 25.2 percent below their level a year ago, reflecting continued pessimism among builders over the near-term outlook for new homebuilding.

July 18: Bear Stearns announces its two hedge funds that invested heavily in the subprime market are essentially worthless, having lost over 90% of their value, equal to over $1.4 billion.

July 17: The Federal Reserve announces a pilot program to monitor brokers, joining the Board of Governors of the Federal Reserve with the Office of Thrift Supervision, the Federal Trade Commission, and state agencies represented by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators, to conduct targeted consumer-protection compliance reviews of underwriting standards, oversight, and risk-management practices within non-depository lenders with significant subprime mortgage operations.

July 10: Standard and Poor’s and Moody’s downgrade bonds backed by subprime mortgages. Fitch follows suit.

July 10: The Senate Appropriations Committee approves $100 million of the requested $300 million for HUD Housing Counseling programs in the Transportation, Housing, and Urban Development, and Related Agencies FY08 Appropriations Bill. With these funds, non-profit agencies are able to provide individual counseling by working one-on-one with borrowers stuck in unaffordable subprime loans.

JUNE 2007

June 22: Bear Stearns pledges up to $3.2 billion to bail out one of its hedge funds because of bad bets on subprime mortgages.

June 14: Goldman Sachs reports flat profit from a year ago due to mortgage market problems.

June 12: Realty Trac announces U.S. foreclosure filings surged 90 percent in May from May 2006. Foreclosure filings were up 19 percent from April. There were 176,137 notices of default, scheduled auctions and bank repossessions in May. The median price for a U.S. home dropped 1.8 percent the first three months of 2007. According to Freddie Mac, typically, more than half of all home sales occur in the April to June period.

June 6: ZipRealty Inc., a national real-estate brokerage firm, announces that the number of homes listed for sale in 18 major U.S. metropolitan areas at the end of May was up 5.1% from April. This is a striking deviation from the general trend as tracked by the Credit Suisse Group, which says on a national basis; inventories of listed homes have typically been little changed in May during the past two decades.

MAY 2007

May 25: The National Association of Realtors reports that sales of existing homes fell by 2.6 percent in April to a seasonally adjusted annual rate of 5.99 million units, the slowest sales pace since June 2003. The number of unsold homes left on the market reached a record total of 4.2 million.

May 17: At the Federal Reserve Bank of Chicago's Forty-Third Annual Conference on Bank Structure and Competition, Chairman Bernanke reiterates his March statement by saying the Fed does not foresee a broader economic impact from the growing number of mortgage defaults.

May 9: The Federal Open Market Committee meets and leaves rates unchanged. The FOMC states in their minutes, "The correction of the housing sector was likely to continue to weigh heavily on economic activity through most of this year, somewhat longer than previously expected." However, the FOMC continued to refer to the housing crisis as a "correction".

APRIL 2007

April 24: The National Association of Realtors announces that sales of existing homes fell 8.4% in March from February, the sharpest month-to-month drop in 18 years.

April 18: Freddie Mac announces plans to refinance up to $20 billion of loans held by subprime borrowers who would be unable to afford their adjustable-rate mortgages at the reset rate.

April 12: According to the Los Angeles Times, Tony Fratto, Spokesman for the White House, said "individuals need to make smart decisions in taking on debt, and there has to be some responsibility for making those decisions." He also said that any federal action would be unwelcome and would encourage "risky behavior."

April 6: American Home Mortgage writes down the value of risky mortgages rated one step above subprime.

April 2: New Century Financial files for bankruptcy.

MARCH 2007

March 27: At a Joint Economic Committee hearing, Ben Bernanke, Chairman of the Board of Governors of the Federal Reserve System, says housing market weakness "does not appear to have spilled over to a significant extent." More Bernanke: "At this juncture, however, the impact on the broader economy and financial markets of the problems in the subprime market seems likely to be contained. In particular, mortgages to prime borrowers and fixed-rate mortgages to all classes of borrowers continue to perform well, with low rates of delinquency."

March 20: People's Choice files for bankruptcy.

March 8: New Century Financial, the second largest subprime lender in 2006, stops making loans.

March 2: Fremont General stops making subprime loans and puts its subprime business up for sale.

March 2: The Federal Reserve announces draft regulations to tighten lending standards. Lenders would be required to grant loans on a borrower's ability to pay the fully indexed interest rate that would apply after the low, initial fixed-rate period of two or three years. New regulations are met with skepticism in Congress.

FEBRUARY 2007

February 20: Nova Star Financial reports a surprise loss.

February 12: ResMae Mortgage files for bankruptcy.
.

DECEMBER 2006

December 28: Ownit Mortgage Solutions files for bankruptcy.

Assembly Banking & Finance Committee
&
Assembly Public Employees, Retirement & Social Security Committee

Joint Informational Hearing

"Insight into the Financial Market Bailout: Present and Future Actions"

Thursday, October 16, 2008
10am-12pm

Los Angeles City Hall, Council Chambers
200 North Spring Street
Los Angeles, CA 90012

Assembly Banking & Finance Committee & Assembly Public Employees, Retirement & Social Security Committee Joint Informational Hearing

"Insight into the Financial Market Bailout: Present and Future Actions"

Beginning last year the Assembly Banking & Finance Committee convened its first hearing to examine the impact of the mortgage crisis on California and the devastating impact on communities and homeowners. As noted then, the subprime crisis that was impacting homeowners was only the tip of the spear as the breadth of the true crisis and its impacts were yet unknown. Subsequently, the committee conducted several other hearings regarding the direct impacts of the foreclosure and subprime crisis.

The last few weeks and months have revealed the true nature of this crisis as major financial institutions have failed, markets have plummeted and as University of Chicago economists Douglas Diamond and Anil Kashyap have pointed out "the most remarkable period of government intervention into the financial system since the Great Depression." First we witnessed the U.S. Treasury takeover of Fannie Mae and Freddie Mac with combined assets and guarantees of over $5 trillion. Not long after, Lehmon brothers became the largest bankruptcy in American history, while a few days later the federal government bailed out American International Group (AIG) with $85 billion dollars.

In the week right after the passage of HR 1424 the Emergency Economic Stabilization Act of 2008, the bill which was intended to provide confidence in the markets, the DOW lost 20% of its value. This current liquidity crisis, a direct result of inadequate risk management on the part of financial institutions has now rebounded to an irrational fear of lending money, even in the best of circumstances. The London Interbank Offer Rate (LIBOR), the calculation used by banks to determine the rate at which they will lend to each other has been hovering around 4.75% a full 3% ahead of where it was prior to 2007. This is indicative of the lack of lending among banks and eventually to consumers and businesses.

On October 14, 2008 U.S. officials announced a plan to take stakes in the nine largest financial institutions as the beginning of a program to funnel $250,000,000,000 directly into banks to free up liquidity and credit. This first round of this plan will involve Treasury purchasing $25 billion in preferred stock of Bank of America, J.P. Morgan and Citigroup, between $20 billion and $25 billion in Wells Fargo; $10 billion in Goldman and Morgan Stanley; $3 billion in Bank of New York Mellon; and about $2 billion in State Street.

Institutions that participate in this direct injection would have to comply with the executive compensation restrictions put in place under HR 1424 that do the following:

- Ensure that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution;

- Require claw-back of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate;

- Prohibit a financial institution from making any golden parachute payment to a senior executive; and

- An agreement not to deduct for tax purposes executive compensation in excess of $500,000 for each senior executive. Treasury is issuing interim final rules for these executive compensation standards.

Additionally, and in order to free up day-to-day lending among banks, the FDIC will temporarily guarantee for certain types of new debt called senior unsecured debt issued by banks and thrifts.

Executive Compensation

Prior to the financial market meltdown, a number of CEO's were living the high life with bonuses, exuberant salaries and exceptional stock options. Oddly enough, the latest occurrences in the financial arena show that although these companies failed, those still coming off on top are the CEO's. CEO's continue to collect bonuses although the nation is in financial turmoil. The amount of money paid out in bonuses and golden parachutes is more money than one person sees in a lifetime. Should someone lose their job or close a business, there is no golden parachute to lean on to save the day. With such perverse incentives there is little to prevent inordinate risk taking or failed management strategies.

According to the Department of Labor in 2007, the average annual salary in the United States was $40,690. The top CEO's of many of the failed financial institutions make more than 100 times that. The latest market shocks pose the question of, if the business fails should these CEO's still receive a well above average compensation? The first of many CEO's to receive a golden parachute was Angelo Mozilo of the California based company, Countrywide Financial. Although this previous mortgage giant, now owned by Bank of America, was under scrutiny and facing criticism for questionable lending practices, Mr. Mozilo still made out with $361.7 million for the 2005-2007 year, most of it from gains on options. At this point, as the following data shows, a number of CEO's began planning ahead by rewarding themselves and employees' colossal bonuses, increasing salaries and selling stock options.

The next big blow came with Fannie Mae, a company once thriving on the fact that it was separated from direct government control. The federal government had no choice but to step in and take it over. In the end, Fannie Mae became over-extending with too much subprime debt that ultimately wiped out the shareholders. This is a case where CEO Daniel Mudd was denied a golden parachute worth $9.8 million, by one estimate, though this was only made possible due to direct government action. But he still took home $11.6 million during the boom years of 2005-07, according to Equilar, an executive compensation analysis company, including $8.3 million in bonus pay.

Similar to Fannie Mae, Freddie Mac also suffered from inadequate risk management with a portfolio burdened by subprime exposure. Freddie was also taken over by the government after conditions worsened. Freddie Mac shareholders got wiped out, and the fiasco contributed to fears that bad mortgage debt would take down the economy. Additionally, small community banks that did not really participate in the subprime boom were punished due to investments in preferred stock of both Fannie and Freddie. The former Freddie Mac CEO Richard Syron walked away with $12.9 million from 2005-07, including $8 million in bonuses. But regulators did snag his golden parachute, worth an estimated $9.8 million.

Following Freddie Mac and Fannie Mae the public had to endure watching Bear Stearns hitting the bottom. Bear Stearns was the first Wall Street giant to show out of proportion weaknesses. The federal government had to guarantee up to $29 billion in bad mortgage-related assets and from there JPMorgan Chase took them over. CEO James Cayne, who left in January, lost millions on Bear stock during the plunge but he had also cashed out millions in stock before the fall. He took home $42.3 million in his final three years on the job, 2005-07, Equilar says, including $29.8 million in bonus pay for accomplishments that included leading Bear Stearns into the arena of mortgage-backed securities.

Unlike Bear Stearns, Lehman Bros. was not able to secure government backing therefore they had no other choice but to file for bankruptcy protection. The chief obstacle was concern about a $30 billion portfolio of shaky commercial-real-estate assets compiled under the watch of CEO Richard Fuld. When Lehman filed for bankruptcy, investors were wiped out, and employees lost their jobs. Despite the consequences of filing for bankruptcy felt by almost everyone at Lehman Bros. Fuld walked away with $186.5 million in earnings from the prior three years, Equilar says. Fuld, who seemed to defend his compensation while testifying before a congressional panel on Oct. 6, 2008 got most of that by cashing out options but he also took home $36.8 million in bonus and incentive pay.

The big insurance giant, American International Group (AIG), under the leadership of CEO Martin Sullivan, got itself in deep trouble through the use of exotic financial products known as credit default swaps. In September, the insurer needed an $85 billion bailout from the Federal Reserve to avoid bankruptcy. AIG shareholders were virtually wiped out in the deal but Sullivan, who left the company in June, came out of it a multimillionaire. He raked in $25.4 million in take-home pay over three years, according to Equilar. Furthermore, recent revelations have shown that AIG spent $440,000 on a spa get-away junket not long after accepting the federal bailout.

Next came, Merrill Lynch under the leadership of Stan O'Neal. Merrill Lynch took more than $10 billion in write-downs on bad debt in the second quarter. Fears about what was yet to come forced Merrill to accept a buyout from Bank of America to avoid disaster. O'Neal left Merrill a year ago with $66 million in earnings under his belt for 2005-07. That included $32.6 million in bonuses.

Kerry Killinger, CEO of Washington Mutual plunged headfirst into the kinds of adjustable-rate mortgages and home-equity loans that failed to account for potential future difficulties for homeowners who could not refinance due to depressed markets or that their income had not risen as much as anticipated. The largest U.S. savings and loan faced losses from residential mortgages of as much as $19 billion when it was seized by the FDIC and then sold to JPMorgan Chase. Killinger took home $36 million in 2005-07. That included $11 million in bonus pay for his performance.

Like Washington Mutual, bad loans piled up too high at Wachovia; in the second quarter of 2008 alone, the bank reported an $8.9 billion loss. The chief culprit: "pick-a-pay" loans that came in the door when Wachovia bought California thrift Golden West Financial in 2006. Golden West specialized in those risky mortgages. Wachovia seems to have become an inquisition of Wells Fargo. CEO G. Kennedy Thompson, who left in June, did well during his tenure. He took home $16 million during 2005-07, including $10 million in bonus pay, according to Equilar.

Last but not least, Citigroup has took on more than $57 billion in write-downs and losses since the crunch hit. Citigroup has been forced to cut its dividend and raise more than $30 billion. The man at the helm while the mess developed was CEO Charles Prince, who has since left the company. He earned $35.6 million in bonus pay during the boom years of 2005-07 and took home a total of $41.5 million.

As the failures show, CEO's are walking away with a lot of cash in their pockets while taxpayers are ask to pay the bill to prop up failed enterprises.

Corporate Governance:

How has corporate governance impacted the credit crisis? It is too early to make any conclusions about the management of certain banks over others. However, the lack of transparency regarding certain exotic financial instruments has been a major criticism of the corporate structure of the financial industry. Innovation and risk taking has been rewarded in contrast with transparency and conservative growth.

The Association of Chartered Certified Accountants (ACCA) a global body for professional accountants has singled out poor corporate governance at banks as a principal cause of the global credit crunch. In a recently released policy paper, ACCA said unacceptable practices had encouraged short-term thinking and poor risk assessment fuelling the ongoing financial crisis.

Key elements of good corporate governance principles include honesty, trust and integrity, openness, performance orientation, responsibility and accountability, mutual respect, and commitment to the organization.

Of importance is how directors and management develop a model of governance that aligns the values of the corporate participants and then evaluate this model periodically for its effectiveness. In particular, senior executives should conduct themselves honestly and ethically, especially concerning actual or apparent conflicts of interest, and disclosure in financial reports.

Commonly accepted principles of corporate governance include:

- Rights and equitable treatment of shareholders: Organizations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by effectively communicating information that is understandable and accessible and encouraging shareholders to participate in general meetings.

- Interests of other stakeholders: Organizations should recognize that they have legal and other obligations to all legitimate stakeholders.

- Role and responsibilities of the board: The board needs a range of skills and understanding to be able to deal with various business issues and have the ability to review and challenge management performance. It needs to be of sufficient size and have an appropriate level of commitment to fulfill its responsibilities and duties. There are issues about the appropriate mix of executive and non-executive directors. The key roles of chairperson and CEO should not be held by the same person.

- Integrity and ethical behavior: Ethical and responsible decision making is not only important for public relations, but it is also a necessary element in risk management and avoiding lawsuits.

- Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making. It is important to understand, though, that reliance by a company on the integrity and ethics of individuals is bound to eventual failure. Because of this, many organizations establish compliance and ethics programs to minimize the risk that the firm steps outside of ethical and legal boundaries.

- Disclosure and transparency: Organizations should clarify and make publicly known the roles and responsibilities of board and management to provide shareholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information.

HR 1424
Emergency Economic Stabilization Act of 2008

Faced with an ongoing economic crisis that has not improved despite several instances of direct government intervention, Congress passed HR 1424, what has commonly been referred to as the $700 billion bailout package. The core of the proposal will provide access to the Treasury Secretary of up to the $700 billion over stages with $250 billion being made available immediately. They key driver of the bailout package is the ability of the government to purchase troubled assets, namely mortgage back securities and other financial instruments tied to mortgages.

Since the passage of HR 1424, Wall Street has continued to see record losses. Some indications have emerged at the time of writing this review that Treasury may alter the plan to allow government to buy stakes in financial institutions or provide direct injections of liquidity. This injection could amount to $200 billion, though early news is unclear as to whether this is part of, or in addition to the $700 billion previously authorized.

The following is a summary of the provisions of HR 1424. It is important to note that based on the provisions of the bill that Treasury Secretary is now the most powerful cabinet level position in the executive branch.

PURPOSE AND MISSION:

- Provide authority for the Secretary of the Treasury to take action as necessary to restore liquidity and stability to the financial system.

- Ensure that the authorities provided for in the legislation are used to:

    - Protect home values, college funds, retirement accounts and life savings;
    - Preserve homeownership;
    - Promote jobs and economic growth;
    - Maximize returns to the taxpayers; and
    - Provide transparency and accountability.

TROUBLED ASSET RELIEF PROGRAM (TARP):

- Defines "troubled assets" as residential or commercial mortgages and any securities, obligations, or other instruments that based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, the purchase of which will promote financial market stability; and any other financial instrument in which if purchased would promote financial market stability.

- Provides authority to the Secretary to purchase and make commitments to purchase trouble assets from any financial institution on terms and conditions determined by the Secretary.

- Implements TARP under the new Office of Financial Stability headed by the Assistant Secretary of the Treasury to be appointed by the President.

- Provides the Secretary to take such actions as deemed necessary to carry out the provisions of TARP including, but not limited to:

    - Direct hiring authority;
    - Ability to enter into contracts for services;
    - Designating financial institutions as financial agents of the Federal Government.
    - Establish vehicles to purchase, hold and sell troubled assets; and
    - Issue regulations and guidance that may be necessary.

- Requires that within the first two days of the purchase of troubled assets the Secretary shall publish program guidelines and procedures.

- Requires the Secretary to take such steps as necessary to prevent unjust enrichment of financial institutions participating in TARP.

INSURANCE OF TROUBLED ASSETS:

- In addition to the power to purchase, trade and hold troubled assets, the Secretary is also authorized to set up a guarantee program for these assets.

- Establishment of a guarantee program will also require the establishment of premiums for such guarantees.

- Premiums will vary based on product risk and the Secretary shall publish the methodology for setting premiums.

- Upon request of a financial institution, the Secretary may guarantee the timely payment of principal of, and interest on, troubled assets in amounts not to exceed 100% of such payments.

- Establishes the Troubled Assets Insurance Financing Fund (TAIF) that will collect premiums to pay potential guarantee claims.

GUIDELINES AND CONSIDERATIONS:

- In exercising his authority, the Secretary shall take into consideration the following:

    - Protecting the interest of the taxpayers;
    - Providing stability and preventing disruption to financial markets;
    - Assist and help families keep their homes and stabilize communities;
    - Determining if the purchase of assets meat long term viability of TARP;
    - Ensuring that all financing institutions are eligible to participate in the program;
    - Providing financial assistance to community banks and to financial institutions that serve low and moderate income communities that have assets less than one billion dollars and that as a result of devaluation of Fannie and Freddie preferred stock will drop in capital levels;
    - The need to ensure stability for United States public instrumentalities; and
    - Protecting retirement accounts.

FINANCIAL STABILITY OVERSIGHT BOARD (FSOB):

- Creates FSOB, which shall be responsible for:

    - Reviewing the exercise of authority under TARP;
    - Making recommendations to the Secretary regarding use of authority under TARP; and
    - Reporting any suspected fraud, misrepresentation, or malfeasance to the Special Inspector General for the Troubled Assets Relief Program or the Attorney General of the United States.

- FSOB will be composed of the Chairman of the Federal Reserve, the Secretary, Director of FHA, Chairman of the SEC and the Secretary of HUD.

- Requires FSOB to report to Congress quarterly.

REPORTING REQUIREMENTS:

- Requires the Secretary to report to Congress within 60 days of the first exercise of authority granted under TARP to report every 30 days thereafter.

- Requires the reports to include the following:

    - An overview of actions taken under TARP;
    - Actual obligations and expenditures of funds provided for administrative expenses.
    - A detailed financial statement with respect to the exercise of authority including:

        - All agreements made or renewed;
        - All insurance contracts entered into;
        - All transactions occurring during the reporting period;
        - The nature of the assets purchased;
        - Projected costs and liabilities;
        - Operating expenses;
        - The Valuation or pricing method used for each transaction; and
        - A description of vehicles established to assist in the exercise of the authority granted under TARP.

- Requires specified Tranche Reports to Congress that include:

    - A description of all the transactions made during the reporting period;
    - Justification for the price paid for and other financial terms associated with transactions;
    - A description of the impact of TARP on the financial system;
    - A description of challenges that remain in the financial system; and
    - An estimate of additional actions under the authority provided that be necessary to meet new challenges.

- Requires the Secretary to review the current state of the financial markets and regulatory system and submit a report to Congress analyzing financial markets and providing recommendations regarding potential new regulatory action.

FORECLOSURE MITIGATION EFFORTS:

Like most provisions of the bailout bill, this section is very broad yet unspecific regarding the actions that the Treasury Secretary may take to encourage loan modifications. In granting authority to the Treasury Secretary is uses terms such as the Secretary may "encourage" modification efforts, instead of a clear grant of power to enforce such modifications. However, with $700 billion at his disposal, the Treasury Secretary encouragement may have the same effect as a mandate. It is too early to tell the full effects of this package.

Specifically, section 109 does the following:

- Requires the Secretary to implement a plan to maximize assistance to homeowners and use the authority provided to "*encourage*" loan servicers to take advantage of the HOPE for Homeowner's Program *or other* available programs to minimize foreclosures. The guidelines for the HOPE program, as passed in HR 3221 (Housing & Economic Recovery Act of 2008) are as follows:

    - The borrowers mortgage must have originated on or before January 1, 2008;
    - The mortgage debt-to-income must be at least 31 percent;
    - The borrower does not own second homes.
    - Maximum 90 percent loan-to-value ratio (This requires a write down of principle to 90% of the current value as appraised by FHA);
    - $550,440 maximum mortgage amount;

    Considering the stringent debt-to-income ratio requirements and the requirement that lenders must write down the principle of the mortgage this program will probably suffer from little to no utilization. Also, FHA estimates that this program will only assist 400,000 borrowers.

- Provides that the Secretary may use guarantees and credit enhancements to facilitate loan modifications.

- Requires the Secretary to coordinate with other federal agencies and entities that hold troubled assets to identify opportunities for the acquisition of troubled assets that would improve the loan modification and restructuring process and to permit tenants to remain in their homes under the terms of the lease.

- In cases where the Treasury owns all or part of the assets of a mortgage pool the Secretary shall consent to "*reasonable*" requests for loss mitigation measures, including term extensions, rate reductions, principle write downs, or other means to remove limitations on modifications.

- Requires the Federal Property Manager (FPM) to implement loan modification and assistance plans within 60 days of enactment of the bill.

- Requires the FPM a report to Congress every 30 days on the number and types of loan modifications made and the number of actual foreclosures occurring during the reporting period.

- Provides that when the FPM does not own a mortgage loan, but holds as interest in obligations or pools of obligations secured by mortgage loans the FPM shall encourage implementation of loan modifications by servicers and assist in facilitating any modifications to the extent possible.

Adam Levitin, Associate Professor of Law, at Georgetown University concludes that the buying up of mortgage backed securities by the government is not enough to give the government the ability to unilaterally modify mortgages. Typical pooling and servicing agreements (PSAs) specify that it takes two-thirds of all the MBS holers in a pool to consent to a modification. Under this scenario, Treasury would have to buy up two-thirds of the MBS in a pool to force across the board modifications. However, even if Treasury could or was willing to purchase the necessary amount, the conversion of MBS into collateralized debt obligations further dilutes the ability to purchase the sufficient number of securities. Professor Levitin advocates the best way to engage in loan modifications is too allow judges to write down values in bankruptcy proceedings.

EXECUTIVE COMPENSATION:

As noted earlier in this background, executive compensation has become a hot button issue as Americans witness CEOs walking away with multi-million dollar paydays after the collapse of their company in what can only be described as utter failures in leadership and responsibility. These are the types of failures that would get most middle income workers, regardless of industry, fired on the spot. When the first bailout plan was floated to Congress it did not include limits on executive compensation. Subsequently, Congress and the public expressed outrage at the handover of billions of dollars of taxpayer money without any limits on CEO pay or the use golden parachutes.

HR 1424 contains the following limits on compensation:

- When the Secretary directly purchases trouble assets from institutions without a bidding process and such sale results in the government having an equity or debt position in the institution, then the institution must meet specified governance and executive compensation standards.

- These standards are:

    - Exclusion of incentives for senior executive officers of institutions to take unnecessary and excessive risks that threaten the institution during the period in which the government holds and equity position.
    - A provision for recovery of any bonuses or incentive compensation based on statements of earnings, gains or other criteria that are later proven to be materially inaccurate.
    - A prohibition on the making of any golden parachute during the period in which the government has an equity or debt position.

- If troubled assets are purchased at auction and when the investment in a single institution is at least $300,000,000 the Secretary shall prohibit, for such financial institution any new employment contracts that provide a golden parachute in the event of an involuntary termination, bankruptcy filing, insolvency or receivership.

The provisions in this section may provide little long term comfort to those concerned with executive compensation. The limits and terms are vague and narrow. For example, assistance to an institution is not enough for the protections to kick in. It requires that the government either have an actual ownership position in the institution or an investment over $300,000,000. So the TARP plan could provide $299,000,000 in assistance to one entity but the limits on executive compensation would not apply. Furthermore, recovery of bonuses or incentives is allowed if statements of earnings, etc are proven to be inaccurate. The legislation is unclear on who would make such a finding, either a court or the Secretary? Lastly, the limits only apply for the duration that the government holds an equity position so the day after that relationship ends the institution could begin to adversely reward executives even though they only survived due to government intervention.

COORDINATION WITH FOREIGN AUTHORITIES AND CENTRAL BANKS:

- Requires the Secretary to coordinate with foreign financial authorities and central banks to work toward the establishment of similar programs by foreign authorities and central banks.

The federal government and several members of Congress have, over the last few years, expressed concerns regarding the influence and reach of sovereign wealth funds, particularly those from Arab counties such as the United Arab Emirates. Ironically, the TARP program may be the beginning of the largest sovereign wealth fund in the world.

MINIMIZATION OF LONG-TERM COSTS AND MAXIMAZATION OF BENFITS FOR TAXPAYERS:

In carrying out the TARP program the Secretary is required to develop policies that will minimizes risks to the taxpayers by taking into account direct outlays, potential long-term returns and the overall economic benefits to the program. In order to carry out this provision the Secretary shall:

- Hold assets to maturity or for resale until such time that the market is optimal for selling such assets;

- Sell such assets at a price that the Secretary determines, based on available financial analysis, will maximize return on investment for the Federal Government;

- Make purchases of assets at the lowest price; and

- Use market mechanism such as auctions and reverse auctions.

Discretion is provided to the Secretary to determine whether market mechanisms are feasible, or if direct purchase would better suit the goals of the program. This section leaves this authority to make such determines entirely to the discretion of the Secretary.

Finally, TARP provides that the Secretary may not purchase any troubled assets from a financial institution, unless the Secretary receives from a publicly traded institution a warrant giving the right to the Secretary to receive nonvoting common stock or preferred stock when deemed appropriate. If the institution is not publicly traded the Secretary shall receive a senior debt instrument.

MARKET TRANSPARENCY:

- Requires the Secretary to make available to the public a description, amounts, and pricing of assets acquired under this Act, within 2 business days of purchase, trade, or other disposition.

- Provides the Secretary to determine if public disclosure of off-balance sheet transactions, derivatives, instruments, contingent liabilities and similar sources of exposure is adequate to provide sufficient information to the public that reveals the true financial condition of the entity.

OVERSIGHT AND AUDITS:

HR 1424 establishes oversight by the Comptroller General of the United States on a continuing basis that will review and audit key provisions of the act, as well as, the performance of any agents and representatives of TARP. The subjects of Comptroller oversight include:

- The performance of TARP, particularly performance issues related to,
    - Foreclosure mitigation;
    - Cost reduction;
    - Ability and effectiveness is providing stability to the financial markets; and
    - Protection of taxpayers.

- The financial condition and internal controls of the TARP, its representatives and agents.

- Characteristics of transaction and commitments.

- Characteristics and disposition of acquired assets.

- Efficiency of the operations of the TARP in the use of appropriated funds.

- Compliance with all applicable laws and regulations.

- The efforts of the TARP to prevent, identify, and minimize conflicts of interest involving any agent or representative performing activities on behalf of or under authority of the TARP.

- The efficacy of contracting procedures.

Finally, the TARP is required to annually prepare and issue to the appropriate Congressional committees the public audited financial statements prepared in accordance with generally accepted accounting principles, and the Comptroller shall annually audit such statements.

STUDY AND REPORT ON MARGIN AUTHORITY:

Requires the Comptroller General to undertake a study to determine the extent to which leverage and sudden de-leveraging of financial institutions was a factor behind the financial crisis. This report must be submitted no later than June 1, 2009. The study shall include:

- An analysis of the roles and responsibilities of the Federal Reserve Board, SEC, the Secretary, and other Federal banking agencies with respect to monitoring leverage and acting to curtail excessive leveraging.

- An analysis of the authority of the Board to regulate leverage.

- An analysis of any usage of margin authority by the board.

- Recommendations for the Board and Congress with respect to the existing authority of the Board.

SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSET RELIEF PROGRAM:

Creates a special Inspector General to review and monitor the TARP with the responsibility of auditing and investigating the purchase, management, and sale of assets by the Secretary including the collection of the following information:

- A description of the categories of troubled assets purchased or otherwise procured by the Secretary.

- A listing of the troubled assets purchased.

- An explanation of the reasons the Secretary deemed it necessary to purchase each troubled asset.

- A listing of each financial institution that such trouble assets were purchased from.

- A listing of and detailed biographical information on each person or entity hired to manage such troubled assets.

- Current estimate of the total amount of troubled assets purchased and sold and a detailed account of the profits and losses incurred from the disposition of each asset.

- A listing of insurance contracts issued.

AUTHORITY TO SUSPEND MARK-TO-MARKET ACCOUTING:

First, what is mark-to-market accounting? Also known as "fair value" accounting it requires institutions to value assets on their balance sheets based on what those assets would be valued at on the market. If the current trading value of an asset is 85 cents on the dollar then that the amount that would be claimed on the balance sheets, thus causing a write down in value of 15 cents per dollar. Mutual funds make these types of reports every day on the value of the stocks in their portfolio while investment banks like Goldman Sachs do these reports every quarter. During the subprime boom financial institutions created such exotic instruments that there was no real market to which one could base a realistic pricing analysis. In these cases, the investment firms used complex algorithms to "guess" at what the true market value of these products might be or tied their fortunes to indices that were most likely to face volatility in such a distressed market and that's exactly what has happened. Additionally, this accounting rule as required many banks to write down holdings based on the current value of real estate that backs up mortgage securities. This had contributed to a massive write down in values. Several policy makers, investors, CEOs and others have called for suspension of the mark-to-market rule, blaming it in large part for the current financial crisis, pointing out that such exotic products as collateralized debt obligations cannot possible be priced correctly in such a panicked marketplace. However, it should be noted that no one complained about the mark-to-market rules with the market place was overly optimistic and firms were able to mark large returns on their balance sheets.

HR 1424 provides the SEC with authority to suspend by rule, regulation or order the mark- to-market rule if need for the protection of investors.

Additionally, the SEC will study the mark-to-market accounting standards with an emphasis on:

- The effects of such accounting standards on a financial institutions balance sheet.
- The impacts of such accounting on bank failures.
- The impact of such standards on the quality of financial information available to investors.
- The process used by the Financial Accounting Standards Board in developing accounting standards.
- The advisability and feasibility of modifications to such standards.
- Possible alternative accounting standards to those currently provided under mark-to-market.

TEMPORARY INCREASE IN DEPOSIT AND SHARE INSURANCE COVERAGE:

In order to instill consumer confidence in the retail banking sector, the FDIC deposit insurance limit has been raised from $100,000 to $250,000 through December 31, 2009.

Assembly Banking & Finance Committee

"Mortgage Lending Regulatory Reform & the Secure & Fair Enforcement for Mortgage Licensing (SAFE) Act of 2008**"**

California State Capitol
November 12, 2008
10:00 a.m., Room 444

Secure & Fair Enforcement for Mortgage Licensing (SAFE) Act of 2008

Title V of Public Law 110-289

Background:

Under California law, mortgage loans can be made and originated under several different structures and licensing regimes. Mortgage brokers operate under a real estate license from the Department of Real Estate. This license requires several hours of educational training and ongoing direct oversight by the department.

Under the California Finance Lenders Law or the Residential Mortgage Lending Act, originators offer loans under the umbrella license of the company they work for. Under this structure, the loan originator is not licensed nor statutorily mandated to maintain certain levels of educational experience. This is the similar to a loan officer works at a bank or credit union. The logic in with this model is that the wrongdoing of an individual places the whole license in jeopardy so institutions are more likely to self regulate. Some distinctions have been made in recent years regarding individual employees. For example, several legislative proposals have come forward in recent years that have put some requirements on individuals in these cases such as expanded background checks.

On July 30, 2008 President Bush signed into law HR 3221, the Housing and Economic Recovery Act of 2008. This legislation provides reforms for Fannie Mae and Freddie Mac, as well as, new programs designed to assist homeowners facing foreclosure. Among its many provisions, HR 3221 contained a section known as the SAFE Act (*Title V of P.L. 110-289*), a wholesale regulatory change of the licensing and regulation of mortgage originators.

The SAFE Act requires California and other states to have a framework in place by August 1, 2009, or face direct oversight and implantation from the Federal Department of Housing and Urban Development (HUD). States may receive an extension if they are making a good faith effort to implement the requirements. Since the creation of California's multi-layered framework, the system has been somewhat of an arbitrage where lenders could pick and choose licenses based on their business models or market needs. Some lenders have acquired licenses across all licensing laws.

Implementation of the SAFE Act will be the easiest for the Department of Real Estate (DRE) as currently all real estate agents and mortgage brokers are individually licensed. The Department of Corporations (DOC) will face the most challenge as the current license system for finance lenders and residential mortgage lenders is a corporate licenses where employees work under the licenses of their employer. A change to the requirements of the SAFE Act will require a wholesale restructure of those licensing frameworks.

The Regulation of Mortgage Lenders

As mentioned previously, there are a variety of regulators at both the state and federal level who oversee lenders and administer mortgage lending laws. Below is a brief summary of this regulatory framework.

Non-Depository Mortgage Lenders

Department of Corporations (DOC)

In California, non-depository institutions may make mortgage loans under two separate licenses administered by DOC, the residential mortgage lender's (RML) license or a California finance lender's (CFL) license.

The California Residential Mortgage Lending Act was enacted in 1994 to provide a unique license for mortgage bankers that act as loan originators and/or loan servicers. A RML licensee may also serve as a mortgage broker who secures a mortgage loan on behalf of a borrower from a third party lender.

The RML authorizes licensees to make federally related mortgage loans. Those loans are made, insured, guaranteed or assisted in any way by the federal government, made in connection with a US Department of Housing and Urban Development program or intended to be sold by the originating lender on the secondary mortgage market to a government-sponsored enterprise such as Fannie Mae or Freddie Mac.

Applicants for a RML must:

- Be an approved lender and/or servicer from the Federal Housing Administration (FHA), Veterans Administration (VA), Farmers Home Administration (FmHA), Government National Mortgage Association (Ginnie Mae), Federal National Mortgage Association (Fannie Mae);

- Demonstrate a minimum tangible net worth of $250,000; and

- Maintain a surety bond in the amount of $50,000.

For each RML, the DOC conducts on-site audits at least every 4 years. Those audits are conducted to determine each licensee's compliance with the provisions of the various laws governing mortgage lenders.

Under the California Finance Lenders Law, "any person who is engaged in the business of making consumer loans or making commercial loans" is a finance lender. Under the CFL Law, licensees may make first and second mortgages, personal loans and business loans.

A CFL license may be issued to a corporate entity and individual employees are not required to obtain a license. A corporation or person applying for a finance lender license must submit an application to DOC, pay a $300 initial fee and have a net worth of $25,000. The DOC reviews all applications to ensure that various requirements are met. In general, the company's principals may not have a criminal history or a history of non-compliance with regulatory requirements.

Once a license is obtained, licensees:

- Are subject to periodic examination that each licensee must pay for;

- Must pay an annual assessment each year;

- Have to file an annual report with DOC;

- Must maintain a $25,000 surety bond at all times.

In addition to the ability to make loans directly, the CFL Law provides some ability for finance lenders to broker loans as long as the loans are only brokered to other licensed CFLs.

Department of Real Estate (DRE)

California's real estate law provides for the licensing and regulation of real estate brokers by DRE. Under the law, licensed real estate brokers may:

- Buy, sell or solicit prospective buyers and sellers of real property;

- Serve as a property manager who leases or rents real property; and

- Serve as a mortgage broker who, on behalf of borrowers or lenders, negotiates loans secured by liens on real property.

In most transactions, the mortgage broker is usually an agent for the purpose of arranging the home loan transaction.

To obtain a salesperson's licensees or a real state brokers license, the applicant must have completed the following educational requirements:

Successful completion of the following college-level courses is required to become a real estate salesperson:

- Real Estate Principles; and
- Real Estate Practice; and

One course from the following list:

- Real Estate Appraisal
- Property Management
- Real Estate Finance
- Real Estate Economics
- Legal Aspects of Real Estate
- Real Estate Office Administration
- General Accounting
- Business Law
- Escrows
- Mortgage Loan Brokering and Lending
- Computer Applications in Real Estate
- Common Interest Developments

The following educational requirements are necessary for a real estate *brokers licenses.*

- Real Estate Practice
- Legal Aspects of Real Estate
- Real Estate Finance
- Real Estate Appraisal
- Real Estate Economics or General Accounting

And three courses from the following group:

- Real Estate Principles
- Business Law
- Property Management
- Escrows
- Real Estate Office Administration
- Mortgage Loan Brokering and Lending
- Advanced Legal Aspects of Real Estate
- Advanced Real Estate Finance
- Advanced Real Estate Appraisal
- Computer Applications in Real Estate
- Common Interest Developments

In additional to the educational requirements, in order to receive a brokers license, the applicant must have two years of experience as a salesperson, or a four year degree, or be a member of the state bar.

Depository Institutions

Depository institutions (e.g., banks, thrifts and credit unions) may be chartered by the state through the Department of Financial Institutions. Alternatively, these types of institutions may choose a national charter regulated primarily by one of three federal regulators: the Office of the Comptroller of the Currency, the Office of Thrift Supervision or the National Credit Union Administration.

Regardless of whether they hold a state or federal charter, banks and thrifts are also subject to regulation by the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC).

Department of Financial Institutions (DFI)

The DFI oversees state chartered depository institutions such as banks, credit unions, industrial banks and savings association. These depository institutions make a variety of loans to borrowers including loans on real property. These licensees may also broker mortgage loans to other lenders.

The authority to make mortgage loans is an inherent part of the lending authority as a DFI-licensed financial institution. While the California Financial Code does not contain a "mortgage lending" section with respect to these institutions, their mortgage loans are governed by various laws throughout the Financial Code and by the numerous federal laws that apply to loans on real property and regulate lending practices. In addition, these institutions are subject to all general state laws governing mortgage lending such as the state's covered loan law.

Each DFI licensee is subject to a periodic examination at least once every two years.

Office of the Comptroller of the Currency (OCC)

The OCC charters, regulates, and supervises all national banks. It also supervises the federal branches and agencies of foreign banks.

Of the federal regulators, the OCC has been the most active in warning the institutions it charters against engaging in predatory lending practices. For example, in an Advisory Letter issued in 2003 (AL 2003-3), the OCC concludes:

> "National banks may confront risks when they obtain loans through brokers or through purchase transactions that contain or reflect abusive lending practices. . . . Failure to [take affirmative steps to avoid them] could raise serious supervisory concerns, and could result in supervisory or other actions directed against national banks, their operating subsidiaries, and the third-party brokers and

originators involved in the transaction."

National Credit Union Administration (NCUA)

The NCUA is an independent federal agency that charters and supervises federal credit unions.

Office of Thrift Supervision (OTS)

The Office of Thrift Supervision (OTS) is the primary regulator of all federally chartered thrift institutions, which include savings banks and savings and loan associations.

Purpose and Methods of the SAFE Act.

The SAFE Act is designed to encourage every state, through consultation and coordination with the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators to establish a Nationwide Mortgage Licensing System that will accomplish the following:

1. Provides uniform license applications and reporting requirements for State-licensed loan originators.

2. Provides a comprehensive licensing and supervisory database.

3. Aggregates and improves the flow of information to and between regulators.

4. Provides increased accountability and tracking of loan originators.

5. Streamlines the licensing process and reduces the regulatory burden.

6. Enhances consumer protections and supports anti-fraud measures.

7. Provides consumers with easily accessible information, offered at no charge, utilizing electronic media, including the Internet, regarding the employment history of, and publicly adjudicated disciplinary and enforcement actions against, loan originators.

8. Establishes a means by which residential mortgage loan originators would to the extent possible, be required to act in the best interest of the consumer.

9. Facilitates responsible behavior in the subprime mortgage market place and provides comprehensive training and examination requirements related to subprime mortgage lending.

10. Facilitates the collection and disbursement of consumer complaints on behalf of State and Federal mortgage regulators.

Definitions:

1. Defines "loan originator" as an individual who:

    a. Takes a residential mortgage loan application; and

    b. Offers or negotiates terms of a residential mortgage loan for compensation or gain.

    c. It does not include those who provide clerical or administrative task on behalf of a "loan originator" or a person or entity that only performs real estate brokerage services.

2. Defines "Nationwide Mortgage Licensing System and Registry" as a mortgage licensing system developed and maintained by the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) for the State licensing and registration of State-licensed loan originators and the registration of registered loan originators or any system established by the Secretary under section 1509.

3. Defines Nontraditional mortgage product as meaning any mortgage product other than a 30-year fixed rate mortgage.

4. Defines "registered loan originator" as any individual who--
    a. meets the definition of loan originator and is an employee of--
        1. a depository institution;
        2. a subsidiary that is--
            a. owned and controlled by a depository institution; and
            b. regulated by a Federal banking agency; or
            c. an institution regulated by the Farm Credit Administration; and
    b. is registered with, and maintains a unique identifier through, the Nationwide Mortgage Licensing System and Registry.

5. Defines "residential mortgage loan" as any loan primarily for personal, family, or household use that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling (as defined in section 103(v) of the Truth in Lending Act) or residential real estate upon which is constructed or intended to be constructed a dwelling (as so defined).

6. Defines "Loan Processors" or "Underwriters" as an individual who performs clerical or support duties at the direction of and subject to the supervision and instruction of—
   a. a State-licensed loan originator; or
   b. a registered loan originator.

<u>Requirements for registration and compliance:</u>

1. Prohibits an individual from engaging in the business of a loan originator without first--
   a. obtaining, and maintaining annually--
      i. a registration as a registered loan originator; or
      ii. a license and registration as a State-licensed loan originator; and
      iii. obtaining a unique identifier.

2. Provides that a loan processor or underwriter who does not represent to the public, through advertising or other means of communicating or providing information (including the use of business cards, stationery, brochures, signs, rate lists, or other promotional items), that such individual can or will perform any of the activities of a loan originator shall not be required to be a State-licensed loan originator.

3. Provides that an independent contractor may not engage in residential mortgage loan origination activities as a loan processor or underwriter unless such independent contractor is a State-licensed loan originator.

4. Provides that in connection with an application to any state for licensing and registration as a state-licensed loan originator, the applicant shall, at a minimum, furnish to the Nationwide Mortgage Licensing System and Registry (System) information concerning the applicant's identity, including--

a. fingerprints for submission to the Federal Bureau of Investigation, and any governmental agency or entity authorized to receive such information for a State and national criminal history background check; and

b. personal history and experience, including authorization for the System to obtain—

    i. an independent credit report obtained from a consumer reporting agency described in section 603(p) of the Fair Credit Reporting Act; and

    ii. information related to any administrative, civil or criminal findings by any governmental jurisdiction.

5. The minimum standards for licensing and registration as a State-licensed loan originator shall include the following:

    a. The applicant has never had a loan originator license revoked in any governmental jurisdiction.

    b. The applicant has not been convicted of, or pled guilty or nolo contendere to, a felony in a domestic, foreign, or military court--

        i. during the 7-year period preceding the date of the application for licensing and registration; or

        ii. at any time preceding such date of application, if such felony involved an act of fraud, dishonesty, or a breach of trust, or money laundering.

    c. The applicant has demonstrated financial responsibility, character, and general fitness such as to command the confidence of the community and to warrant a determination that the loan originator will operate honestly, fairly, and efficiently within the purposes of this title.

    d. The applicant has completed the pre-licensing education requirement.

    e. The applicant has passed a written test that meets the test requirement.

f. The applicant has met either a net worth or surety bond requirement, or paid into a state fund, as required by the state

6. Specifies that in order to meet the pre-licensing education requirement a person shall complete at least 20 hours of education approved in accordance with which shall include at least--

    a. 3 hours of Federal law and regulations;

    b. 3 hours of ethics, which shall include instruction on fraud, consumer protection, and fair lending issues; and

    c. 2 hours of training related to lending standards for the nontraditional mortgage product marketplace.

7. Provides that pre-licensing education courses shall be reviewed, and approved by the System.

8. Requires loan originators to pass a qualified written test developed by the Nationwide Mortgage Licensing System and Registry and administered by an approved test provider.

9. Requires the written test to measure the applicant's knowledge and comprehension in appropriate subject areas, including—

    a. ethics;

    b. Federal law and regulation pertaining to mortgage origination;

    c. State law and regulation pertaining to mortgage origination;

    d. Federal and State law and regulation, including instruction on fraud, consumer protection, the nontraditional mortgage marketplace, and fair lending issues.

10. Provides that an individual shall not be considered to have passed a qualified written test unless the individual achieves a test score of not less than 75 percent correct answers to questions and provides the following allowances and limitations to retest.

    a. An individual may retake a test 3 consecutive times with each consecutive taking occurring at least 30 days after the preceding test.

b. After failing 3 consecutive tests, an individual shall wait at least 6 months before taking the test again.

c. A State-licensed loan originator who fails to maintain a valid license for a period of 5 years or longer shall retake the test, not taking into account any time during which such individual is a registered loan originator.

11. Each mortgage licensee shall submit to the Nationwide Mortgage Licensing System and Registry reports of condition, which shall be in such form and shall contain such information as the Nationwide Mortgage Licensing System and Registry may require.

License Renewal Standards.

1. The minimum standards for license renewal for State-licensed loan originators shall include the following:

   a. The loan originator continues to meet the minimum standards for license issuance.

   b. The loan originator has satisfied the annual continuing education requirements described in subsection (b).

2. In order to meet the annual continuing education requirements referred to in a state-licensed loan originator shall complete at least 8 hours of education which shall include at least--

   a. 3 hours of Federal law and regulations;

   b. 2 hours of ethics, which shall include instruction on fraud, consumer protection, and fair lending issues; and

   c. 2 hours of training related to lending standards for the nontraditional mortgage product marketplace.