National Housing Forum

National Press Club

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Washington, D.C.

Claude Rollin: Well, good morning. My name is Claude Rollin, and I'm with the Office of Thrift Supervision here in Washington, D.C. I want to welcome all of you to the OTS's second National Housing Forum.

Before we get started, I just have a few brief housekeeping announcements. First one is, please turn off your Blackberries, cell phones, pagers, so we don't have any unexpected disturbances during the program. Any messages we have for conference attendees will be at the registration desk right outside the ballroom doors, and if there's anything at all that we can do for you while you're with us today, please see one of the OTS hosts, who will be happy to assist you in any way that they can.

We have a very exciting program for you today, with lots of top-notch speakers, and some very interesting issues. So, let me just give you a brief overview of what we're going to cover today.

In just a few minutes, I'm going to introduce the Director of OTS, who will make some opening remarks. Following the Director's remarks, we will hear from our nation's chief house official, the Secretary of Housing and Urban Development.

Following HUD Secretary Jackson's remarks, we'll call up our first panel, who will share with us their outlook for the U.S. housing market, and the potential impact on financial institutions. That panel will be moderated by CNBC Anchor Maria Bartiromo.

At 10:30, Treasury Secretary Paulson will be here, and share with us his perspective on the current situation in the housing and mortgage markets.

Following Secretary Paulson, we'll take a short break, and come back here at 11:00 for our second panel, who will discuss the current challenges and risks in the home mortgage market. That panel will be moderated by Kathleen Hays of Bloomberg TV.

At about noon, we will have to clear out of this room, to allow the Press Club to set up for lunch, and we'll come back at 12:30 for the luncheon, where we'll have a speaker who is the former FDIC Chairman Bill Seidman, Chief Commentator on CNBC.

Our third panel after lunch begins at 2:00, where we'll discuss some of the critical consumer protection issues in housing finance, including the growing problem of foreclosures. That panel will be moderated by Barbara Rehm, of the American Banker.

Our final panel of the day, beginning at 3:30, will examine the impact of the capital markets on housing finance. That panel will be moderated by Ron Insana, of Insana Capital Partners.

At 4:45, Director Reich will be back to make some closing remarks, and then from 5 to 6:30, we'll have reception for all of the conference participants in the Holman Lounge, right down the hall from the ballroom.

Now, without further adieu, it's my great privilege to introduce the Director of the Office of Thrift Supervision, the Honorable John M. Reich. Director Reich spent the first 23 years of his career as a community banker in Illinois and Florida, including 10 years as President and CEO of the National Bank of Sarasota. He was then persuaded by his good friend, U.S. Senator Connie Mack, to come to Washington and serve on the Senator's staff, which he did for 12 years.

From 1998 to the year 2000, he was Senator Mack's Chiefs of Staff, overseeing all of the Senator's offices and Committee assignments, including the Senate Banking Committee.

In January 2001, Director Reich was appointed a member of the FDIC's Board of Directors, shortly thereafter, he became Vice-Chairman of the FDIC. In August of 2005, he was appointed as Director of OTS, his current position, and in that capacity he remains a member of the FDIC board.

As Director of OTS, John Reich has upgraded and revitalized the Agency, making it one of the premier regulatory agencies in Washington. He's proven to be an extraordinary leader, inspiring me and countless others, to reach for the stars and do the best we can on a daily basis.

During his tenure at both FDIC and OTS, Director Reich has been a tireless advocate for community banks, and a real champion of reg burden relief for the entire industry.

Please join me in welcoming our host, OTS Director John Reich.

[Applause.]

John Reich: Thank you, Claude. Maybe a bit of hyperbole in that introduction. Thank you very much to all of you for being here today, I'm pleased to officially welcome you to the second National Housing Forum sponsored by the Office of Thrift Supervision.

With us today are many CEOs and other senior level representatives from many banks, thrifts, mortgage companies, insurers and security firms, we also have home builders, realtors, leading economists, accountants, banking lawyers, key leadership from Fannie Mae and Freddie Mac and a number of prominent Wall Street executives here today.

We're also honored to have a number of the agency principles, some of them will be here a little bit later this morning, key Congressional staff, distinguished leaders from national consumer and community groups. Finally, there are senior officials from all of the bank and thrift regulatory agencies, as well as from the Department of Housing and Urban Development.

So, welcome to all of you and we appreciate your being here today.

There's almost nothing more fundamental in this country than home ownership. Accessible and affordable housing is a critical building block of communities, large and small. And, the fact is most people are unable to buy a home without a reasonably-priced mortgage at payments that they can afford.

We at OTS have a keen interest in the future of housing in America. Specifically, home mortgages lie at the core of what our agency is all about.

As you may know, thrift institutions supervised by the Office of Thrift Supervision are required by law to keep a majority of their assets in home mortgages and other consumer-related loans.

As Director of OTS, I oversee an agency with more than 1,000 employees, responsible for supervising 830 savings institutions, with total assets of approximately $1.6 trillion.

We also supervise 470 savings and loan holding companies with approximately $8.5 trillion in total domestic assets.

Our institutions, by and large, have done an outstanding job of making the dream of home ownership come true for millions of Americans. In the third quarter of this year, thrift institutions originated nearly one in three mortgage loans in the country. So, the housing sector slowed down and the recent challenges in the credit and mortgage markets, obviously are of great interest to OTS.

That is why we believe that we should, once again, sponsor a National Housing Forum to bring together thought leaders from across a wide spectrum of housing-related organizations, to delve into the most critical housing finance issues facing our nation today.

It would be an understatement to say that much has happened since our last Housing Forum last December. At that time there was considerable uncertainty about the future of the housing sector, a downturn was widely anticipated, but few predicted the major disruptions that we experienced in August of this year.

In fact, many economists and regulators believed problems in the housing sector would largely be contained and have limited impact on the broader economy.

Few expected the problems in the sub-prime market could have such a profound impact, not only domestically, but internationally. Virtually no one foresaw the multi-billion dollar losses recently reported by some of the largest U.S. banks and brokerage houses, or the negative impact that U.S. housing market woes would have on banks in Germany and Japan, among other countries.

Yogi Berra is given credit for saying, "It's tough to make predictions, especially about the future." So, instead of trying to predict the future, let me give you a current snapshot of the housing sector at the end of the third quarter of this year.

Housing starts were down more than 30 percent. New home sales were down almost, excuse me, 23 percent compared to a year ago, and at the end of October, there were 516,0000 new homes for sale, an eight and a half month supply at the current sales rate. Sales of existing homes were down almost 20 percent from a year ago, and were at a 6-year low. The total inventory of unsold homes rose to 4.4 million units. In fact, at the current sales pace, it would take ten and a half months to eliminate the inventory, a record length of time.

A total of more than 635,000 foreclosure filings on more than 446,00 properties were reported nationwide in the third quarter, a 30 percent increase over the second quarter in this year, and a 100 percent increase from the third quarter of last year. These statistics give some indication of the challenge ahead.

For those insights, we will rely on the many experts that are here today. As Claude outlined a few moments ago, our program today will attempt to cover the most significant issues affecting the housing and mortgage markets.

We've assembled an excellent group of speakers and panelists, well-recognized in their own rights as leaders in industry, government and consumer organizations. I hope we'll hear some views that will speak to some of the burning issues of the day, including how deep and long-lasting will the current slowdown in housing be, and what will be the ultimate effects on the broader economy.

How will the mortgage lending business have to change to address the problems that we are currently facing, while assuring the continued availability of credit in the future? How much foreclosure activity do we expect in the next few years, and what steps can be taken to mitigate foreclosure rate? What caused the capital markets to freeze up last summer, and what lessons have we learned from the market downturn?

So we hope you will find this program informative.

And now it's my privilege to introduce our first speaker, the Honorable Alphonso Jackson, Secretary of Housing and Urban Development. In nominating Mr. Jackson as the 13th Secretary of Housing and Urban Development, President Bush called him, "One of America's most experienced and respected authorities on housing."

Secretary Jackson has worked tirelessly at HUD, to increase home ownership, improve public housing, and better serve societies most vulnerable. Please join me in welcoming our nation's top housing official, HUD Secretary Alphonso Jackson.

[Applause.]

Secretary Jackson: Thank you very much, John, for the kind introduction, and good morning, ladies and gentlemen.

I am pleased to open the conference this morning. We met here today with a time of great challenges, in this sub-prime crisis. In my mind, this is a very decisive moment in the economic history of our country. This is a time for our best effort. For us to make a difference, to set the housing market on the most positive course that we can.

We must turn the housing market around, and create greater stability and predictability. We cannot let the descent -- it descent into free-fall at this point in time.

We can really see the effect of the sub-prime crisis in this country on our landscape. The tragedy of losing a home is haunting. Every one foreclosure is a foreclosure too many. We see the jarring impact on our larger economy, and each day we are confronted with the ripple effect of the sub-prime crisis.

Reports out of China, Switzerland, Germany, Finland, shows that the sub-prime market has sent shockwaves through the world economy.

So, this morning we gather here to discuss the topic that is on the minds of millions -- maybe billions, as John said -- of people worldwide. The U.S. housing market must take the lead. And these countries are worried, some are frightened. They see the sour statistics -- higher foreclosures, lower housing starts and lower resale of existing homes. They're suspicious of the news from Wall Street. There is disbelief, second guessing, loss of confidence, lack of trust, and a somber mood. Positive empowerment rates and more consumer income are ignored. Just last week we learned from the Commerce Department that our economy grew a phenomenal almost 5 percent, from July to September.

But that was followed by sad faces predicting the growth will not last. It is as if we simply expect bad news.

The Financial Times put it well last Wednesday, when they said, "Grenades keep going off, and nobody knows what to think, or expect. The fear is of the unknown."

Precisely, that is right. There is fear. You can sense it. And some of the fear is based on changing circumstances, an historic feeling that we can't win.

I've heard some economists talk about the cycle of housing, the spiraling process of good periods followed by bad ones. That the record gains of 2000 to 2005 must generate deeper cuts, and perhaps, many months or years to come, we will have this problem.

Economists talk about the market correction and responsive action. In my mind, they might as well use the word faith or destiny, as if the future was written by the stars. They talk about housing like a Greek tragedy -- that the hammer of the gods have fallen, and the mere mortals, we cannot overcome the power of this physical force, unleashed by the good fortune of the early years. And based on that view, many people wait for further gloom and doom reports. For them, the only question is one of length -- how long must we go?

Frankly, I'm losing patience with that. So have many Americans. People facing foreclosure don't want to be told that they are victims of a cycle, or that their homes are lost because of credit tightening. They don't want to hear that today.

With respect, people want answers, solutions, and they want policy makers and financiers to make sure that we stop it now. They want us to do whatever it takes to prevent it from happening again. They want you and I to be instantly reactive and at the same time proactive, helping to address the current crisis, and avoid repetition of the future.

I know that we can stop many of these projected foreclosures. Let me say this again. We can stop the upcoming foreclosures. We can help end this cycle, perhaps end it quickly.

We have learned a very hard truth about the lending practice in this country. The complex interrelation that stimulates global investment requires a solid foundation, and that begins with the first loan, the loan to purchase a home. Loans themselves must be solidly, must be bedrock.

We know that the favorite housing market attracts lenders, and those lenders attract other lenders, they attract repurchases, and so on. Housing, in my mind, is an investment for the buyer, and for those all alone, the market lending line. So lending practice must be sound, transparent and responsible. We have learned that nothing good comes from predatory lending, or shady lending deals. Ultimately, in my mind, what goes around comes around. Slick and sinister lenders also the bowels by their own questionable, unethical, practical, hurts the whole country. And they hurt people who have invested all of their lives to own a home.

But there must also be understanding. That not all sub-prime loans are problematic. In fact, about 70 percent will not fall into foreclosure, which means that most sub-prime loans contributed to home ownership and wealth creation for many Americans in this country.

But we need to learn the difference between risky, but good loans, and ridiculous and unaffordable loans. The bad loans often came when some lender exploited the homeowner with an impossible repayment burden. Often the bad loans were passed on to secondary lenders, carrying the impossible reset rate like a virus, waiting to infect the process. There's no wonder that the Japanese governor called the sub-prime market, "A serious disease." It must look like that to some people.

And we must not only cure the disease, but vaccinate ourselves against further outbreaks. That is why I believe the role of housing counseling remains prominent in the years to come.

There are more than 2,300 HUD-approved housing counseling centers in this country. They can help the prospective homebuyer determine the loan, whether it's affordable, or not. They can help the homeowner understand the contract, and avoid unavoidable resets.

The sad truth is that many foreclosures could have been avoided on the front, if we had only paid attention to the contract, and greater understanding of the fine print.

The President understood the value of housing counseling, and funding has doubled since he has been President. Earlier this year, I announced $44 million in new housing counseling money -- grant to 400 States and local governments.

The President in this '08 budget has asked for $50 million more. It is my hope that the prospective homebuyer routinely consults counseling as part of the home ownership process. We must also bring stability to the housing market. Let me say that again -- we must also bring stability to the housing market, and the FHA Administration can help us do that.

That was the original role of the FHA in 1934, to help stabilize the real estate market during the Depression. If we can do this, it will break the cycle of foreclosure and price depreciation, and bring much more needed liquidity to a very tight market. As Secretary, I have directed FHA to proactively do as much as possible to help homeowners. But working within the current regulatory authority, FHA has provided refinancing options to tens of thousands of homeowners who are eligible, and face foreclosure, under the current non-FHA limit.

But we need to do more. So, this summer President Bush announced a new initiative, to build on the previous work. It's called FHA Secure. The program is both those who have either a conventional loan, or a sub-prime loan.

Under FHA Secure, borrowers who otherwise were credit-worthy, but who have recently become delinquent in their mortgages, will now be eligible for FHA-backed loans. So families with otherwise strong credit histories, but in default because of the reset of their mortgage, will get help.

We believe wholeheartedly that through FHA Secure, we estimate we can help an additional 80,000 delinquent, yet credit-worthy borrowers, refinance a safe FHA loan. This is in addition to the 160,000 non-delinquent borrowers we already expect to help next year. This would bring the total of new borrowers assisted by FHA existing refinancing programs, FHA secure, to 240,000 families next year.

People understand the value of an option. FHA Secure was announced in September -- two months ago -- and we have already helped more than one -- we've already accepted more than 111,000 applications, and closed on 33,000, to date. The market values of the loans we approved is worth more than $4.2 billion.

This shows, in my mind, the importance of this effort, and how much difference we can make for those facing foreclosure. But we need more than that. We have exhausted all of our administrative actions. We need legislation to help even more people.

So, President Bush has pushed Congress to modernize FHA, a bill that the Administration introduced two years ago. Let me say this emphatically -- we need the new legislation to refinance FHA. We need to help more and more Americans keep their homes. Every day that we delay in passing that legislation, more families are at risk. These families are in danger of losing their homes. Think of what that means to them.

So, I urge Congress and I ask for your help today, to tell Congress to pass the FHA legislation. We have had the House to pass it, it has been sitting in the Senate for too long.

I want to mention one more public/private sector effort called Hope Now. It shows great promise. It's an Alliance of the mortgage industry, national counseling agencies and other investors in the industry associations. At the request of my colleague, Secretary Paulson and I, this group has contacted hundreds of thousands of Americans at risk of losing their homes. The Alliance has set up a hotline for homeowners to call. It's 888-995-HOPE.

This hotline today is up and running in both Spanish and English. Alliance members are working to adopt HUD credit counseling standards, which will help fortify lending practices.

This corporation is yet one more way that can smooth the housing cycle. We must do this, and more. The cumulative effect can shift a market's incentive, provide a smoother housing cycle, vastly reduce the difference between the extreme fluctuation that we see today. In the near future, home ownership should continue to be the bedrock of the economy. The time of affordable loans should never end.

We need to aim for slow, but yet steady growth. We must put in place a process to eliminate the highs and the lows, or at least convince the cycle into something more than predictability, and less severe.

This is a moment for us to be strong, credible, bipartisan, and for global leadership. What we need today is cooperation, statesmanship and visionary action. We must dispel the uncertainty. We must act responsibly and wisely. And in this time, we must look beyond the paradigm, and give people hope.

I believe that what the President has put in place, and with the action of Congress, but especially with your help, we can solve this problem and solve it very quickly.

I leave you with this: What we do in our economy will dictate what happens in the world. Let's do a positive job, and make sure that we come out of this crisis.

Thank you.

[Applause.]

John Reich: Thank you, Secretary Jackson.

You've set the table for us today.

It's my pleasure now to introduce the moderator of our first panel, Maria Bartiromo, the anchor at CNBC. Maria is anchor of CNBC's Closing Bell, and Managing Director of the Wall Street Journal Report, a financial and economic news program. She can be heard on the radio across the country, on Your Money Matters -- also she writes a bi-weekly column in Business Week Magazine, entitled Face Time, and a monthly column in Readers' Digest magazine called MoneyMakers.

Maria is noted for being the first journalist to report live, breaking news from the floor of the New York Stock Exchange. She's also a best-selling author for her book, Use the News - How to Separate the Noise from the Investment Nuggets and Make Money in Any Economy.

She's covered the housing slowdown and current tight credit environment extensively on her CNBC program, and in her Business Week column. It's a pleasure to have her here today to moderate our panel, Outlook for the U.S. Housing market and potential impact on financial institutions.

Maria Bartiromo.

[Applause.]

Maria Bartiromo: Thank you very much. Good morning, everyone, it is good to be here. I'd like to thank the Honorable John Reich, as well as the entire team at the Office of Thrift Supervision for having me, and thank you for coming.

This is an important topic, let's get right to it. On our first panel this morning, we have truly some of the leaders of this industry. As I mention your name, do join me up on stage.

Please welcome Frederick Cannun, Managing Director of Research at Keefe, Bruyette & Woods, Angelo Mozilo, Chairman and CEO of Countrywide Financial, Robert Toll, Chairman and CEO of Toll Brothers, and Dr. Mark Zandi, Co-founder and Chief Economist, Moody's Economy.com.

[Applause.]

Maria Bartiromo: Well, we heard the statistics just a few moments ago of what's going on in the business. Why don't I kick it off -- and I hope we can be as conversational as possible, so if you hear something that some of your colleagues on the panel -- if you agree with, you disagree with, please jump right in so we can have a conversation.

We do have microphones in the audience, so please do get some questions ready, because I'm hoping to come to all of you to also participate in the conversation.

Let me kick it off as the status of where we are right now, Angelo? Give us a status check, where are we in this cycle of slowdown for housing?

Angelo Mozilo: I don't know why you'd pick on me first, Maria --

Maria Bartiromo: Well, you're the leader.
Angelo Mozilo: Yeah.

I think the Secretary laid out a good portion of the issues, but I do -- I don't know where we are in the cycle, I wish I did. The -- but I think we're dealing primarily with the results -- I think, I hope now is a very important initiative, I think all the initiatives are very important to avoid foreclosures, but I think we're dealing, clearly, with the results, and not with the cause, nobody's addressing the cause, and that's what has to be addressed, ultimately, and that's the fact that values of homes continue to go down, and as they go down, the problem gets exacerbated. And until we stop that cycle, we'll continuously deal with this break in the dam.

And the cause of the deterioration in values is a lack of liquidity. You'll hear that throughout this whole, I'm sure, the capital and liquidity. But liquidity, primarily. I mean, we're at the forefront, we deal with the mortgagor, it's very difficult to get financing today to buy a home, unless you're in with the Freddie/Fannie limits, and many areas of the country are beyond that. So, the cycle, the major cycle is house price deterioration.

And, it's interesting to me -- and then I'll stop talking -- but it's interesting to me that we had none of these problems while values were going up. We were making these loans for 5 or 6 or 7 years -- no problems, no delinquencies, no foreclosures -- same loans. But values were going up, and people were able to work their way out of a problem, either through refinance or selling the home, you know, they had equity.

Once their equity was gone, then the problems were exposed, and that led to a whole series of actions, including lack of liquidity in the secondary market, cutoff liquidity in the secondary market, and the only available liquidity being Fannie and Freddie. And so, that's the issue that has to be addressed, and that's a very complex one.

The one we're dealing with today in terms of resets, and how we deal with resets is relatively easy. That can be done, and will be done. It's how do we stop it. And you have to get the inventories, that the Secretary talked about, were huge inventories of homes that have to be purchased. And there has to be liquidity for people to go out there and purchase.

And that's the problem, as I see it.

Maria Bartiromo: Robert Toll, how do you see it?

Robert Toll: I don't see it as a liquidity crisis, because the reality is, we had a housing crisis long before we had this sub-prime debacle and so-called liquidity crisis. The housing market went bad with Katrina '05. I don't know what the connection is, necessarily, but I can make it up.

[Laughter.]

Robert Toll: But so can you -- lack of confidence, we saw ourselves as incapable, and like Bangladesh in a storm -- people floating upside down, and the government couldn't do anything about it. And too many people went to the window at the same time and said, you know what? Cash these.

Of course, you had no housing crisis when housing prices are going up, how could you? If you can't afford to pay the mortgage, sell the house, take the profit, go buy another one and keep on rolling. The problem was that it became too easy, we had mortgages available to the alive and standing –

[Laughter.]

Robert Toll: And those were about the only criteria, again, why not? Because if a guy can't pay the mortgage, he's going to sell the house for more money, and we'll keep on rolling. So, it was good times. We had probably 15 to 20 percent -- that's not a lot -- 15 to 20 percent more demand in the market than under an owner-occupied situation, circumstance.

When they went to the window, not only did they stop demanding, they started supplying. So, if you've got 15 to 20 stopping in demand and adding to supply, you've got all of a sudden 30 to 40 percent -- now that's a big number -- differential in the market.

And what happened was, that hit us like a ton of bricks, housing prices started to fall, and they may not have stopped falling yet, certainly, I'm going to say that this is the best time to buy a home -- you've got sellers on the ropes, and buyers so reticent, you're going to kick yourselves for not scooping up all of those condos in Florida --

[Laughter.]

Robert Toll: But that's for another time.

I think we can do a lot to help ourselves out of the situation. You know, once upon a time we passed speeding limits, and everybody said, "This is un-American, to tell me that I can't rev it up in the Southwest and do 100 miles an hour," or in Maine do 75 or 80 -- but we learned to live with it, double nickel speeding limits for a long time, to conserve energy -- maybe we ought to re-think that -- and to conserve lives.

There's no reason why we can't set limits to how we originate these loans, so that we don't get caught with people that can't possibly pay, other than by selling out of an investment that goes up, because, as we know, they don't always go up.

And so, I would urge that the legislation be carefully drawn, and that regulation be put in place, very carefully, so as to set limits -- not guidelines, but limits -- so that you can't negative am a home. So that you can't teaser 2, 4, 6, 8, who do we appreciate –

[Laughter.]

Robert Toll: And so on and so forth. And, I think through a decent amount of study in the Senate and in the House, we can get ourself some regulation so that we learn from this, and prevent it from happening again. We're not going to make it go away, it's happened. There's the Right of Contract out there, there's lenders, and you can't just say you're going to take the hit.

I mean, you know, why pick on the poor sap in Germany who bought a bond that's backed by a bond, that's backed by a bond, that has to do with a schlub who bought a house for a 1 percent interest rate, and then he goes to 8, and the house has now dropped by 20 percent in value -- why can't the German investor get out of that situation, why does he have to support the poor fellow that bought the house that was teased into it.

Now, we can't regulate used car salesmen, we're not going to regulate originators, but what we can regulate is how fast the car can go, and what the originator can put on the books.

Maria Bartiromo: And, of course we want to get to solutions, we do want to hear your thoughts at some point about what you know about the Treasury plan to freeze certain mortgage rates, we'll get to that in a minute, but Frederick Cannun, you've studied this industry for a long time -- what is your expectation of the resets happening over the next year, and their impact on the broader economy?

Frederick Cannun: Well, the sub-prime reset issue is certainly a piece of the issue, as was mentioned earlier. But, I think it's important to recognize it's just one piece of a broader issue. It we look at -- let's just, before we talk just about the resets, it's important to recognize a number of people who won't be helped by the resets.

For example, at the end of June, already 20 percent of sub-prime loans were either delinquent or in foreclosure. Helping with the reset problem won't help those people.

We know that a large share of the sub-prime loans were actually made to investors, rather than homeowners. That's not set up to help those people.

So, we do believe there's a number of individuals, and certainly as a positive that we can help address the reset issue, but I think it's very important for everyone listening to know, this problem is much deeper than the sub-prime reset issue. We saw just two weeks ago, Wells Fargo announced an 8.5 percent loss on a pool of prime home equity loans. That has nothing to do with the reset issue. So, we're seeing losses spread broadly.

And, as we look out, I think it's important to recognize some of the things that were already said, I think, especially by Angelo, and that is that the real issue underlying this is home prices are down.

We had years of, what I call, asset-backed lending, rather than income-backed lending, and because of that, we've got a situation that's going to play itself out over an extended period of time, and investors globally don't really know what to buy, or how much to price these assets, because home prices are falling at an accelerating rate, and we really don't know the number of defaults that are going to be out there. So, as a result, we have to get through a pretty difficult time to find a bottom. Addressing the reset issue is just one part of an overall, everything that needs to be addressed here.

Maria Bartiromo: So, how do you get through that? How do you operate in an environment where you really don't know what the securities are valued at?

Frederick Cannun: It's tough. I think that one of the challenges we find right now is that's essentially what makes it tough. What we have to have is we have to have some investors willing to step in, into the market, to value those securities. But, really what we need to have is something that was mentioned by both of the gentlemen earlier, and that's really what we have to have people start stepping into buying houses. Because until we find that bottom in home prices, it's going to be very difficult to truly value these securities.

Maria Bartiromo: Mark Zandi, how do you see things, and do you see this market bottoming out, that perhaps would lure homebuyers in?

Dr. Mark Zandi: Well, we have, I bought a home in Florida, I think I caught the falling knife, though.

Maria Bartiromo: So did I.

[Laughter.]

Dr. Mark Zandi: Well, the housing market peaked two years ago, over two years ago, I think it has at least another year to decline. I'm a numbers guy, so I'll give you some numbers.

Home sales peaked at 8.5 million units in the summer of '05, they're now running five and three-quarter million units, I think they'll bottom out at about 5 million units, early in '08, the Spring of '08.

Starts, they peaked at two and a quarter million units in the Spring of '06, they're now running one and a quarter million, they'll be below a million, I think, but the summer of next year.

In terms of prices, they peaked a little over a year ago on the Kay Schuller, they're down about 7 percent. I'd be surprised if we're halfway done. Somewhere about 15 percent effective declines after non-price discounts, at least 15 percent. And they won't bottom out until the end of '08, probably early '09.

And that forecast assumes no recession, that we avoid recession, which I think is a significant threat -- the economy is probably contracting at the moment.

It assumes more interest rate cuts, the Federal Reserve cuts rates, so 4.5 percent funds rate, at least 4 percent funds rate, not 4.5. And, it assumes a significant amount of loan modification effort success that, so far it's been very bad. According to Moody's, through July the modification rate -- I don't believe it, but they said 1 percent, but that kind of gives you the sense of the effort so far.

We'll need to see something somewhere between 20 and 30 percent modification effort in '08 to get to my forecast. If any of those things don't happen, if we have a weaker economy, a recessionary economy, if the Fed doesn't become aggressive. If the modification efforts do not pick up significantly, I think it's at least through the end of the decade, and the declines would be much more severe.

Angelo Mozilo: What was the denominator? In terms of, 1 percent of what?

Dr. Mark Zandi: That, 1 percent of all the loans that came up for a reset in -- between –

Angelo Mozilo: Sub-prime or all loans?

Dr. Mark Zandi: All loans between January and July of '07, 1 percent had some kind of modification.

Angelo Mozilo: That's probably right, I'm -- I just, if I could make a couple -- I'm going to stick to my position with all due respect to Bob, who I love -- that there is a liquidity crisis. And it's in the secondary market, you really can't -- there's no secondary market. And that really has been historically very important in mortgage finance, having a very liquid secondary market, long before sub-prime. Jenny Mae started that, but we've had a very viable market since the 70's, and we don't have that market any more, and I think that's essential.

Secondly -- so we do -- liquidity is both on the back end and on the front end, for the mortgagor to buy a home, that's one of the reasons why the values continue to go down, because there's two aspects to it -- one, it's very difficult for people to get financing in high-cost states, if not impossible, but also it's psychology of the falling knife. The psychology of the borrower today is, "Look, rates still have to go down lower, and prices still have to go down lower," until you change that psychology, you're going to have this trend, and what can change it is a momentum of people getting, where Bob wants people to go out and buy homes today. And, you need lower rates to do that, but you need a more active, with all due respect to a fail, we need a much more active Fannie and Freddie, with higher loan limits, and taking the cap off of their balance sheets, so the can participate. But it needs a start.

Robert Toll: I'll vote for that.

Angelo Mozilo: Will ya? Good, thanks. Thanks, Bob.

Robert Toll: I didn't say we don't have a liquidity crisis, what I said was, the crisis doesn't come from a liquidity crisis, the crisis comes from the crisis which began at least a year and a quarter, maybe a year in a half before you even saw the cracks in the liquidity chain. So, we know that one of those things to fix it is to overcome the liquidity crisis we have. But in order to get it fixed, to learn from the problems we have now, we can't just fix the liquidity, we have to go to the origination, the beginning.

Angelo Mozilo: Yeah, I think the origination is self-curing, because most originations are gone, originators are gone, and those who are left know why they're gone, so that's, I think, a self-curing process.

That's going to be the problem, is that people are just not going to make these loans any more, because of reputational risks, and that's going to hurt a lot of people. But, I do think we just need to jump start it, because I just wanted to --

Dr. Mark Zandi: I can reconcile the debate.

[Laughter.]

Dr. Mark Zandi: That's what economists do.

Most fundamentally, it's inventory. There's just too much of it. The homeowner vacancy rate is 2.6 percent between 1985 and 2005, it was 1.6 percent. That translates into 2 to 2.5 million unsold, vacant homes. That's just swamping the market, it's why house prices are falling, that's why mortgage credit quality is eroding, and why the mortgage securities market is completely shut down, is a mess.

Now, the liquidity problem is exacerbating the inventory problem -- inventories are going to increase before they actually improve, and the only way you get the market going is two-fold: One, you cut construction, significantly -- you've got too much inventory, how do you fix an inventory problem? You reduce supply and you increase demand. So, you cut construction, massively. We're going to have to go well below a million units for an extended period -- and you cut price. Because that will improve affordability, it'll bring in those investors, and it will stimulate demand, and therefore you need both of those things in a very significant way.

That's why the housing downturn is going to be very severe over the next 3, 6, 9 months -- it's happening now. The most positive development is that the psychology in the marketplace has shifted, which is very important. It's capitulation, people do not realize -- the builders realize, the lenders realize, the sellers realize, if they hold on this is going to get worse, so they're cutting price, they're cutting construction, and so we're going to see a very severe downdraft in the next 3, 6, 9 months.

Maria Bartiromo: So, we're talking about two different issues here, really, liquidity versus or as well as the decline in housing.

Let me just talk a little about liquidity for a minute. What caused the credit markets to freeze?

Angelo?

Angelo Mozilo: The secondary markets, I think probably go back to when Moody's S&P downgraded bonds that investors were holding, they thought they were holding triple A bonds, and suddenly they're holding something substantially less than that. And that froze that sector -- the total loss of confidence in these securities, that were traunched -- as Bob points out, there were lots of traunches in these securities -- but they were rated by S&P and S&P said, "Look, you know, I was just testing your sense of humor, I'm coming back and am going to re-rate downgrade them," --

[Laughter.]

Angelo Mozilo: And people said, "What are you talking about?" And so, that total loss of confidence by the providers of capital to that market said, "That's it. We're not touching that stuff anymore," and that's always overdone. And I think that was the -- at least to me, that's the thing that comes to mind, maybe the good doctor has a different view of it.

Dr. Mark Zandi: Well, you know, I'm from Moody's, but I want you to know it's not my fault.

[Laughter.]

Angelo Mozilo: It never is.

Dr. Mark Zandi: I sold my company to Moody's two years ago, and it's been a great experience, and they are now using my house price forecast, so you can all be assured going forward we're in good shape. We're in good shape, very good shape.

Maria Bartiromo: What kind of responsibility, though, should be held with the Moody's and S&Ps of the world. The ratings agencies clearly missed the boat on this.

Dr. Mark Zandi: Let me just preface my answer by saying, I am not part of the ratings agency, I am an independent subsidiary.

Maria Bartiromo: Understood.

Dr. Mark Zandi: But I observed this pretty closely, and I'll say three things. One, they got it wrong, but so did everyone else in this room -- pretty much everybody else in this room, they're not alone. I would say this is the most serious housing downturn since the Great Depression, so this is your 1 in 100 year event, so this is a very special kind of period, so we all missed it.

Two, you know, I think it's easy to say

mortgage quality is going to erode -- that's pretty obvious, when house prices are falling, and you see the underwriting standards. It's very difficult to pick a security and say, "That traunch of that security should be downgraded." That's a process that takes time, you need information -- you can't do it overnight, it takes a period to gather the information, and to be right into reinforce that point, if you're wrong in your assessment of the market, you don't want to be wrong in downgrading the bonds, because as Angelo pointed out, it just exacerbates the problems in the marketplace, so you want to be absolutely sure that what you're doing is appropriate. So, that also argues for caution, and to be deliberate in any decision that you make.

And then, third, there's obviously there should be changes. The ratings process is changing, they've adopted my house price forecast, that's a change. So, you know, I think that's very important. And also, they're developing new tools to understand the impact of liquidity on credit, because I think as Angelo is pointing out, that credit quality probably would have eroded, regardless, but it wouldn't have eroded to the degree that it is, if we didn't have this liquidity problem and the consequent impact on housing demand, and the downdraft in prices.

Frederick Cannun: Mark, just following up on that liquidity issue, I mean, one of those things looking back, of course, is all lending became -- at least for the companies that I've talked to, asset-based, home-price based, rather than income-based, largely.

Now, one of those things looking forward, and obviously, depending on what your home price forecast has been three years ago, it might have been different, it might not have been different -- but right now there's a second liquidity issue, and the liquidity issue is, is that home lenders are tightening up, quickly. Doesn't that just add to the liquidity challenges that we face, as a home owner tightens up, and what does that mean for the consumer, moving forward?

Dr. Mark Zandi: No, it's all now self-reinforcing, right? We're now in this self-reinforcing, negative dynamic where house prices beget credit problems, which undermine the values of the securities, which beget rating downgrades, which begets a lack of liquidity in the marketplace, which causes lenders to tighten up, which causes demand to weaken, which causes prices -- and you're off and running.

And now adding to this cycle is that we're throwing the economy into the mess, it's now bleeding out. It's affecting consumer spending, and it will measurably more so as we make our way into next year, so now we're going to -- weakening job market -- and all of this is actually, most severe in very specific parts of the country: California, where Angelo is, Florida, where I bought that home too early, Arizona, Nevada, D.C., the industrial Mid-West.

In fact, if you add up all of the mortgages that back Alt-A and sub-prime securitized loans, they could for well over one-half of all of the securities outstanding. So, it's California, Florida -- and those economies are now in recession. So when you throw the economy into the mix, we're now in a very significant, self-reinforcing negative dynamic.

Maria Bartiromo: Angelo, you say the market needs a jump start. Let's talk about the Treasury plan, here, to freeze up certain mortgage rates -- will you buy into that? Do you like the plan?

Angelo Mozilo: Yeah, I think, we gave birth to the plan, to some extent. I mean, we were a contributor to it, we announced two weeks ago, a $16 billion initiative to -- on all sub-prime loans where reset is taking place, that if we determine that they can't afford the reset, we will keep them at their existing rate for three to five years, until their income catches up. And we have -- we've worked with the security holders to work that out. We've done about 55 or 60,000 so far this year, we'll end up the year at about 75,000 of these loans, and we'll continue to do it until we've worked through the entire book of business, or until something else changes.

But, I agree, I mean, we're in a terrible cycle here, and it's a question of how you get out of it, and my issue is the jump start, and I'll stay on this, because it's the only time I'll have the forum, is to -- you know, I think Fannie has to play a major role here, Fannie and Freddie, and FHA, and I think FHA is trying to do their best with what they have to work with.

I'm about the only one, I think the only one at this table who continues to take loan applications. And, so I reflect -- because I agree, it took a village to get where we are, it's not Moody's alone, it's not lenders alone, it's mortgagors -- the reason why I say I take loan applications, is because I ask the borrower to, what kind of loan they want, if they're going to live in a house for three years, and there's a normal yield curve, they're not going to live 30 years in the house, and they want a lower rate, they select the lower rate, and therefore the three year, thinking they'll only be there for three years.

So, I would be opposed to going back to 55 miles an hour -- I bought my new car, anyways. America is about choice, and I think that it's very important that we keep as many choices for the consumer, not assume that consumers are stupid, and as many choice as possible for them, as long as the loans are underwritten responsibly.

Robert Toll: Isn't that the key on the written response?

Angelo Mozilo: Yeah, but not taking away -- and I agree, I agree with that, absolutely agree with that. But I don't -- I'm against taking away options for people to buy homes, because I think it does two things: One, I think it hurts the market, but secondly, it doesn't give the consumer what they want or what they need in their particular situation.

The problem that we're having now -- everything else being stable, if we had liquidity is that the -- the reason why people go delinquent is, for only three reasons. One is loss of health, loss of marriage, loss of job. Those are the only three reasons. People don't wake up in the morning and say, "My house is worthless -- "

Robert Toll: And a loss of asset, why not?

Angelo Mozilo: No. Texas proved that, back in the eighties, they do not. If the value of the asset goes down below the mortgage, it doesn't make for great cocktail conversation, no question about it, they don't like that. But they will not leave their home -- this is a home, it's not a house -- it's churches, it's schools --

Robert Toll: You're assuming they're owner-occupied.

Angelo Mozilo: Yeah, they're owner-occupied. I'm not talking about spec, I'm not talking about the investors that got into the game here –

Robert Toll: There's a huge amount of that.

Angelo Mozilo: No question there's a huge amount of that, but I'm talking about the -- and of course, that's all gone now, as a result of it. Any lender -- no lender can afford to do those loans again.

So, we're trying to say, "What are we going to do going forward?" And we do need, you know, we need a viable secondary market -- I don't know when that's coming back. Because, I think that holders of those securities who got screwed are going to say, "I'm going to do this again." Something's going to have to happen to get them, to give them a confidence to go back, and take in mortgage-backed securities.

Something will happen, it'll be in a different form, but I think that we've got a way to go there. I think the, again, the jump start is going to have to be done through government agencies, as it was during the Depression.

Fannie was created in '34 when HUD was created, for this same purpose. This is a time they have to step up to the plate and take action, and try to create liquidity in the market.

Maria Bartiromo: We've already seen some regulation loosened, how much more do you want in terms of Freddie and Fannie and what about the Fed -- is it, across the table, are we all expecting the Fed to be very aggressive here in the next year?

Frederick Cannun: I guess, speaking from my viewpoint, in terms of Fannie and Freddie, I think there's two issues: There's one, is having them act, as I think Angelo was talking about, the second is ensuring the strength and stability of the organization. I have to say from my perspective, as an analyst who covers Fannie and Freddie, I've actually been quite pleased with the controls and the strength of the regulator on this issue, to make sure that it's responsible, in terms of moving forward, especially given the kind of results that we've seen in the most recent releases we've seen for both of them.

Maria Bartiromo: Angelo?

Angelo Mozilo: I think that I come from a different place. I'm not an analyst, I provide mortgage finance. Countrywide has been, for 40 years, about providing people an opportunity for the American Dream, so I come from a totally different place. And I think that -- I don't think there's a conflict between being safe and sound, and playing a greater role in this marketplace. I don't think they're mutually exclusive at all, and so I just think it's very, very important at that point in time for Fannie and Freddie to step up to the plate, for the regulators to step up to the plate and make a difference.

I think it's the only way out of this thing, to shorten this cycle. Otherwise, it's going to be prolonged and very, very painful, and it shouldn't be. People shouldn't be suffering the way they're suffering today.

Maria Bartiromo: And the question on the Fed -- everybody thinks the Fed is going to be very aggressive in the next year? What are your thoughts? Let's go down the table, Mark?

Dr. Mark Zandi: Yeah, I think they'll have to be very aggressive. The futures market are anticipating 3.5 percent funds rate target, and I wouldn't argue with that, I mean, it sounds reasonable to me. So, I think the Federal Reserve will have to be, in part because the efficacy of the monetary policy has been short-circuited by the housing problems. I mean, the most direct link between monetary policy and the real economy is through housing -- at least the most quickest direct route -- and that's now short-circuited because of the breakdown of the securities market, and so you'll have to press, I think, even more to get a little bit more juice into the economy.

But, let me just say on policy, you know, I agree with Angelo, I think Fannie and Freddie -- and I'm surprised we haven't moved on this more quickly, it was a mistake not to 3, 6 months ago. They're the only way to get credit into markets like California -- 85 percent of all loans in the very of California are non-conforming, and so Fannie plays no role there, so -- and Florida -- and I think that's vital.

Now there are current financial problems that are an issue, and I don't know how that plays into allowing them to become a little less fettered, but I think, seriously think about that.

The Treasury Secretary's plan is excellent, except, you know, this is a pretty -- it's easy to say in theory, it's very difficult to implement in practice, because these -- identifying the kind of borrower you want to help is going to be very, very difficult, I think. And actually have the servicers up and running to implement this is going to be difficult, very quickly.

So, I'm going to romance the ball with two other proposals. One is, there's a proposal in Congress to allow for cram downs for first mortgages in Chapter 13. I think that's a great idea. I think that's very important to get passed. If the Treasury plan doesn't work, then this will allow homeowners to use 13 as a way to hold onto their homes.

And then finally, I'm not saying that we should do this, but I think we should start thinking about this, is that the Federal government may want to think about some RTC-type fund, just in case liquidity doesn't come, and we've got something in place 3, 6, 9 months down the road, the Federal government can step in, like many State governments are doing, already, and provide it on a bigger scale, and step in and provide liquidity into the marketplace.

Maria Bartiromo: Robert, what do you think? First on the Fed, and then comment on Mark's ideas.

Robert Toll: The Feds are, I think, obviously behind the curve, the market speaks for itself. I think the bond rates are a point underneath where the Fed is, if not more. The Fed didn't plan it this way, but there it is, the market speaks now, loud and clear, and they're going to have to get into line, and of course, they're going to want to, too, because we see the economy -- notwithstanding the stats that we heard this morning -- tanking.

And the Fed will do whatever it has to do to prevent that tank from taking the ship down. And that is the Feds job, so I don't think we have any problem there, I think the Fed is going to lower rates. Fannie and Freddie -- limits of 417 can help the high price regions, so you've got to get those limits raised, Fannie and Freddie, that can be done fairly quickly, and I think Fannie and Freddie are probably the best way out of the liquidity crisis for us.

With respect to cram downs, respectfully, I disagree. The key to this business is liquidity in the secondary market. There is no chance that we're going back to a system where the S&Ls give mortgages. We're going to have to live with financing in the mortgage market coming from the secondary finance sector, and if you're going to have the secondary market back mortgages, you're going to have to make those mortgages more sound.

You can't wish for the market to reassert itself. You can't wish, respectfully, for the providers to worry about their reputation. You can't wish that S&P

and Moody's are going to do a better job, especially in light of the comment that -- to some extent -- they had to worry about their impact, which has a tie to it that we don't want to hear.

What we're going to have to wish for is that what goes into those secondary bonds, I mean, goes into the secondary market, is credit worthy. And you won't get it from an investigation by Moody's and S&P because frankly, the packages are too difficult. So what you're going to have to count on is that we -- with the incentive, commission-based system that we're on -- everybody's on Commission -- from the house salesman, to the originator and -- to some extent -- even the home buyer. I mean, he walked in and said, "I want an 80 percent, 30-year mortgage," and the mortgage originator said, "Fine, let's do the paperwork." And then he's got his client sitting before him, and he says, "You know what? Why do an 80/20? I can get you a 90/10, you can have lower payments," and so on and so forth until he's finally got this guy on 100 percent, and he's busted his credit rating, but he's still at a relatively decent spot, and it helps us because, what happens is, the salesman says, "Now we can buy more home for the same amount." And it goes on to the house, that flips him into the secondary market, and it goes on to the secondary market -- everybody's working on Commission, and they will forever.

So, I don't see a way of righting the problem, until you get into limits as to what you're going to be able to put into these pools before they sell. Otherwise, if you lose a secondary market, you're in a big problem.

I think the market, by the way, can turn around quicker and faster than anybody thinks it can. The stats, I believe, are wrong. We're being told by Census, who develops the stats, that 700,000 homes, annualized, are being built. I called them, I said, "Where do you get your info from? My brothers are down by 50 percent." I said, "What number do you have for cancellations?" Are you ready? "We don't use cancellations." I said, "What do you mean, you don't use cancellations? There's 33, 35 percent cancellations in the market. Well, we believe that that stat will right itself when we go to the other side --

Dr. Mark Zandi: That's new home sales data --

Robert Toll: Right.

Dr. Mark Zandi: But the housing starts data --

Robert Toll: No, I'm talking new --

Dr. Mark Zandi: -- which is what really matters, that's rock-solid. That's -- you put a foundation in the ground, and they count it.

Robert Toll: Right. No, I'm talking about new home sales.

Dr. Mark Zandi: Right.

Robert Toll: They're saying that you've got 700,000 annualized --

Dr. Mark Zandi: Right. Right.

Robert Toll: -- in new home sales. If they're not deducting the 35 percent, you're down to 500,000 in new home sales.

Dr. Mark Zandi: The market's worse, is what you're saying.

Robert Toll: So, the end is -- right. Well, but, but also the inventory, because new home sales guides the inventory -- the inventory's being shrunk –

Dr. Mark Zandi: No, no, well, that does

Robert Toll: We see it.

Dr. Mark Zandi: Not -- the 2.7 percent homeowner vacancy rate is a completely independent survey, done by Census -- it has nothing to do with the new home sales data. It's a survey done of the stock.

Robert Toll: The builders are building for sales, they're not building for speculation. And if you don't have the sales, you don't have the building. And if you don't have the building, your inventory will shrink, because simply, it's not being added to. While the wealth creation didn't go away, immigration didn't go away, job loss is not that terrible. So, I think we may see a turnaround faster than anybody imagines.

Maria Bartiromo: What's your timing on that? What kind of a turnaround would you expect, in what timeframe? When would you expect things to bottom?

Robert Toll: I wouldn't expect to see things turn until we start to engage in a debate -- a political debate, a Presidential debate about how great the country is, and what America stands for, and how we're going to be moving again -- so until the focus comes off of the negative side of the political arena, and shifts to the positive side, which you will get once you get candidates starting to pitch to an electorate, as opposed to candidates starting to pitch, I mean, now pitching at one another.

Unless we get off of the focus as to how bad things are, I don't think you'll see a turnaround. So, I think the earliest it will be is once the Presidential debate starts to talk about the future of the country, as opposed to the past. It may even take as long as an inauguration, and some positive moves. That bully pulpit has got to be used to turn the country around.

Dr. Mark Zandi: You know, if history is any guide, and we could use California as a good guide, New England as a good guide, markets -- housing market corrections, they last a long time. Not that prices and starts and sales have to continue to decline --

Robert Toll: That's true.

Dr. Mark Zandi: But they stay at a bottom for a long time -- 3, 5 years, and I think given the shift in the psychology in this marketplace, the investor is completely evaporating, and is not coming back until we get a new generation that forgot what mistakes we made -- this could go on well into the next decade, that we're not going to go back to what we think are normal levels of sales, construction and price growth until we're well into the next decade.

Angelo Mozilo: Yeah, I generally agree with that. If I could make a couple of points. One is I just, Secretary Paulson will be speaking here about Hope Now and I do, I want to make sure that you understand from my viewpoint that I consider it a very important initiative, and that's why Countrywide is a major part of that initiative. I think we all have to, since we all played a role in creating the problem, we all have to play a role in trying to resolve the problem, and nobody sit back and continue blaming everybody else for it. We all have responsibility for it, and I think what the Secretary has done has been quite courageous in coming forth and trying to get all of the lenders together and work on this Hope Now program, and working on resets, and trying to avoid foreclosures and mitigate delinquencies. And so I think it's very important that he continue pushing that initiative, and I guarantee at Countrywide, we'll play a major role.

The other -- and I agree with everything that's been said here in terms of the market turnaround, it will take a long time to resolve this problem, it took a long time to get there, and these markets don't come back quickly.

And one of the problems that we have is in growing the balance sheets -- we talk about thrifts making loans, making these loans -- you can't grow your balance sheet, because not only has liquidity come out of the mortgage market, liquidity has come out of the market, period. We can't -- Countrywide, which operated off of medium-term notes and commercial paper for 40 years, has no access to commercial paper, no access to medium-term notes. There's been a fundamental structural change in the financial services business. And the only way you can make loans is either you -- they're agency loans, FHA, VA, Fannie, Freddie, or you put them on your balance sheet which you can't get access to capital, because confidence has not only been lost in the mortgage business, it's been lost in the mortgage sector.

And so, getting capital put into the banking sector, getting capital to be placed in the banks, has been very difficult, and you can't grow your balance sheet without capital. So, it's a capital and liquidity problem. It is a global issue, and very broad in its scope. So, we're talking about a narrow, very important part of it, or a narrow part of it, the consumer, and trying to get them, help them out, and trying to stimulate sales, but the whole financial industry has been materially impacted for a long period of time, there's a question, how are you going to get capital and liquidity back into the market so we can achieve what we want to achieve -- get rid of inventory and get, and have the average American have access to a mortgage in California, in New England, in high-cost areas. It's a complex issue.

Frederick Cannun: Angelo, don't we have to be a bit careful what we ask for in terms of liquidity? If we see liquidity come in at a very low level, isn't that a high risk? I mean, we saw the E-trade deal last week at 27 cents on the dollar, some people are trying to apply broadly -- I mean, if we see liquidity come back, aren't we in danger of marks that can create all kinds of issues for the financial services sector?

Angelo Mozilo: Well, I think you've got to take what the market gives you, and I'd rather be breathing than dead --

[Laughter.]

Angelo Mozilo: So, I just don't know if you can orchestrate it, Fred, that carefully. I mean, I'd love to be able to orchestrate it carefully, we're going to be faced with this marks issue in any event, because most of the investment bankers have to start marking their book, so we're going to have not a marked in med, but a market very shortly, and it is going to be what it is, and it's going to be very, very painful. But, I think we just have to go through this painful period to get to the other side, I don't think there's any way to get to the other side without going through some pain.

Maria Bartiromo: As far as the fundamental changes, is the originate and sell business model still viable?

Angelo Mozilo: Originate and sell in the secondary market? No, it's not a viable model, unless it's an agency -- Joe, I'm not really picking on you, Joe, a lot -- but you are a major factor here. In fact, you're such a major factor -- just take it back -- I'm an old guy, I've been around a long time, I've been doing this since I was 14 years old.

About 1967, 1968 -- I'm off maybe a year or so -- there was total disintermediation in the secondary market which, at that time, was savings banks -- they had zero dollars. And they reneged on every commitment, and there was no place to sell an FHA or VA loan that year. And every single FHA and VA that was originated was purchase by Fannie Mae, Fannie Mae stepped up and said, "We will by every single FHA and VA loan originated in the United States," and they did. They stepped up to the plate, and immediately created -- within 14 or 15 months, the market came back. Without that, it was over. There was just no way you could originate a loan.

Okay, what was your question?
[Laughter.]

Maria Bartiromo: I think you answered it.
Treasury Secretary Paulson will be up in a few minutes, but let's open it up briefly for some questions. Yes, sir?

Burt Healy: Burt Healy, for the record. There's been some intimations in the Treasury proposal as it's come out so far that it might go beyond strictly voluntary action within the parameters of existing, servicing contracts, and securitization contracts, and possibly mandate some pass-through of losses to investors that are outside of the current limits of the contracts that are now in place.

If that were to happen, what would be the impact of such an action on the competitiveness of U.S. capital markets, and the willingness of foreign investors to buy any type of U.S. mortgage-related investment if, in effect, an after-the-fact change in contract terms?

Angelo Mozilo: What would logic dictate to you would happen? If you're holding a security that you're supposed to get 100 percent, 100 cents on the dollar because you paid that, and somebody forces down your throat the fact that you're going to get 70 cents on the dollar, would you buy again?

Burt Healy: No. But, I'm interested in what you -- I mean, that's my thought, but I'm interested in what you all --

Angelo Mozilo: Well, I happen to agree with you.

Maria Bartiromo: Thank you, sir.
Yes, sir?

Mike Rehart: Mike Rehart, I cover the homebuilding and building product companies for J.P. Morgan equity research. A couple of words that I haven't heard today, yet, so far, is "no-doc" and "low-doc" and I was wondering if Mr. Mozilo could address -- as he's been in the middle of some of the negotiations right now -- you know, aside from reset or loan modification. What talk has there been in terms of applying new standards towards actual loan origination, you know, so that I think as HUD Secretary Jackson said earlier, the integrity of the model can be improved?

Maria Bartiromo: Angelo, we all know that the market went over the top in terms of easy lending, you yourself have spoken about how the industry is at fault, partly, for this -- what is the talk about new standards?

Angelo Mozilo: Well, I don't know if there's collective talk, maybe Jonathon Kempler can talk more about that, what the industry is doing collectively, we're not participating in that, to my knowledge, but I would say, again -- I come from the old school -- so that whole "no-doc" and Nina and SESA and all that nonsense that went you, you know, was a concept that was hard to understand, but you know, the world changes, things improve, there is technology, there are other ways to find out information, rather than get the old verification of employment, verification of deposit, all the other stuff that we used to get. And so, I think there is some middle ground.

But a no-doc, stated-income concept, I'm absolutely opposed to, I think that it's bad stuff, and that's why you don't hear it anymore, because lenders are just not going to do it. It's just nothing but trouble.

There's a reason why someone wants to give you a stated income, right? They're lying. Otherwise they'd give you a piece of paper, what the truth is. So, there's major changes have to be made there, if they had not already been made. Within Countrywide there has been major changes.

Maria Bartiromo: So, what happened, just like the dot com boom, everybody just didn't realize what they were doing, "Yeah, you can have a home -- "?

Angelo Mozilo: It's very hard to see a bubble in the United States, it's very hard to see, Maria, it's very hard to see a bubble forming, and you've seen -- get back to tulip graze -- it's very hard to see it, because there's always justifications for it. There's technology, we already know this information, there's FICO scores -- FICO score will tell you everything, why do you need all this information? There's a secondary market that has an insatiable appetite for mortgages, give us more. There's competition out there that's doing it -- the Ameriquest the New Century's -- people who are not around today -- who set the tone, Gresham's Law.

There's a whole bunch of stuff that went on that, when you're not in the middle of it -- because you have to make decisions every day -- do I compete? Do I keep my sales force? Because they're going to move to the other company because they have this product and we don't have that product. There's all kinds of things, but I don't think any of us saw -- at least I certainly didn't see -- the bubble growing to this magnitude, and busting the way it did.

Dr. Mark Zandi: You know, let me take a risk and throw our host into the mix, along with the other regulators, because I think it's in those frenzied lending times, when you have, as Angelo nicely put it, the pressures of all that work -- which is clearly the case, the bad driving out the good because of the competitive environment -- that's when the regulatory process needs to flex its muscle. And, you know, I don't think we saw that.

The first guidance with respect to IO, neg-am lending, I think, was last September or October, I believe, about a year ago. The sub-prime guidance didn't come out until May or June, and you know, I don't think it's because many in the room didn't know that things were getting frenzied. The problem is that we have so many regulators in the mix, and it's very difficult to get everyone on the same page, and in agreement and then coming to terms on a two paragraph guidance, saying "Don't do this. Don't originate a borrower, assuming they're going to have a teaser rate forever, because they're not."

And so, I do think we really need to think about our regulatory framework. You know, the regulatory process we have in place was invented in the great Depression, and it feels like it, it really does. I mean, I really think we need -- because going forward, we're not going to have a problem in the mortgage market for long in the future, but we are going to have other problems and other lending markets, and we need a better regulatory process, someone to play bad cop and say, "You know, this doesn't make sense."

You know, stated income loans for a self-employed workers? Okay, that makes sense. But if you are on a payroll and you have a W-2? How do you explain that? How do you explain it? The regulators should have said, or someone should have said, to everyone involved, "This doesn't make sense."

Angelo Mozilo: I think, I never say these words, "in defense of the regulators" --

[Laughter.]

Angelo Mozilo: When they did -- they came out with the joint agency guidelines, Mark, you know, there was a lot of resistance. When they came out with, not extending the teaser rates, and all of the other types of loans we were making, that there was deep concern and resistance from the lenders about, "What the hell do you know what you're talking about?" Because everything was going so well. And so I think that they tried.

First of all, it was hard for them to see, as well. It was very difficult for anybody to see in a raging market, when Bob's coming and putting up tents and holding lotteries in order to control the crowds in their subdivisions.

Robert Toll: Ah, those were the days.

[Laughter.]

Angelo Mozilo: Yeah. So, who was to say that the system wasn't working? And I think that the joint agency, the FDIC, the OTS, the Fed, the OCC, when they came out with their collective guidelines about a year or so ago, I think that was quite courageous, in light of everybody saying, "What the hell are you talking about? Things are going well."

So, it was a hard thing to call, we're human beings, we're vulnerable, and we're not perfect.

Robert Toll: Maria, what happened was, we could and so we did. The appreciation of the asset was the amortization on 100 percent, no-doc, interest-only loan. So, you didn't have to worry. The buying of the bonds -- you didn't have to go into the traunches, you really didn't care. Because it was all backed by an asset that was going up by 15, 20 percent a year. So, you couldn't lose.

Maria Bartiromo: Final question, do you see cracks to the global economic story and are you expecting the economy to worsen substantially, given that housing is so much more important to the broader economy today than it was 10 years ago.

Angelo Mozilo: Yes.

Frederick Cannun: I think I would agree, I think one of the issues that's so critical right now and the issue of liquidity, and the question that was posed and answered in the back, is this issue of contract law. We have to make sure that we don't impinge on that issue, globally, so that these securities, when they do find a market, even at low levels, Angelo, people do know what they're buying.

Maria Bartiromo: Well –

Dr. Mark Zandi: I'm sorry --

Maria Bartiromo: Final comment, Mark?

Dr. Mark Zandi: Well, my view is I think the economy's contracting. I think it's -- if we have a few more months of what we got in October and November, it'll be deemed a recession. We're right there.

Maria Bartiromo: Gentlemen, thank you, thanks everybody, we want to keep it to time, Secretary Paulson's up next.

[Applause.]

Claude Rollin: Everybody, could take your seats, please. Please take your seats, please take your seats, hello? Please take your seats as quickly as possible, please take your seats, we have Secretary Paulson on his way in. Okay, could everyone please take your seats?

John Reich: It is my great honor and privilege to introduce the 74th Secretary of the Treasury of the United States, Henry M. Paulson, Jr.

Secretary Paulson was nominated by President George Bush on June the 19th, and unanimously confirmed by the United States Senate nine days later, on June the 28th of last year.

Secretary Paulson is the President's leading policy advisor on a broad range of domestic and international economic issues, including capital and the mortgage market issues.

Prior to coming to the Treasury, he had a 32-year career with Goldman Sachs, and was Chairman and CEO from 1999 through 2006.

Prior to joining Goldman Sachs, Secretary Paulson was a member of the White House Domestic Council, serving as a staff assistant to the President in 1972 and 1973, and as a Staff Assistant to the Assistant Secretary of Defense at the Pentagon from 1970 to 1972.

A graduate of Dartmouth, a member of Phi Beta Kappa, an all-Ivy, all-East Honorable Mention All-American for football, received an MBA from Harvard. He and his wife, Wendy, have two children.

Please join me in welcoming our Secretary of the Treasury, Hank Paulson.

[Applause.]

Secretary Paulson: Well, thank you very much, John. The Office of Thrift Supervision plays an important role in our financial system, and I very much appreciate your leadership at this agency.

Thanks, also, for hosting the 2nd Annual National Housing Forum and providing a timely opportunity for me to give an update on the U.S. economy and mortgage markets.

I mention timeliness, because housing issues are affecting citizens all across the country, and because Congress returns to Washington today. In the final days of the Congressional session, there is much that Congress can do to help American homeowners.

As we are all aware, the housing and mortgage markets are working through a period of turmoil, as are other credit markets, as risk is being re-assessed and re-priced. We expect that this turbulence will take some time to work through, and we expect some penalty on our short-term economic growth.

The positive news, is that we are confronting and managing these challenges against a backdrop of a strong global economy, and the U.S. economy remains fundamentally sound. Core inflation is contained, continued job gains are providing a good foundation for household spending, corporate balance sheets remain healthy overall, and strong growth abroad is supporting U.S. exports.

Our economy will continue to grow, but it is facing a number of challenges. And, as I've said before, the housing market downturn is a biggest challenge to our economy. When home foreclosures spike, the damage is not limited only to those who lose their homes. Homes in foreclosure can pose costs for whole neighborhoods, as crime goes up, and property values decline.

Avoiding preventable foreclosures, then, is in the interest of all homeowners. Mortgage market financial innovation has benefited the U.S. economy and U.S. homeowners, it has also introduced some of the challenges we are facing today.

Financial innovation led to the creation of mortgage products that put home ownership within the reach of more people. At the same time, innovation also made riskier loans, with no down payments, or minimal documentation, and made these loans more widely available.

Similarly, securitization has brought benefits and challenges, making more capital available to mortgages, but creating greater market complexity. As a result, we now have an array of different market participants, often with different interests.

Still, foreclosure is expensive for all participants, lenders and investors, and this expense is a very important incentive to avoid foreclosure, when a homeowners has a financial wherewithal to own a home.

An appropriate role for government is to bring the private sector together when innovation has greatly increased the complexity of achieving beneficial solutions for all parties involved. The number of sub-prime mortgage resets is going to increase dramatically next year, and we need to make sure the capacity is there to handle it.

And so Treasury is aggressively pursuing a comprehensive plan to help as many able homeowners as possible keep their home. We began by convening a diverse group of market participants who represent all segments of the mortgage industry. Based on what we've learned, we are implementing a three-point plan to avoid preventable foreclosures and to minimize the impact of the housing downturn on the U.S. economy.

First, we are increasing efforts to reach able homeowners who are struggling with their mortgages.

Second, we are working to increase the availability of affordable mortgage solutions for these borrowers.

Third, we are leading the industry to develop a systematic means of efficiently moving able homeowners into sustainable mortgages.

This morning I'll provide more detail on the three elements of this plan, an update of the private sector's efforts, the government's efforts, and the additional steps that are needed in each area.

First, we must reach homeowners who are struggling, reach them early and reach them with information and with hope. The need for this effort became starkly clear when we learned that 50 percent of foreclosures occur without borrowers ever talking to their lender or a mortgage counselor. We know that if we were able to make a difference that number has to be reduced.

We learned that mortgage industry leaders had already stepped up their efforts to reach delinquent borrowers, but many borrowers in trouble were afraid to speak to their lenders.

Borrowers did respond more favorably to mortgage counselors, but the counselors didn't know which borrowers needed the assistance.

Treasury and HUD helped bring these two groups together in the Hope Now Alliance, a coalition of mortgage servicers, counselors and investors who are working to avoid preventable foreclosures and to improve the functioning of the mortgage market.

Since its formation less than 2 months ago, the Hope Now Alliance has made significant progress. In the past, some servicers may not have contacted borrowers until after their loans were delinquent. Today, all Hope Now servicers are contacting borrowers 120 days in advance of their mortgage reset, to reach them early, before their mortgage problems become overwhelming.

For those troubled borrowers that servicers haven't been able to reach, Hope Now has launched a nationwide letter campaign. These simple, one-page letters on Hope Now letterhead, provide a toll-free hotline which homeowners can call to explore options with their servicers that may help them keep their home.

Mortgage investors recognize that foreclosure is costly and often not in their interest, and they recognize that quality mortgage counseling can help prevent foreclosures. By bringing together counselors, servicers and investors, the Hope Now Alliance has brought the resource of investors to bear, to enable non-profit mortgage counselors to be more widely available.

The Alliance is scaling up a national hotline that borrowers can call for mortgage counseling. And let me say to those listening out there -- if you are worried about losing your home, call this number: 1-888-995-HOPE, to see if you are eligible for assistance.

Now, I hope none of you are going to need to call this number --

[Laughter.]

Secretary Paulson: But please feel free to do so if you're going to have a problem. This hotline is available 24 hours a day, to provide vital mortgage counseling in multiple languages.

Nothing is worse than doing nothing. The Hope Now effort to streamline refinancings and modifications is a positive step, but it is not a silver bullet. There is no single solution to address all of the issues currently affecting the housing and mortgage markets.

The government has a role to play, as well. First, we need to draw attention to these letters, and urge borrowers who receive them to act on them. Secretary Jackson and I have been doing just that, and we have recently sent copies of these letters to all members of Congress, so that they can alert their constituents. We are asking mayors and governors to do the same.

We will also join Hope Now's effort to broaden its public service announcement campaign to spread the word that "Hope is but a phone call away."

While increased industry funding is very important, we also need to do our part to support non-profit mortgage counseling organizations. For this public outreach campaign to be successful, there must be enough trained mortgage counselors to answer the phone when homeowners call. The Administration's request for funding Neighbor Works America, and other non-profit mortgage counseling operations is in its budget. But the appropriations bill has yet to be finalized. Congress needs to get it done, and get it done quickly.

Of course, reaching homeowners is only part of the equation. The second part of our action plan is to make more products available for our borrowers, who have the financial wherewithal to own a home, but are struggling with a higher adjusted rate on their sub-prime mortgages.

To help with this, the industry is looking at several innovative solutions, including both modifications, and refinancings. State and local governments, especially in the hardest-hit areas, are also developing solutions, including proposing funds that may help financially-able borrowers refinance out of expensive sub-prime loans.

Given the local nature of the housing markets, State and local solutions can be particularly effective. Current laws allow States and localities to issue tax-exempt bonds, only to assist first-time home buyers, or home buyers in designated, distressed areas.

Some States housing agencies have initiated pilot programs back by taxable bonds, to help refinance struggling sub-prime borrowers into more affordable mortgages. Today, we are proposing to allow State and local governments to temporarily broaden their tax-exempt bond programs to include mortgage refinancings. If enacted, this will reduce the cost of innovative mortgage programs, and allow these programs to reach more struggling homeowners.

We in the Federal government are also taking steps. This Fall, HUD initiated FHA Secure, to give the FHA more flexibility to help more families stay in their homes. Even those who have good credit, but may not have made all of their mortgage payments on time.

An estimated 240,000 families can avoid foreclosure by refinancing their mortgages under the FHA Secure plan.

The Administration is taking action to help homeowners, and Congress must do the same before it leaves this year. Since August, the President has been calling on Congress to pass his FHA modernization proposal which, by lowering the down payment requirement, increasing the loan limit, and allowing risk-based pricing, will make affordable FHA loans more widely available.

The Administration's proposed bill would help refinance another estimated 200,000 families into FHA-insured loans.

Since August, the President has also called on Congress to provide tax relief for mortgage debt forgiven, homeowners who finally find relief, shouldn't get put back in financial straits because of the tax code.

Additionally, Congress needs to complete it's work and create a strong, independent regulator for Fannie Mae and Freddie Mac. Fannie Mae and Freddie Mac have an important role to play in making mortgages available and affordable. And appropriate regulatory oversight is critical to their ability to serve their public policy purpose.

The third element of our plan involves a pragmatic response to the reality that the number of homeowners struggling with their resetting sub-prime mortgage will increase throughout 2008. As volume increases, we will need an aggressive, systematic approach to fast track able borrowers into refinance or mortgage modification. This third element does not and will not include spending taxpayer money on funding or subsidies for industry participants or homeowners.

While the reality is a bit more complex, in the interest of simplicity, there are four categories of sub-prime borrowers.

First, there are those who can afford their adjusted interest rate, these homeowners need no assistance.

There are also a substantial number of homeowners who haven't been making payments at the starter rate on their sub-prime loan, and may not have the wherewithal to sustain home ownership. These homeowners will likely become renters again.

A third category of homeowners might choose to refinance their mortgage, putting them in a sustainable mortgage while keeping investors whole. This is the first, best option. Servicers should move quickly to assist those who can refinance.

And the fourth category is those with steady incomes, and relatively clean payment histories who could afford the lower, introductory mortgage rate, but cannot afford the higher, adjusted rate. We are focusing on this group, determining who they are and what steps may be appropriately taken to assist them.

However, given the diffuse nature of todays mortgage market, the steps towards refinancing and modification can be more difficult than it would seem. The company collecting your mortgage payment every month is most often doing that on behalf of those who own the mortgage and they are limited in the decisions that they can make on behalf of those ultimate owners, who are spread all over the world.

We are determined to bring this diverse group together to develop a set of standards that will be implemented across the industry. From the largest mortgage servicers to the smaller specialty servicers, an industry-wide approach is critical to the effectiveness of this effort.

To speed up the modification process, we are working through the Hope Now with the American securitization forum to convene servicers and investors, so that they can develop categories of borrowers eligible for appropriate modifications and refinancings, and an industry-wide solution. This work takes time.

As all parties seek to define categories of borrowers for streamlined refinance and modification where that is in the best interest of both the borrower and the mortgage investor. I am confident that we will finalize these standards soon, and I expect all servicers will implement them quickly, and create benchmarks to measure their progress along the way. As a result, what has been a fragmented, cumbersome process, can be a coordinated effort which more quickly helps able homeowners.

Through continued, dedicated efforts by industry, non-profit organizations and the government, we can strike the necessary balance to mitigate the risk to our economy of this housing downturn.

The issues are complex, and will take time. We are working aggressively and quickly, utilizing the available tools and creating new ones, to help financially responsible, but struggling, homeowners. This, in turn, helps their neighbors by preventing foreclosures and sales which can drive down property values, and undermine the financial stability of families and communities.

It also helps investors and lenders avoid unnecessary and costly foreclosures that are not in their interest.

We will continue these efforts -- measuring progress and making adjustments when necessary, to ensure that as many able homeowners as possible are reached and helped. The Administration and the private sector are taking action. Congress needs to act now, to appropriate funds for mortgage counseling, to pass FHA modernization and GSE oversight legislation. To pass legislation to temporarily relieve liability for mortgage debt forgiven, and legislation to temporarily increase capacity and allow State and local governments new flexibility to use tax-exempt bonds for home mortgage refinancings.

(Off the record 10:47 a.m.)
(On the record 11:01 a.m.)

Sharon Stark: Good morning, everybody, and welcome back.

It is my pleasure to introduce our next panel and moderator -- thank you, Joe -- thank you very much. It's my pleasure to introduce our next panel, moderator

Kathleen Hays, anchor and economics editor for Bloomberg's On the Economy, a show that's on in the afternoon. She focuses on many of the forces that affect the global markets, including the economy, but also things that are happening in the financial markets, as well as in the housing markets.

Kathleen has over 20 years of experience in television and print journalism -- many of you may know her as one of the very first women journalists in financial news, and I have to say I have a special place for Kathleen in my heart, because she was the first person who ever interviewed me on television, and she was very gracious and very gentle.

[Laughter.]

Sharon Stark: That was 20 years ago, right?

But Kathleen does have a reputation for landing rare interviews, including those with many Fed officials who are often difficult to land for an interview. I think one of her most recent, and most notable interviews was with St. Louis Federal Reserve Bank President William Poole, recently, and I think that conversation and that interview shed a lot of light on where the Federal Reserve is in terms of their thinking on the economy, and where we may be headed for interest rates, as you heard in the first panel.

But, it's my pleasure to introduce Kathleen Hays to moderate our second panel, which is going to address the issues of mortgage finance. Now that we've talked about the state of the mortgage markets, and have heard from some of the servicers, as well as economists and analysts associated with that market. We'll now hear of what the future might hold for us.

So, Kathleen, I will turn this over to you, and thank you for being with us.

Kathleen Hays: Well, Sharon, thank you very much, and I just want to say what an honor and a privilege it is to be here, I was thrilled -- hello, Bill Steven -- it's fun to see old friends and faces from the years I've been covering the economy and the credit markets and the Federal Reserve, and I knew it would be a great forum -- housing, come on. And then when I saw my panel, I was even more thrilled.

But, certainly something that has given this all the more excitement and focus, and real importance, is the movements afoot to make some big changes, some new initiatives for the mortgage market, and of course, Treasury Secretary Paulson just spoke, and went into a little bit more detail about what is developing at the Administration now.

So, could this be more timely? Of course not, and I'm so glad I helped Sharon get to where she is today.

[Laughter.]

Kathleen Hays: So, let me start by introducing my panel, starting with Kerry Killinger who has made an express trip out from Seattle, I grew up in Olympia, Washington, so that's why you sat next to me -- not really -- Chairman and CEO, of course, of Washington Mutual, he is -- it says, "Under his leadership, of course, Wa Mu has grown into the nation's 6th largest financial services company, an employee base of over 50,000 people, 2001 American Banker magazine named him its Banker of the Year."

And, I must say, a story I read about him recently talked about how he is zooming all around the world, all of the time, he had a weekend at home, and he remodeled the bedroom or something. This is a guy who can't stop.

Anyway, to Kerry's left, Denise Leonard who is a Board member at the National Association of Mortgage Brokers, another group really, really in the spotlight now. Denise has over 25 years of experience in operations, administration and finance, she has constructed and developed departments within small company environments, helped them grow over the years. She's currently owner, Chairman and Chief Executive Officer of Constitution Financial Group, Incorporated, a mortgage lender and mortgage broker in Wakefield, Massachusetts -- she's been there for the last 17.5 years, since she got out of high school.

[Laughter.]

Kathleen Hays: Next, Daniel Mudd, as you know, President and CEO of Fannie Mae, which is headquartered in Washington, D.C., also a Director of the company. Previously, he served as Chief Operating Officer and was responsible for the origination systems, and administration areas of the company and we also thank him for joining us at this very busy time.

Joe Smith is the North Carolina Commissioner of Banks, he's at the end of the table, an office he's held since June of 2002, his current term goes to March 31st, 2011, so he can say anything he wants today.

As Commissioner, he heads an agency charged with the supervision of banks and thrift institutions with aggregate assets in excess of $190 billion, the licensing and regulation of over 1600 firms, and 16,000 individuals engaged in mortgage banking and brokerage. He also regulates a variety of consumer finance enterprises, so again, a person who is uniquely qualified to bring perspective and experience, and knowledge of what's really going on in the industry to this panel, and I think you'll agree with me, we really have a great spectrum of viewpoints.

Having introduced my panelists, and stated all that, I want to go just right down the line, and have all of you give me your reaction to what we see so far, coming out of these talks at the Treasury Department.

Kerry, you've been involved -- what's come out so far, and how is it going to solve the problem?

Kerry Killinger: Well, obviously we do have a very serious problem in the country that needs to be addressed from a variety of fronts. I think specifically on the Treasury, I applaud them for taking the leadership. What this country is looking for are people to say that housing is important, that we're going to attack this problem, we recognize the problem, and we're going to get on with it. And again, how -- and all the elements of -- getting there are things that we should be talking about today. But, I do applaud Treasury and the Administration for taking that leadership and getting us focused on the dialogue.

Again, the specifics of what we need to do to make this happen are wide-ranging, so it's not a simple solution of, "Let's take care of sub-prime modifications." Yes, that is something we need to do. But this is really an issue around, what are we going to do to get -- we heard on the panelists this morning -- what are we going to do to get liquidity back in the marketplace? What are we going to do to help the non-conforming markets? What are we going to do for the sub-prime markets? How are we going to take full advantage of FHA? How can we take full advantage of the opportunities with Fannie and Freddie? How can we take advantage of trying to get private capital back into the liquidity stream -- these are very, very important questions, none of them have a simple solution, but I'm really glad to see that we're getting that very positive dialogue going. Because consumers want to hear that we care, that we're going to take the leadership, we're going to make this happen.

Kathleen Hays: Denise?

Denise Leonard: I agree with Kerry. You know, we do applaud the Treasury as well, and the fact that they have involved us in the process. That we've been more involved, because we know it the best. You know, we are the first line with the borrowers, in most cases, which has been critical in terms of not having an overreaction or going, you know, having things be so far-reaching that it ends up having a grave, unintended consequence, and adding more to the credit crunch.

We do have to have liquidity back, we do have to, you know, get some loosening, so we can get back to being able to solve the problems for these borrowers that we can't now solve, because of the, you know, when the housing prices are declining, it's very difficult. And now we've got products and programs that are, you know, were once available that were gone, so I think to look at, as Kerry said, the multi-faceted approach to how we can, you know, go about solving this problem is key.

Kathleen Hays: Dan?

Daniel Mudd: Again, a positive step, I think the Treasury program puts this in a pretty firm footing, as part of the national agenda. I think when you had the initial dislocation there was a lot of question, "Is this a long-term problem? Is this a short-term problem? Is this going to go away, is it State-by-State?" And the realization has come, "No, it's not." It's a broader problem, Treasury's put it on the agenda.

And now, the way that I see the problem being addressed, it's being addressed in the right way -- it's an issue of time. The way I see it is that the over inflation in the market is coming out, and underneath it you've still got longer-term, very good fundamental supply and demand in the home ownership market.

And as that demand comes up, and as that over-demand deflates, you need time to cure. And so, the aim, as I read it, in the Treasury program, is to enable those folks for whom time, making some payments, building some equity, getting a little home price appreciation, will be able to help them out.

So, we're supportive, but as everybody else, I think everybody needs to play a role in this. It's not just one institution, it's probably everybody in the room.

Kathleen Hays: And Joe, of course, you bring in this perspective of a State regulator.

Joe Smith: Yeah, well, I would like to agree with everything that's been said before -- I certainly applaud the Secretary's efforts, and I applaud, particularly, in his talk today, the idea of the incorporation of State and local efforts, as well as Federal efforts. I actually think his talk was measured, and helpful in the sense that he did not imply that everybody's problems are going to be solved, all at once, everywhere.

I'm irritated with him, only because I've been making a living -- I felt so smart talking about triage in the mortgage market, where you separate people who can sort of be helped, people who can't be helped, and then the middle. He invented four categories, so now I'm --

[Laughter.]

Joe Smith: Of course, he's smarter than I am, he's a little taller, too. But, I mean, so now I've got a quat-trage, I guess, is our new idea.

And I will say that the States have -- we do have resources at the State level to help resolve the current, temporary crisis, and the Attorneys General -- dare I mention them -- along with my good friend, Mark Pierce, my colleague from North Carolina had been working with servicers also, in terms of standardized documents for modification.

So, I think everyone does need to pull together, and I think a whole lot of good effort's being made to do that.

Kathleen Hays: I want to ask some specific questions on this, because I think there's a lot of questions it raises. And I know we don't have a complete announcement yet, but even so, everyone's already debating this.

And Kerry, what I want to ask you is, investors have really have not been at the table yet, and an originator has to sell the mortgages into the secondary market -- how will they be included in the dialogue and how do you think the investors are going to react? Because so far the take is, if there are -- if there's something to be eaten by somebody, the investors may have to eat it.

Kerry Killinger: Well, let me first say, again, I think helping on modifications and helping refinance out sub-prime borrowers and other where there is a payment shock, I think is a very important public policy thing for the country. Unfortunately, for those of us that are -- have loans in our own portfolios, it's much easier to make those modifications and adjustments. We are all goal-aligned about how are we going to help the end-consumer? And we work extraordinarily hard on trying to make that happen.

Naturally, it becomes more complicated when loans have been originated and sold at the secondary markets, because the interest in the various securities and the interests of the servicers and the interests of the consumers, potentially are not aligned directly.

I think, certainly, again I applaud Treasury for trying to take the leadership and trying to pull the groups together, and I think they are talking to the -- all the constituencies, including the representatives of those in the securities industries. And what we all need to do is to find that right, safe harbor that is fair and reasonable to work our way through on this.

Again, as the Secretary mentioned this morning, this is not an easy thing, it's something they are working through very hard, and again, I applaud them for doing it, and we just need to see if we can't get to a collective decision that protects everyone -- does the right thing for the consumer, and at the end of the day does the right thing for the securities holders.

Because what we know is that when a loan that is going to go into default -- everybody loses. The consumer loses, the security holder loses, the servicer losses, they have higher costs and the like, and if we can somehow isolate and get those loans figured out and get more proactive in a modification of those, I think that we can create a winning situation for all of those constituencies.

Kathleen Hays: Dan?

Daniel Mudd: Kathleen, if I could –

Kathleen Hays: Yeah, I wish you would, yeah.

Daniel Mudd: It's one of the notions that's being dispelled over the course of the past few months that it's in anybody's interest to foreclose, unless that's absolutely the last resort and the last step. Maybe I could construct a scenario for you where, in a market of massive home price appreciation, somebody benefits from a foreclosure, but right now, it's certainly not the consumer, it's certainly not the servicer, it's certainly not the investor in these products. And I think, largely, the industry is beginning to reconstruct itself from a set-up which was market, collect, delinquencies, foreclosures, to those roles being mixed up a little bit, and realizing that some of the guys that are working on foreclosures are actually working on modifications now, and you're seeing that start to spool up.

We've done about $10 billion of modifications for sub-prime loans, so far this year. So, it can be done, whether you're an investor, or at the front end.

Kathleen Hays: Here's what's confusing to me, though. That these -- the mortgage-backed securities are pools of mortgages and they're set up in traunches, and AAA will get paid, and if there's defaults, the lower traunches don't get paid. Well, if the lower traunches don't default, because of modifications, the payments to the pool are going to be different. That's, I think, where the question for people -- you hold them, a lot of big institutions hold them, they're held around the world. How complicated is that to work out, and again, do the investors have to agree, it's okay?

Daniel Mudd: It's complicated, is the answer, and to Kerry's point, it depends who holds them. You know, if somebody holds the entire security, if somebody holds the mortgage as a whole loan, it's pretty easy. If you're dealing with three or four consecutive traunches that have been redistributed three or four times, it's more complicated. I think the initial, literal reading of most of the trust documents said, "This is a hard and fast rule about modification. A broader reading says, you have to do what's in the best interest of the trust in many cases and in a lot of cases, the best interest of the trust is to avoid those foreclosures.

Kathleen Hays: And Joe, jump in on this, because you've got a foot in both worlds, because you're overseeing the banks, and you're –

Joe Smith: Well, it seems to me, Kathleen, that the issues are different with people who are portfolio lenders, that's one set of lenders, and that includes the sub-prime components of bank holding companies, right? Those people can, they hold them, they can deal with them.

I must say, as an outsider looking in, the securitization discussions look a lot like Brazil, about 10, 20 years, whenever it was, when we were trying to work it out, because you've got to get all of the various players to agree. But, I will say, having -- I don't know, has anybody else here but me ever done a foreclosure? Followed it all the way through to the end? Am I the only one?

Voice: Amazing.

Joe Smith: The one-eyed man is King.

[Laughter.]

Joe Smith: Well, I mean, the truth of the matter is, it's a disaster. And the people in those, holders of those securities are going to get, are going to get whacked one way or the other. I just, all we can do is to hope that people see reason. Because if they don't there's going to be, they're going to get hurt.

Kathleen Hays: Denise, I want to ask you about another aspect of modifications. Again, the contrarian view would be, "Look, you're going to help people stay in houses," and I know that one of the Treasury Secretary's points is, find the people who are making their payments just fine, it's just the reset that's going to hurt them. But, if it's not done on a case-by-case basis, if it's done for a group of borrowers that gets a little tougher.

And what about the rates of default for people who have modifications, aren't they -- what is your experience? Does this work? How often does it fail? Because if something is tried that doesn't work, it seems that you could end up -- certainly the individual homeowner could end up in a worse mess, the mortgage servicer could -- everybody could end up worse off if this doesn't work.

So, again, for people who get these work-outs, these modifications, how does -- what does history tell us? What does your experience tell us about how this goes?

Denise Leonard: Actually, I don't have a lot of experience with people who have had work-outs. What

I've found is that a lot of the programs that are put out, you know, they're limited to only certain people. And, especially in an area like, you know, Massachusetts where, I think the bigger issue becomes, you know, the value of the home, I can honestly say that it's been more difficult for any of the modifications to take place, because -- especially if you're not a portfolio lender, that if the values aren't there, they just can't do it. I've not actually had enough experience in working with borrowers who have gone through that process.

Joe Smith: If I could add something, I do think that, as a bank General Counsel back in the last real state of deflation we had in North Carolina, what happens is, when you modify is, you give yourself time to work, to see what happens next. I mean, a piece of this is just, to me, that's important is that you buy time so that on a -- regrettably in some ways -- case-by-case basis, you can work through the facts and circumstances of each loan.

I mean, you've got these massive amounts of securities, even with the loan, it's a lot of stuff coming through the system, a lot of loans coming through the system. You give yourself a chance, at the local level, in conjunction with industry, with State housing finance agencies, with FHA, with others, to work out some solutions. But, it's going to be messy, and it's going to take time. But if you don't stop the train, right? The foreclosure process starts, and I have my own concerns about that, if I were an investor, I'd have huge concerns about the foreclosure process.

Daniel Mudd: I think we need to be careful of the notion that you can draw a firm line about who gets hurt in a reset, and who will pay in a reset, and who won't get paid in a reset, it's going to vary enormously from product to product, State to State, borrower to borrower, home to home. So, a lot of this is, and this is the reason it's going to take some time, is that it's going to be worked out on the ground, where people live.

Kathleen Hays: Let me throw out a general question, and maybe Kerry you want to start with it. Broadly speaking, we've got the Hank Paulson plan shaping up, Senator Hillary Clinton, running for President apparently has also got a plan that she's talking about to freeze sub-prime payments for 5 years, a 90-day foreclosure moratorium, so obviously something's in train here, broadly. What is your outlook for the resolution of this whole sub-prime crisis, problem, whatever you want to call it?

Kerry Killinger: Well, first of all, I'm going to reframe a bit. I don't think it's a sub-prime issue, specifically, it's really a problem for the country in which home prices are declining right now, and it's impacting sub-prime, naturally. It's also impacting prime home equity loans, and now it's starting to impact prime home loans. And it's primarily as a result of, again, of housing prices falling.

Now, if you look at the underlying issues of what's going on, it's simply the supply of housing is too high, demand is low, in part, demand is low because consumers are not stepping up, wanting to buy homes right now. So, a fair bit of what we need to do, I think, is attack that whole consumer confidence, and understand, again, the importance of home ownership.

If I was putting my game plan together of what would ultimately turn this around, I think it's multi-faceted -- first, I think the Federal Reserve needs to keep cutting interest rates, I think that, I think that we need to have the level of rates continue to come down to help provide some available financing. I think that there's a very important market segments that underserved today, which is both the sub-prime and the non-conforming markets, and I think that we ought to look seriously about temporary extensions of authorities for Fannie and Freddie and the other GSEs to help into some of those categories.

I think there's a very important role for FHA, and so I'm very supportive of legislation to help them modernize and expand their capabilities. I think there's an extraordinarily important role for the Federal Home Loan Bank System in the United States, they are a very important source of liquidity and provider of financing for portfolio lenders, which will be all of the community banks around the country and others that are doing lending on their balance sheets, and that's a terrific source of liquidity.

I think that State and local programs need to start kicking into gear. Again, I was very positive on the comments I heard this morning about potentially increasing authorizations for what can be done at the State and local levels in some of the financing to help people through this.

I think part of the program is loan modifications, and helping people through the reset periods, and that's why we applaud Treasury and why we all need to step up and do what we can do there.

And then I think you get down on the consumer confidence front. I think it's very important that we approach this with excellent transparency to the consumer, that we improve the disclosures that we have, so that they feel comfortable that they know the ground rules that are going on there. I think that we've been proponents for higher standards for the overall mortgage industry. I'm supportive of licensing of mortgage reps, I'm supportive of having capital requirements, I'd be supportive of whatever it took for the industry to be on as strong a footing as it possibly can.

And I think it's also, again, very important that we understand and tell the consumer that there's confidence in this system, home ownership is still important in this country, it can be very critical, not only nationally, but for the State and local governments for their tax revenues, and so forth, and I think we've just got to get everybody coalescing and hitting from all of these sources of confidence and liquidity, as well as standards in the industry.

Denise Leonard: I agree wholeheartedly with pretty much everything Kerry said, especially with regards to the FHA piece, because again, in Massachusetts I've been FHA-approved and not been able to do one loan, because of the loan limits. You know, we just can't serve the borrowers in our area, in the different counties, because, you know, the loan limits prohibit that, that's number one.

But, in terms of the higher standards and the professionalism, you know, our organization since 2002 has pushed for higher standards in our industry. We had, you know, we wanted State licensing with the model State statute that we put forth. And, you know, I love how he spoke about transparency. You know, we need to focus more on function than form.

Although, you know, disclosure -- that's a key thing, as well. Part of what happens is, you know, with the complexity of the different products and programs that are out there, you know, one of the questions that we had been given was -- would, you know, how do you deal with that in terms of disclosure? I think you can simplify it.

You know, I look back when, you know, I did my first loan, I think I signed 8 pieces of paper. When I signed my last one, it was probably 40 to 50. And, you know, so over-disclosure, and the complication of the process is not always the best way to go. The more that we can do to just keep things concise and clear, transparent -- you know, so that people do understand all of the features and the benefits of the loans that they're getting --

Joe Smith: You going to disclose yield spread premium?

Denise Leonard: Absolutely, we do.

Joe Smith: Oh, good.

Denise Leonard: We already do, we have. And again, if you want to allow consumers to really compare and to shop -- have everybody do it. It should be a uniform way that it's done.

Kerry Killinger: You know, I'd jump right in, just to add on that. We adopted a very simple program earlier this year that, you know, there are so many disclosures for the consumer, it can become fairly complicated. So, what we decided was that for any loan for us coming through a mortgage broker, that we would have a one-page, simple form, in which it clearly laid out anything on the loan terms -- reset periods, whatever the rates are, if it's anything that's -- trying to make it as simple as we could for the consumer.

The second thing we show is, any compensation going to a broker. So that, that was totally on the table.

And the third part of that program is that we said, we're going to contact every customer that comes through a broker before the loan is closed -- or at least make an attempt -- so that we could explain the terms of the loan that much simpler and be sure that, as a servicer, that we started to connect with the consumer.

So, again, that's something that we think the industry ought to think about. For us, we think was an appropriate initiative, and so far it's worked out just fine.

Daniel Mudd: I would jump in and be slightly disagreeable and just say that, you know, as soon as a document lays out a term like "yield spread premium," you're beyond the financial ken of about 30 percent of the people you're trying to sell the loan to, and it would seem to me that the answer to this solution starts pretty simple, which is -- front page says, "Here's your starting rate, here's your maximum rate, here's your starting payment, here's your maximum payment." And, if you can get that 30 percent to at least get that, you're part of the way down the road.

The other part, I would say is, I think it's important for the industry that this problem get divided into two parts. One part is what you do about the here and now and the people that are already in trouble, or are going to be in trouble, or what you do to get the market back to where it needs to be, and some of that will go to taking time.

The other piece of it is, what do you do to reform the industry, so that the next time around, you avoid some of the problems, and incorporate some of the lessons we've learned. It's helped us to think about those two spheres, a little bit separately.

Joe Smith: I agree with that. I agree with that, totally. I think that the issue, to me, is in times of stress -- the S&L thing was mentioned earlier this morning, well, the response to that was legislation, which was complained about, bitterly, at the time which resulted in a new regulatory regime. It might have been good, might have been bad, but it increased capital requirements, it did a whole lot of other stuff, and I agree with you, Dan, if I may call you that.

But, an important issue to think about is, what are we going to do for the next time? Because, just remember, gang, yes you had the Asian Contagion and the Russian Default -- what's the hottest asset class in investments right now? Developing markets, emerging markets, brick -- so these things do turn around.

People -- I heard a person say earlier this week, last week, rather, in a seminar, that in the S&L crisis someone said that there'd never be a commercial building built again in the United States, no more office buildings in America, because of this lack of liquidity. So, there will be a next time, and I agree with you, we need to think about that, too. A lot.

Kathleen Hays: Joe, does that south investment, so forward investment pool send shudders up your spine? The one where everybody started pulling out their money, because it had losses and it had bad mortgage debt?

Joe Smith: Am I worried about it? Sure, sure.

But, I mean, the issue is going to be to me, what do we do to bring the money back? And I think that's what my new friend Dan was talking about, too, the issue is how do we set up a structure in the industry that gives people confidence to reinvest, right?

Kathleen Hays: Well, let's follow that point, right? Keep going.

Joe Smith: And, I think Mr. Killinger raised a bunch of them, but I think the issue of originator licensing or registration of the kind contemplated in H.R. 3915 is an important factor. And that is a -- of course, that's the piece we're doing, the States would start a nationwide system, for those who wish to join, nobody turned down for lack of interest.

January 2nd of 2008, that's about a month from now. So, that piece of the structure is available and it's with the NASD, or now it's called FINRA, so it's not a low-tech system, it's big.

I think the other thing, though, I might say, and it has less to do with the people on this panel then it has to do with the people who do Wall Street securitizations and the like -- it's stunning to me -- the other thing to me that would bring confidence back in the marketplace would be, if the guys with the gold would make the rules. Why don't they set some standards for who they will buy from, and enforce them more vigorously.

I mean, yes, we can -- what was interesting to me about the last panel was this call for the government to step in. Buccaneer capitalism, 21st Century variety, you know? "Dear government, please come help us." Okay.

[Laughter.]

Joe Smith: Really, right?

And so, I think the issue is that the -- no, I think the industry, though, can do a lot to set its own standards, as well, and I think the industry can contribute, frankly, to the development of standards rather than -- and right now, correct me if I'm wrong, I haven't heard anything yet, the pins -- I can still hear a pin drop on that one, and I'm talking mainly about the Wall Street cats.

Daniel Mudd: Yeah, and it seems to me, I want to agree with Joe, my new friend Joe –

[Laughter.]

Daniel Mudd: Are you called Joe, or Joseph?

Joe Smith: Joe is fine.

Daniel Mudd: Yeah, Joe, okay. Joe, I agree with Joe.

The, you know, that we need to do some reforms at the basic level, so the underlying foundation of the system is good and sound, people know what they're getting, they qualify for the loan, they get the best mortgage product, it's all disclosed.

Standards in the industry -- exactly what we all define as a sub-prime loan, and what we all define as a reset, and what we all define as a predatory loan, and what we all define as a -- those things have gotten very mixed up over the years.

Now, the spreads -- the credit spreads on those are starting to move back out again, so you can differentiate between the products, but I think some industry-standard definitions of what we're talking about here would be a generally helpful think to move to, and I think that then begets -- along with this idea of making sure that investors understand that this is on the national agenda -- helps to keep this huge flow, I mean, it's a magical thing about this system that we're involved in, that there are huge dollars of foreign investment that come in, effectively, to invest in U.S. housing. That doesn't happen anywhere else in the world, and we ought to be sure not to mess that up.

Joe Smith: Absolutely.

Kathleen Hays: What about the current state of credit? We know that on August 17th, the Fed cut the discount rate, a little bit of a panic, the Fed cut again on September 18th, the Fed cut on October 31st -- feeling that things were balanced, and that everybody scratched their heads, and the bond market rallied and kept pushing rates down, because investors just said, "Huh?" And then just last week, you know, you mentioned the Fed, Kerry, Don Kohn, Vice-Chair, a speech that was clearly a message, very well thought-out, saying -- you know, and in fact the Q&A, I was at the Council on Foreign Relations -- Don said, "You know, on October 30, 31st, things looked different. It looked like the credit market turmoil had gotten better, and it didn't look like that was, there was that much spillover," now it looks different again, we've seen -- there's been more of a sense -- I come in and start reading about what's going on every morning, and talking to people of that kind of scary, "What's going on?" What is your sense of what's going on in the credit markets now?

Kerry Killinger: Well, I think as I said earlier, we are certainly in a, with a lack of liquidity in the non-conforming parts of the market, the credit spreads have widened out significantly and the flows of capital are severely limited, and I think you kind of have a bifurcation right now, that both at the sub-prime level, and then at the non-conforming level, the liquidity is very scarce.

And I think the non-conforming market continues to have good liquidity, but even there, again, over time the pricing appears to -- needing to widen out with increasing fees that will likely be charged from the GSEs. So, I think the -- this is as challenging a period of liquidity as we've seen.

Kathleen Hays: Do you think Fed rate cuts will help? And again, if there's so much industry constriction, and so much uncertainty about who owns what, and what the investors want to buy, and if there's an overhang of housing inventories and et cetera, et cetera, will rate cuts really help solve this?

Kerry Killinger: Again, I think it will help, but it's not going to be the sole solution, as I commented earlier. Again, it takes awhile for monetary policy to work itself through the system, but certainly -- directionally -- if the Fed continues to reduce rates, that will increase the likelihood, over time, that the other forms of interest rates will move in line with that.

Of course, one of the major disconnects we have in a short-term basis, is the Fed continues to ease policies, and LIBOR continues to be extraordinarily wide. So, certainly that's reflecting concerns for both credit and liquidity, not only in the United States, but on a broader basis.

Kathleen Hays: Any other thoughts from my panel?

Denise Leonard: Well, I think in terms of the, it will help with the purchase market more so, because you've got people who then, you know, are going to start to think about buying again, if the rates are low, they don't want to miss that opportunity, and that's, you know, part of what we need to do to get that segment jump-started. I do think it will help with some of the refinance, but until the actual, you know, housing prices start to appreciate, it will -- it's going to do part of the job, but not all of it.

Daniel Mudd: I think some of the front-end of the market needs to clear, so that there are other asset classes out there in front of mortgages, whether CIBS or CDOs, or other things that sort of need to clear the market, and to the extent that rate cuts help the banks earn their way through that problem, I think that's generally helpful to make some progress, it goes into the general theme of being able to buy time for folks to work through this.

So, directionally positive, but it shouldn't negate the fact that there are structural issues in the industry that also ought to be addressed in the process.

Joe Smith: I don't think that rate cuts will make bad paper good. There's bad paper out there that's just bad, and it's going to have to be taken care of some way or other, right? It's got to, you've got to have a foreclosure, or a write-down or a forced sale or something else, it's just out there for, until it's resolved.

And that -- by the way, I do think a thing that the, the "stop the train" movement which we've had, we've seen today will help is, the other thing it will do it, at least try to arrest some of the increase in the inventory in the market, I mean, if real estate -- to get back to real estate prices, if that's a problem, Bayer Stearns has done a study, I think that shows -- I know -- that shows that take whatever number Marcus Andy said, and add what, 2, 3, 4 months on top of that if these houses all get foreclosed. And that doesn't help the cause any at all.

Kathleen Hays: Well, Joe, if that's the case, if it's just going to take time, and then bad paper is just going to be bad paper, you know, there are people out there -- small camp, maybe, but who feels that the, that the Fed is just going to help create another mess, they're going to cut rates too much, we're going to have too much liquidity, ultimately down the road we'll have inflation, and there are just some things that rate cuts don't fix.

Joe Smith: Yeah, well, if I were smart, I'd be an economist, I guess.

[Laughter.]

Joe Smith: But I just, all I was saying was, I think in terms of the quality of the paper that's out there it's, it is what it is, and that just has to be worked through. I think the rate cuts may well address collateral issues in the economy and, as a bank supervisor of small or medium-sized banks, primarily, I'm concerned a little bit about the overall effect of all of this on the housing market, the real estate markets, which our banks depend on. I mean, banking in the Southeast, in particular, is real estate.

So, there are collateral effects that are very important to me, for my selfish perspective as a bank regulator, to try to address, too. And I think that's more what rate cuts might address, although I'd leave that to the experts.

Kathleen Hays: Let's talk about another big, big topic -- the role of Fannie Mae and Freddie, and Kerry you said that you thought it would be appropriate for them to take a larger role.

Denise, from the perspective of a mortgage broker -- and you also mentioned, of course, that you have customers you can't get FHA loans, you'd like to see that change. What about Fannie and Freddie as that trickles through the mortgage market, do you think Fannie and Freddie should have a bigger role, or not?

Denise Leonard: I'd like to see them beat, you know, the caps raised so that they could have more role in the non-conforming market, absolutely.

Kathleen Hays: Dan, I bet you have some thoughts on that.

[Laughter.]

Daniel Mudd: I'm sorry, what's the issue?

[Laughter.]

Daniel Mudd: You know, actually, can I take the question about whether the Clinton program is better than the --

[Laughter.]

Kathleen Hays: Sure, how about the Barney Frank program? You can jump in on that.

Daniel Mudd: Yeah, I'll go through it point by point and --

You know, I think -- there are things that we can do, and there are things that we're doing right now. As I mentioned we're working very hard to prevent foreclosures, we're working very hard with servicers, our guarantee business, which basically puts the securities into the market is going like gangbusters. Where there are opportunities to invest, we're doing that.

But, we're also being careful, I mean, this is an environment, and it's a little bit relevant to the question we asked before, which hasn't found its new level yet. It's very -- you think things are over, and then you have a couple of bad days, you have a couple of good days, you have a couple of -- and the market needs to settle out and kind of find its level. Some of that is the fourth quarter, clearly itself out and working into next year, the rates and all of that, working their way through.

So, I think it's important -- we're being as careful as anybody else is about taking an approach here, and making sure that we're in the right capital position, and that the lending standards that are being forwarded out there, make sense for what's -- an environment that's going to take a couple of years to settle out. So, we're doing as much as we can, where we can do more, we will.

Kathleen Hays: And, let me ask you this, Kerry, because we know in the past, this has been -- this has been a contentious issue, there's been a lot of debate back and forth about Fannie Mae and Freddie Mac having a bigger role, and an institution with a quas -- GSE, the government-sponsored enterprise aspect versus purely private institutions. And, let me ask you this question -- are we at a point -- has this mortgage crisis, this foreclosure wave -- do you think, is this changing the view in the industry? Is it kind of making people feel that, whether you like it or not even that, somehow, this is something that have to be done, or do you sense among your peers and counterparts that there's -- this is still a question, there's still a lot of debate?

Kerry Killinger: Well, clearly there's a lot of debate. In the support I have, is really around returning liquidity to the marketplace quickly. And that's why I used the word temporary. So, I think that there is a very important role that can be done to help restore liquidity over the next several quarters, that may not be required on a perm -- which is not required on a permanent basis.

So, I think that one of the public policy things we need to keep looking through is, what can we do jump-start liquidity into a market where there is a tremendous disconnect today. And, I think again, I think that's predominantly in the non-conforming, and in the sub-prime areas, and I'm just trying to look for all of those institutions, particularly those that have been chartered with a public purpose, and those that -- where the government can legitimately make judgments about how do we optimize the amount of liquidity that these institutions can help bring to this situation?

So I'd, I think there could be a very important role there, but frankly, if it's not acted on very quickly, it's almost not worth doing. Because, we need liquidity for the immediate future, we don't need it for three years from now.

Kathleen Hays: Joe, I'm going to start with you on the end. In terms of looking back, what could have been done differently -- everybody made mistakes, I'll say it didn't -- my mistake didn't make much difference. In going into this thing, I just somehow didn't think the whole sub-prime issue was going to hurt the economy that much, because so many people were in the homes, they're making their mortgage payments, they have jobs, and here we are where it seems to be having a very big impact. So, I can say, I know I could have -- I don't know if I could have done anything differently, I didn't know.

I think it's a question -- when you look at yourself as a banking regulator, or just at the industry, what would you have done? What could people have done differently?

Joe Smith: Well, I'll point my finger at myself, first, and then I'll point it at others, how about that?

As a, we've been licensed -- when I took the job, I thought I was going to be Banking Commissioner of North Carolina -- it says Banking Commissioner, and we'd have this Mortgage and Lending Act, which was licensing mortgage brokers, and so I became Mortgage Commissioner, for the next 5 years. And if I had to do differently now, if -- knowing now -- if I knew then what I know now, we would have required greater financial responsibility from brokers, in particular, by which I mean, net worth requirements and a lot of other financial requirements, sooner rather than later.

I think I probably would have tried to write -- we know who the leading mortgage lenders are every year, I mean, you know, the statistics are published, they're all, mostly out-of-State in the sub-prime area, and mainly in the prime area -- Wells Fargo has been the leading mortgage lender in North Carolina for the last 5 years running, and so I probably would have written the chairs, or some of those people and talked to them about, "Do you know whose originating mortgages? You may not be buying, I don't know who's buying from whom, but do you know whose out there?" Because, the people I ran into for the first 5 years were an incredible, an interesting array of folks, sort of like the Duke and the King in Huck Finn, you know?

So, that's what I would do. I think there was a point in time when Governor Graham had talked to Sir Alan Greenspan, when they might have done something with HOEPA a little bit sooner than they did otherwise, and I think in retrospect I don't know if Sir Alan thinks this or not, regrettably, Ned Graham has gone to his rest, but that might have helped matters a bit.

I actually think people who were buying and securitizing these things might have asked themselves more carefully about due diligence -- who the heck out there is selling this stuff to us? Because, I will tell you, I mean, I license these people. I have met people -- I met a guy -- I put a guy out of the industry, my favorite, is who would have been disbarred, essentially from the sale of used cars in Virginia and North Carolina --

[Laughter.]

Joe Smith: -- who was originating home mortgages. Now, I put him out, but somehow the guy made -- he was selling to somebody, I don't know who. So, I think the failure of the industry, the securitization industry, the capital market leaders to set -- to use the Golden Rule to set standards was a big source of our difficulties.

That fair enough?

Kathleen Hays: Yeah, yeah.

Joe Smith: One on me, two on them. That's my story.

Kathleen Hays: Dan, anything else?

Daniel Mudd: The -- I think for anybody that's in this business that's -- let's say you're in a broader business and you're a secured lender -- if you can be guaranteed up-front that the security underneath your loans is going to be worth 10 percent more next year than it is this year, you can do pretty well without being very smart. And you can even convince yourself that your -- you know, that that's the way the industry works. And I think a lot of people got convinced that this would go on forever, and the standards got sloppy, the risks got layered, so there were products that were probably pretty suitable for a lot of the folks in this room -- you could read it, you could understand it, you could sign the documents, and you knew what a reset was, you knew what a neg-am was, you knew what a -- you know what a floating rate -- you could figure all that stuff out. And then those products got mainstreamed and mass-marketed in a way that I'm not sure that everybody could necessarily understand what they were in for, and the short resets on some of the ARMS accelerated that a little bit, and then we had this disruption. And the disruption has caused people to go through and re-think a lot of that.

I think -- I would defend myself from Mr. Smith --

Joe Smith: Oh, we're not friends?

Daniel Mudd: No, we're not friends any more, because you said the secondary market didn't set standards, you know --

Joe Smith: I said the Wall Street guys.

Daniel Mudd: Oh, the Wall Street guys.

Joe Smith: No, I'm serious --

Daniel Mudd: I agree with Joe --

[Laughter.]

Daniel Mudd: The -- you know, a lot of the advancement in the securitization market caused almost anything that could, you know, that had the breath of life in it to be able to be securitized, and all of that probably went too far -- that's the way the economy works, the adjustment happens pretty fast, the retrenchment happens pretty fast, we're on the way to getting back to where we need to be, and I think a lot of the cure goes to what we do the next time around. We'll work on the old part, but what we do the next time around, in terms of clear disclosures, in terms of what everybody's rolling the system, I think I go back to that, that's a really important foundation under what we're all trying to do.

Denise Leonard: I don't know what we could have done differently, other than, you know, I think that a difference could have been made if, what we were pushing for in 2002 had been put into place then, to have minimum standards -- you know, educational requirements and things. And as, you know, Joe said, not just being able to fog a mirror and be in this business.

You know, and again, we pushed for that transparency so that you can't have a gentleman like he just described bounce from one place to another, and that they have to be able to track bad actors, we have to be able to and it's got to be across every distribution channel.

If that were -- would that have solved it completely? Absolutely not, we -- I mean, because the economic factors we have no control over. But from the behavioral standards, perhaps, I think that would have made a bigger difference.

Kerry Killinger: Well, clearly everyone has learned from what's turned out to be a very difficult and interesting cycle. We know what came when you have double-digit home price increases, when you have excess capital coming in from all over the world, when the underwriting standards were somewhat relaxed, when innovation probably went too far on the product front, and where, you know, homeowners and investors were getting caught up into that speculation, as well, and fraud became more of an issue than it should ever be.

I think the important thing now is, okay, what have we learned from it? And we should quickly try to learn from that. Put in whatever appropriate new standards and approaches we want to have, I think we can all agree on those relatively quickly. But I think it's very critical that we get beyond that, and get onto what is -- what are we going to do to restore consumer confidence, get things moving ahead and get liquidity back into the marketplace.

So, I hope we spend increasingly less time on the mistakes of the past, get those fixed as quickly as we can, and get on with what are we going to do to move this country ahead.

Kathleen Hays: Well, that sounds like a nice point to say we have -- I think we have some people out in the audience with microphones, and we've got a few minutes, and I think there are people with questions.

And this gentleman was really fast. Even before I said it was time for questions, he had his hand up.

So, sir, just tell us your name, and where you're from, and what your question is?

Steve Albert: Steve Albert, Cherry Hill, New Jersey. I have a prime concern -- you talk about disclosure to increase consumer confidence. Fine. Except, every day we hear about banks finding SIVs or CDOs or some other type of wealth-balancing thing that they never seem to disclose until they're caught. And it just seems to me that there is no disclosure, and it's killing consumer confidence, and maybe what we really need is -- where are the bank examiners? Where is somebody else to oversee the bad stuff that's going on in your industry? I don't get it.

Kathleen Hays: Who wants to comment?

Joe Smith: Well, the SIVs are mainly national banks -- where in Cherry Hill?

[Laughter.]

Joe Smith: And they weren't involved in sub-prime.

I would like to talk for a minute, though, about consumer disclosure. I don't agree with the idea of consumer disclosure making the market better. Alan, and there's two or three people that -- we were together last weekend in Cambridge, Massachusetts with a group of people who were fairly high-level academics, but not just academics, they were people from the real world. I mean, people from professions, people from the financial industry.

And we did a little Richard Fineman-type test, it was one of these horseshoe deals, and the moderator said, "Well, everybody who has a mortgage, stand up." So, all but a few whackos stood up. And then, "Okay, everybody who's got a fixed rate, sit down." So that was about, I can't remember, Alan, but I think it was like half, maybe. So everybody else had a variable rate mortgage, I guess, I don't know what the heck they had. And then, "Everybody who knows your current interest rate sit down," I mean, keep standing, but everybody, if you don't, sit down. Well, a couple of people sat down after. And again, this wasn't the first 10 names in the Cambridge phone book, this was a fairly select group. Finally, he said, "Okay, everybody who knows the next reset date on your loan, the amount, how it is determined and what the variables are, remain standing, everybody else sit down." Well, everybody sat down.

So, I think actually that there's little -- what we need is, I think product simplification can go a long way, we can have disclosure if we must, but we've got to simplify the product lines first, at least for all but the very sophisticated, because it's just -- nobody understands this stuff, and I think it's a potential continuing harm to the market.

Kathleen Hays: Okay, and I must say I share your concern. A lot of people never had a problem until they announced it the next day, and then it keeps getting bigger week by week.

But, that's another story -- sir, what's your name and institution and question?

James Montgomery: My name is James Montgomery, I ran a company called Great Western through the last crisis, the savings and loan crisis, I think, very successfully. I've also been a Director of Freddie Mac, and Federal Home Loan Bank of San Francisco, so I have a lot of experience in what we're talking about.

I think what has been discussed all morning is commendable, the Treasury's program -- which I call a top-down approach -- makes a lot of sense. I think, frankly, counseling is an interesting sound-bite, but it doesn't really do a whole lot. I think the top-down approach only works if you have a bottoms-up approach happening at the same time.

Let me tell you what I'm talking about. Take my State of California. You've got a house -- you've got a notice of default is filed, there's 120-day redemption period. At that time the notice is filed, you know the borrower of record, the lender of record and the property address. We go out and look at the property, if it's empty, it's probably a fraud situation, you go to the next one. You go to the next one, you find a borrower that's hopelessly over their head, they should be a renter, you go to the next one. You find the third one could be helped with a modification of the loan. I, as the local lender, can buy that piece of paper from the master servicer -- if I can find him -- and actually re-write the loan -- not even re-write the loan and do a new title policy -- but take over the loan at a lower rate, re-appraise the property and do it.

From a practical, bottoms-up approach, I think if we get the trade associations -- the American Banker's Association, the America's Community Bankers, and these people to tell their constituents to do this from the bottoms-up, it'll really work. The top-down approach will not work, every State has a different foreclosure law, it's a mess.

Kathleen Hays: Are you saying you don't think the Paulson approach is going to work?

James Montgomery: I say the Paulson approach will work from the top-down, if it's supplemented by the --

Kathleen Hays: It has to have the bottoms-up.

James Montgomery: -- bottoms-up approach at the same time, otherwise, we're going to do a lot of wheel-spinning, and frankly, it won't work.

Kathleen Hays: So, are you asking the panel if they agree with your statement? Is that the question?
Okay, well, I think it's an important question.
Kerry, you feel like you want to jump in?

Kerry Killinger: No, I agree. I think, again, these loans get done one at a time, and you've going to have the bottoms-up really working it hard, and I think Jim gave a good cross-section of the kind of situations we all run into, and we just need to work them hard, one at a time.

Kathleen Hays: Okay, a woman right over there, name and institution, please?

Female Speaker: -- I have a question that, deals a little bit on the foreclosure issue and the impact that State law has. I know Denise might be familiar with a situation where the Mass Attorney General recently made, took some actions, and I'm wondering what the panel thinks about whether or not States taking action will really address the sub-prime issue, and how that's going to interplay with future Federal action?

Denise Leonard: Well, I'd like to speak to that, I can't speak to it, specifically, from the sub-prime thing, but the approach that I'd like to see take place, I've had a dual situation in Massachusetts, I've had the, you know, been fortunate enough to have a Commissioner who had a -- brought a summit together last November, and had 50 people who were involved in that from every facet of the business, you know, industry was there, lenders were there, the consumer groups -- and we worked on recommendations, you know, looking at what the problem was, saying as Dan said, "What can we learn from it?" We knew we couldn't fix what was, other than trying to do some work-outs with the lenders, but what can we do moving forward? And that group came up with recommendations which have now, basically come out in the form of one of our House bills that just got passed.

What happens when that doesn't take place, and you have a situation -- as I said at the beginning, you know, to keep us involved, because we understand this business. When the Attorney General promulgated her regulations, she changed our UDTP, our Unfair and Deceptive Trade Practices. The problem was, what she was attempting to do was to, you know, limit anti-steering to loans that have added incentive. We didn't have a problem with that. The problem was how the language was written, that the legal departments at many of the large investors said, it's now illegal to do a no-point loan and they pulled out of the State. And we were able to get a push-back on the effective date, but it was literally going to shut down in like 5 days, the whole entire mortgage market in Massachusetts, and it was going to ultimately harm the consumer. So that's the danger of not having all of the right players at the table, and really listening to what the issues are and how they need to, you know, move forward in terms of -- don't have those grave, unintended consequences that we talked about, because we understand the market, we understand what the impact is going to be.

Female Speaker: -- for more standardization, and even on State law issues with UDTP.

Kathleen Hays: Okay, I want to take one more question, who's the lucky person? And you've got your hand up first, so you go. Name and institution, please, once you get the mic.

Rob Dubitsky: Rob Dubitsky, Credit Swiss.

There's been a lot of talk about rate modifications, post-reset, but the reality is most loans that are delinquent today are pre-reset, and the big driver of delinquencies and defaults are lack of equity, one concept being the second being 80/20s. Is there any talk around relief around that second lien? Second lien modifications or payoffs or anything along those lines? I think that's for Kerry or Dan, or anyone else who would like to comment, thanks.

Daniel Mudd: Not that I've heard, so I don't know.

Kerry Killinger: Not that I'm aware of.

Kathleen Hays: Okay, well, that was it --

[Laughter.]

Kathleen Hays: Now you know, Rod. Suggest that.

I want to thank, again Sharon Stark, and the Office of Thrift Supervision for inviting me. I want to thank my panel -- Kerry Killinger, Denise Leonard, Daniel Mudd, Joe Smith -- now best friends, I think, pen-pals forever.

I want to remind everybody to watch Bloomberg Television, generally, On the Economy at 2:00, in particular. We pursue these kind of topics a lot.

And again, it's just been thrilling to be here, I look forward to talking to everybody around here the rest of the day, and let's have a great lunch.

[Applause.]

Sharon Stark: If we could now please clear the room, they need to set up for lunch, so if you could take your belongings and --

(Off the record 12:00 p.m.)
(On the record 1:12 p.m.)

John Reich: If I could have your attention, please. If you're eating dessert, please continue.

I want to introduce our luncheon speaker. He's a man who's had extraordinary success in a number of high-profile positions in business, government, education, and most recently, in the media. His name is Bill Seidman a name familiar to all of us.

Bill is currently Chief Commentator at CNBC TV, the publisher of Bank Director magazine, he's a consultant to RWB Capital Management, and a director of a number of companies, including Promontory Interfinancial Network, Pfizer, U.S. Order, Incorporated, that's only what he does today.

Bill's done so many impressive things throughout his career that last week he received the American Banker's Lifetime Achievement Award at a black-tie function in New York City. And when you look at his incredible resume, it's obvious why they chose Bill Seidman for that award.

Many of you know that Bill served as the 14th Chairman of the FDIC from 1985 to 1991. During his tenure at the FDIC, the Agency handled over 1,000 bank failures, and took over the Insurance Fund for the savings and loan industry.

He also became the first Chairman of Resolution Trust Corporation, or RTC, in 1989. While at RTC, he supervised the creation of an agency, virtually overnight, which ended up with 8,000 employees, and handling over $400 billion in assets of failed institutions.

But what you may not know about Bill is that during World War II he served in the U.S. Navy as a communication officer on a submarine, and received the Bronze Star, for service in the Philippines, Okinawa and Iwo Jima.

He was also the managing partner of Seidman & Seidman, CPAs, now BDO Seidman, in New York, from 1968 to 1974. Under his stewardship, the firm expanded from a small family enterprise to become a national public accounting firm.

He then went on to serve in the White House as President Ford's Assistant for Economic Affairs from 1974 to 1977. He also served President Reagan, as Co-Chair of the White House Conference on Productivity from 1983 to 1984.

Among his many high-profile positions, Bill was at one time, Dean of the College of Business at Arizona State University and Chief Financial Officer and Director of Phelps, Dodge. He also found time to author two books.

He received his undergraduate degree from

Dartmouth, law degree from Harvard, MBA from the University of Michigan.

For the last 64 years, Bill has been married to his high school steady, Sally. They have 6 children, 11 grandchildren, 1 great-grandchild.

He's become a staple on business television, offering investors straightforward assessments of everything from the banking industry to oil prices, as CNBC's Chief Economic Commentator.

Although he may be a bit embarrassed, let's see what his colleagues at CNBC had to say about him.

[Video played.]

[Applause.]

John Reich: Ladies and gentlemen, Bill Seidman.

Bill Seidman: Thank you very much, John, for inviting me here, it's a great pleasure to be here. I thank my colleagues at CNBC for the comments that they did not put in the film --

[Laughter.]

Bill Seidman: -- which I have heard from time to time. And I'm very pleased to be here, particularly since I'm somewhat of a retired regulator, you know. I've been out of regulation for a long time, I gave it up and reformed --

[Laughter.]

Bill Seidman: And I always think of Sam Houston's story of, after he was thrown out of the Governorship of Texas, he went to his preacher and said, "I want to reform." He said, "All right, Sam, we'll take you down to the river and baptize you." They took him down, and in the water he went, he came up sputtering and the preacher said, "Now, Sam, all your sins are washed away." And Sam said, "I'm concerned for the fish downstream."

[Laughter.]

Bill Seidman: That's pretty much the same thing that I'm in.

Well, I guess I'm here today because I happen to have been in charge of the FDIC and the RTC during the last major problem that we had in the financial system, now known as the S&L crisis, but it actually also involved at least 1,000 banks that failed.

And I can just tell you, as background, that crisis threatened the entire financial system. I mean, clearly, CitiBank, Bank of America and other major banks were very close to failing, so there was a chance that it could bring the whole system down.

So, that's the first point I'd make to you. I don't see today that this problem, as big as it is, looks like a problem that will bring down the financial system. And the reason really is that when we were running the RTC and we saw the huge amount of non-conforming assets, mainly commercial, that we had to handle, we were looking for a way to sell them in big amounts. I figured out one day if I sold a million dollars a day every day that it would take me 230 years to get the RTC closed down. So, we decided we'd look for something else.

We went to just putting a group of assets together and asking for bids. And then with the financial experts on Wall Street, we came up with what is now called traunched securitizations, rated by the rating agency. So, we invented what is clearly today at the heart of the problem.

[Laughter.]

Bill Seidman: I thought you'd all like to know that. I like to come in with clean hands, or at least, total disclosure.

We invented that system, and I can remember talking to Alan Greenspan about it, and he said, "Well, that's a wonderful idea, because we will spread the risk." And we did. We spread it from villages in Norway to Düsseldorf to Tokyo, but what we didn't foresee is that we would increase the risk, because of the securitization system. And, if we had known at that time, obviously we wouldn't be here for this kind of a conference.

Because if we look at what has happened today and compare it with the previous problem, there's some great similarities, with some great differences.

In the first place, back there the government was heavily involved, because insured institutions were failing. So the government was immediately involved, because it was the insurer.

Today, so far the government is not financially involved, it's a pure private sector situation. And then I -- I want to make my first important point, I hope. And that is, after the RTC, we went all over the world -- if you are an alumni of the RTC, you could advise in every country from the Antarctica to Bosnia -- everybody had bank problems, and the RTC people were called in.

And the first thing that we always found when we got there was that whoever it was they would like to unload the losses they had incurred in the banking system, on the government. And my first point here is that, I think we have to be very careful that that doesn't happen in these circumstances.

There are a lot of ways you could do it. You could do it by over-taxing the home loan bank system. Or if the home loan bank system doesn't keep tight control. You could do it with Fannie and Freddie, if Fannie and Freddie doesn't have tight and effective government regulation, and as you all know, at the moment that's a controversial point. There's legislation which I think would be very helpful in protecting against the government ending up with these losses.

And finally, you could put it into the banking system, with the insured deposits, and everything, and therefore the regulators there have to take great care. Because this is a private sector situation, there are private sector losses, and I think it's most important that the government not get into the position of having to pick up these losses.

That said, there's a major problem. And the basic difference in the problem, in terms of handling it between the RTC and those days, was that we had it easy. We owned the loans. And we knew, and I think everybody that's ever been in the lending business knows, that when you have a bad loan, you got to mitigate the loss, and you have to mitigate it by renegotiating the loan, some way, or foreclosing it and putting it in sale.

But we learned very quickly in the RTC, handling well over $500 billion worth of assets, that any kind of asset, once you kicked out the people, and it became empty, its value went down. We used to say, 15 to 25 percent, the day after.

So, if you're in that business, it's clear that you don't want to kick people out -- unless they're crooked, or other reasons, there are some -- but, in general, if you want to mitigate your losses, you want to restructure the loan.

That's why Secretary Paulson and all the people you've heard are spending a lot of time trying to figure out how we can follow-up on Chairman Bayer's recommendation that all these loans get restructured.

She would like to, I guess, or at least the proposals, she'd like to do it on a broad basis. I don't know how that can be done, maybe they will figure that out, if they do, it will be wonderful, but I don't know how you could do it. I think it's a one at a time determination that has to be made -- which is the way we did it -- and we were renegotiating the loans.

Now, I'll quickly point out, we were mainly dealing with commercial property, this is mainly housing, that's different. So, one way or another, if we want to cut these loan losses down, we have to renegotiate the loan. That's the second thing we learned, for sure, in our previous experience.

Now, the third thing is -- and you've heard many people up here say -- we've got to restore liquidity to the market, there's no liquidity. Well, it's not surprising there's no liquidity, is there. Because, nobody knows exactly how much the losses are, where they are, and so forth.

You know, the word "credit" comes from "credo." And "credo" means "belief." And today, there's no credit, because nobody believes. Nobody knows where the market is. The biggest thing that the RTC did, out of all of the things that we were in, was to establish a market for assets so people could believe, could understand what the situation was.

And of course, we did that by offering assets and marking them down until they sold. And we took a lot of, quite a lot of criticism for that. And some of the people that bought near the bottom made a huge amount of money, because they bought the assets at the bottom.

And when I was asked to testify on that, and they said, "What are you doing? You're giving away these assets, the government has to pick up the loss," and I said, "Well, I'll tell you, sir, we have to establish a market, and so far I have not found anybody in our country who wants to buy these assets out of a sense of patriotic duty."

[Laughter.]

Bill Seidman: "It is therefore necessary to establish a market." And I think that's true today in the situation that we're looking at, exactly as it was then.

Now, then the question becomes, how can we establish a market -- and the only way we can establish it is to try to sell some things. I mean, the alternative is to have somebody give you an opinion, and that's how we got in the mess we're in now.

[Laughter.]

Bill Seidman: So, they're going to have to find a way for people to come in and buy some of these assets.

You heard, if you were here before, Mr. Montgomery suggested the local banks come in and go over these and bid on the assets. There may be ways for Fannie and Freddie and others, but one way or another, you won't -- in our experience -- recreate liquidity in the marketplace till you find out what it is, what the values are that you're dealing with. And I know they're working very hard on this, and I just believe that until they really get down to doing the toughest thing -- which is taking some of these assets and selling them -- it's going to be very hard to reestablish credibility in the marketplace.

Now, what else did we learn in our experience? Well, one thing was that these things tend to institutionalize themselves. If you start setting up mechanisms to deal with this, immediately that mechanism has an interest in staying alive, and continuing the problem.

And one of the biggest problems that we had, is that when we took over assets, we would have to manage them. Once we hire a manager, or set up a management organization, then we had a group that didn't want to sell these assets, because they wanted to manage them. So, we had to guard against the possibility of institutionalizing the process of getting this done in the government.

Finally, and I hope I haven't already given you too much of what the old guy says -- actually I was going to retire, and I was all set to retire, and I had in mind a life on a 65-foot yawl with a rather attractive 18-year old crew.

[Laughter.]

Bill Seidman: It turned out, I had the numbers backwards.

[Laughter.]

Bill Seidman: So, it -- that is why you're being subject to this, otherwise I'd be off somewhere, and looking much younger.

I guess the final thought I have for you on this whole problem is that the biggest question in my mind is, is this a problem, or is it more than just a problem? Is it a real threat to the economy, to the financial system? Is it what we had in the S&L days, where clearly it was.

And on that, I guess I could say that, you know, no one knows the answer. But, when I look at it, based on what I saw before, is that this is a problem. It's a loss. It's going to make -- it's very inconvenient and painful for some people, but it's not really a challenge to the financial system of the country. And moving ahead to handle it, I don't think it will be.

But, I have a couple of indicators that I kind of watch to see whether or not it may, in fact, be more than I presently think it is.

And the first would be Fannie and Freddie. They have, obviously, huge mortgage inventories. If those are challenged in a way that imperils them, that would start to be a problem on a whole different level.

Same way if one of our major banks begins to have troubles financing itself or other thing -- in other words, the kinds of signs that say that this is a -- more than a problem.

I can only say, at this point, I don't think it is, I think it will be handled. And I'll just conclude, I like to think of something optimistic, if I can, in terms of this rather pessimistic subject. And I think the one thing I can say is that I am betting that right now, we're overestimating the losses.

In the first place, as you heard, I'm an old auditor. I want to assure you that when I come in to make an audit of any of these outfits, I'm going to mark these babies down so that there's no question about they're not going to have further losses in them. The system is set up to push the values down, and one way you deal with that, of course, is to have a sale.

But my guess is that today, the amount of actual loss is probably less than, at least a lot of the estimates that I've seen. After all, these are loans backed by houses. The houses have reproduction costs, there are people out there that want to buy houses at a price, so that these are not loans with total losses. These are loans with losses, I would say maybe in the 10, 15 percent, max.

So, my final word is, be of good cheer.

[Laughter.]

Bill Seidman: It's the Christmas season, so be happy. Thank you.

[Applause.]

John Reich: Well, it's my understanding that you might be willing to take a couple of questions.

Bill Seidman: Ah, Burt, yes?

Burt: Bill, where was the planning back in the eighties with regard to -- it was the same back in the eighties with regard to a lot of loans that S&Ls and others were re-working, "The rolling loan gathers no loss." Which is a warning about the fact that not all loan modifications pay off, and many times it just prolongs the loss. What concerns do you have today about a potential for a repeat of that, given what you've heard so far about the Treasury plan? Might too many loans be rolled, and their losses rolled into the future, rather than being dealt with today in an aggressive manner?

Bill Seidman: Well, that's always a good question. There's a -- generally a tendency, if you're a financial institution, to lighten out to report large loans, so if you can roll it over, you can reduce your loss.

But I don't think that is really as part of today's problems, because these loans, losses are often people that don't have -- they have only one interest, and that is to get the best deal they can get out of the bad purchase that they made.

And incidentally, and I guess I should have said this, I can remember when there were two real rules in banking. One was, you only lend to people that you know something about, and two, you only lend in areas that you know something about. If you can say one thing about securitization, it is that both of those rules went out the window.

And I would also say, in that regard, when we did these loans at the RTC, we kept the first loss piece. So we had an interest in them performing.

Today, the only people that really have an interest in them performing are the people in Pittsburgh who bought this loan, and they haven't got any idea, you know, what it is or who's there. And the servicers are generally following a contract that says what they do. So, we lost in this process the ability to have the person that puts the money in, monitor that the money will be paid back.

I can remember in law school, the first thing they taught me was "possession is nine-tenths of the law." Bankers violate that every day, and that's why we have all of these other rules.

What an answer.

John Reich: Any other questions?

Well, if not, thank you very much.

Bill Seidman: Thank you.

[Applause.]

John Reich: I'd like to introduce my colleagues in bank regulation who are here with us today. Ron Rosenfeld is Chairman of the Federal Housing Finance Board, and I'm glad to have you, Ron. Governor Randy Crosner with the Federal Reserve, glad to have you, Randy. Sheila Bayer, Chairman of the FDIC, John Dugan, the Comptroller of the Currency. Jim Lockhart, head of the Office of HOFEO; Brian Montgomery, Assistant Secretary of the Housing and Urban Development. Marty Gruenberg, Vice-Chairman of the FDIC, and I hope I haven't missed anyone else who's in the room today.

We're going to take a break and reconvene at 2:00, thank you.

(Off the record at 1:42 p.m.)

(On the record 1:59 p.m.)

Sharon Stark: Good afternoon, everyone.

It's my pleasure to introduce our moderator for the third panel, Barbara Rehm.

Many of you know Barbara, she's been a central figure and a key figure in banking journalism for 20 years, having been at the American Banker, starting as a reporter in 1987, and then becoming the Washington Bureau Chief in 1995, and then in 2005, the Assistant Managing Editor for the American Banker.

Barbara has been very involved in covering a lot of the issues that we've addressed today, including mortgage finance, the state of the mortgage and the banking sector, and the subject of today's panel, the mortgage or the home borrower.

She'll be moderating an important panel as we try to address all of the parties that are affected by what's going on in the housing sector, and today we've asked her to moderate the third panel, entitled, "Keeping the Castle: Critical Consumer Protection Issues in Housing Finance."

So, please join me in welcoming Barbara Rehm.

[Applause.]

Barbara Rehm: Thank you. Thank you very much.

I have been covering this for a long time, and when you're a print reporter, you always know that your issues become, you know, kind of hot when the networks pick it up. And I was watching the news Friday night and all three of the network news casts mentioned, you know, the Paulson Plan, and Brian Williams said, you know, "It appears the government is ready to step in," and then they have Paulson on ABC saying, you know, "No government money is going to change hands." And, I was thinking that might be something we end up talking about, you know, where the plans start today, and what you guys see as coming down the road.

I talked to John earlier, I guess last week, about, you know, whatever the government's thinking about now, he thinks they need to do a whole lot more.

I'm not going to talk a long time. I'm just going to say, you know, Susan is here from the National Foundation for Credit Counseling, Shanna is here from the

National Fair Housing Alliance, John is from the National Community Reinvestment Coalition, and Kenneth is here from Neighbor Works. And they each have a few minutes of comments they'd like to make to get things going.

But, overall, as a moderator, I'd like to encourage you guys to talk to each other. I really enjoyed the North Carolina Banking Commissioner and Dan Mudd's interchange, so if we can get a little of that going, that would be good.

And also, comments from you guys, questions. So, I'll start with you, Susan.

Susan Keating: Thank you. Thank you very much.

It's a pleasure to be here, and I appreciate the opportunity to address this most esteemed group, here.

Let me begin by saying, I spent 29 years in financial services, and really have spent the last three and a half years with the National Foundation for Credit Counseling, which is the longest-standing counseling entity in the U.S. We've been around for decades, over 50 years. And as many who know me in my former life have asked me today, "Gosh, you guys must be really busy these days," and the answer is, we are very, very busy.

We have about 2,300 counselors nationally, and of those, about 1,300 of them are housing counseling professionals who are really trying to help all of us, not only provide a solution, but work with consumers to get consumers back on their feet.

One of those things that I think is important here is that, we are talking a lot about the crisis, and there's no question about the fact that there is an incredible amount of emergency room care that needs to occur. But, in fact, a lot of what our counselors are seeing, and what they suggest to us at the national umbrella organization is that, in fact, many of these consumers, this is a symptom of a broader issue, and one where consumers lack the financial understanding and education to really manage their finances successfully.

And, in fact, a small table here at lunch, we were talking about the difference in mindset and attitude, and for that reason, the NFCC, the National Foundation for Credit Counseling, along with doing the crisis work, is certainly very interested in prevention, and again working to not just, sort of put our finger in the hole, one hold of the dyke to have the leaks go elsewhere, but we really do take a holistic approach and feel that a holistic approach to all of this is really important.

The one thing, hearing the speakers this morning, one of those things that is very different about this current environment, from what we have seen historically in the area of foreclosures, is that in the past, consumers that were facing foreclosures most likely had some interruption of income, or some kind of a family event or an issue that created that interruption, and they were unable to meet the obligations of their loans.

What's very different here is that we have a consumer population that for the most part, is employed, they are not, and have not, faced a reduction in income, and in fact, the loans that they have were underwritten based on, again, as we talked about this morning, the value of the property or what we knew, or what the lenders knew, about that particular consumer at that point in time.

The reason I bring this up is that, today we have consumers whose income hasn't changed, but in fact what has happened is that the interest rates are changing, so the monthly requirements, on average of about an increase as they reset of about $350, is pretty serious, and so that as we counsel, it is not just about thinking about restructuring the credits and all of that, it is re-thinking what this consumer's ability is to manage any kind of outstanding credit over an extended period of time. But we do this one homeowners at a time.

And I will wrap up in saying that really, as we get into it today, very key from a counseling perspective is a reassessment of these consumers, having an independent view and counsel, so that we can help consumers make informed decisions. But as a part of that, reassessment of options, it's really important to understand, again, should they be renegotiating the loan? Is there a way to restructure what they're repayment plan is going to be, or should these consumers, in fact, not be in homes at all, but move back into a rental position and again, the other obviously big consumer issue is should these consumers look to get an additional income source through other means? And we work a lot in that regard.

So, understanding, reassessing the options -- we're going to talk, I hope, about standards and disclosures, we think is important. There's been discussion this morning about freezing rates. From the NFCC perspective, we say we do believe that is very important and we would really encourage everybody to go full speed ahead on that, and then finally, we believe there needs to be counseling for all first-time homebuyers, for individuals who are looking to get into homes, or into anything that is creative or beyond sort of the basics, and that sort of thing.

So, with that, I will turn it back to you, Barbara.

Barbara Rehm: I just had a quick follow-up on that, you know, when you said, we believe, you know, full steam ahead, freezing the rates -- can that be done on a systematic basis? I mean, you were just also saying, "We do this one homeowner at a time." How do those two things go together?

Susan Keating: I think they do go together. What I would suggest here -- the point of freezing the rates is to give the consumer the time, and the counselor, the time to do that reassessment that I was talking about.

So, again, I don't see that they are incompatible, and the key thing here is having the time to regroup, and figure out what the options are, and then work with lender or lender partners, and the servicers and so forth to get a solution that makes sense for that particular consumer.

Barbara Rehm: Okay, great, thanks.

Shanna?

Shanna Smith: I thought what was very interesting from this morning's discussion is that everyone seems to be quite surprised that we're in the fix we're in. And those of us sitting here -- well, at least I know John and I sitting here, along with people from the Consumer Federation of America, Center for Responsible Lending, the AARP, and Center for Community Change, we started looking at this issue in 1995. We saw the ARMs starting to explode, and we saw all the refinancing.

We saw reports about the city of Philadelphia, in primarily the African-American community, their homes being flipped repeatedly, until equity was stripped. We saw that situation expanding across the U.S. So, I'm quite surprised that it's a surprise to everybody else that we're where we are today.

I think for those people in lending and the investment, the National Fair Housing Alliance looks at this from the Fair Housing laws, and the disparate impact, as well as disparate treatment of people based on race, color, national origin, gender, disability, religion, families with kids, and people with disabilities.

We were talking, back in the mid-nineties about having loans that were suitable for the borrower. And I heard Mr. Toll talk this morning about everything's going to continue to be based on commissions, you know, commission from the real estate agent, to the loan originator, all the way up through the investment bankers. And, that's okay, as long as we set a standard that the original loan is suitable for the borrower. That everybody backed away, they were afraid about the whole comment of suitability -- who's going to be liable for it? Well, there needs to be some liability.

And when many of you -- a lot of you are as old as me, or older -- we can remember when the ARMs first came out, the five twenty-fives -- those were designed for a very specific niche market. For people who were in homes that were appreciating, people who had incomes that were going to be increasing.

And then you saw the two twenty-eights roll out, the three twenty-sevens roll out, the IOs roll out -- again, those were appropriate products for a very narrow market. And somehow, those loans were rolled out to the general public, an inappropriate loan for most of the people who got them. And that's why we referred to them as "exploding ARMs."

From the Fair Housing point of view, our issues will be, right now, about the REOs. Which real estate companies are you using, are the lenders using, are the investors going to be using to sell those homes. Are we going to find that you're using real estate companies that we've already identified as discriminating in the market? Engaging in racial steering? Are we going to see economic and racial segregation and isolation continuing through this?

So, from the Fair Housing perspective, we're looking at it from the real estate agent, the loan originator, the appraisal -- and we all told you guys about the inflated appraisals going on all over the country, and the industry chose not to pay attention.

So, now we're going to look and go toward the investors. And we're not feeling really quite sympathetic that the investors are going to take a loss. Maybe if they have a big hit then they'll put in screens when they're buying these loan pools, to see if they're buying loans that were made -- appropriate loans that were made, suitable products that were given to the borrowers, and then we don't end up where we are today.

And the last thing that I want to say initially is, what's been missing here is a whole discussion about the impact -- not just on the homeowner, the neighborhood, the community, the tax base, the school district. I mean, when I look at the City of Cleveland -- I think recently someone told me every 1 in 200 homes is in foreclosure. In the African-American neighborhood, someone said it was 1 in 57 homes in foreclosure.

And you talk about the work-out? There's a difference between a work-out and a modification. I don't know how many of you have been like me, listening in on phone calls with lenders when they're doing the work-outs. They don't say, "Okay, let's try to keep this at 50 percent of your housing income as we re-do this loan, so you won't go into default again." They just say, "Well, how much is this? Can't you pay less on that credit card, you know, maybe you can skip this payments, and just make this house payments." And that's on the work-out.

On the loan modification, we've been working in the Gulf since Katrina, and we still have a hard time finding lenders who will do an appropriate loan modification. And if you don't have a counselor on that phone with you on a loan modification, it's unlikely that you're going to get the information that's correct, or fees waived, and it's really as you say, loan by loan. And I don't know how we're going to do that with 7 to 14 million people over the next few years who are going to be in default and foreclosure.

So, that's my cherry note to you.

Barbara Rehm: That's really interesting. I think one of the -- a lot of it was interesting, but the one I hadn't thought yet about, that next step -- what do we do with all of these homes that end up in receivership or foreclosure -- what is your solution for that problem? As far as the racial steering and -- what do you think needs to be done there?

Shanna Smith: Well, Fannie Mae just signed a new partnership with New Vista, and instead of the homes just going to speculators and investors out there, they're going to use the Community Development Corporations and other neighborhood-based organizations to get the homes back into the neighborhood, so that we have home ownership instead of absentee landlords coming into those communities. So, I think if we can see more of that happening, it will help with keeping a community a community.

On the real estate sales discrimination side, that's really going to have to be us and the other fair housing centers testing and investigating real estate companies. And for those of you who don't know, in testing, we send out African-American, Latino and white testers who are all qualified to purchase a home in a particular price range, generally our recent testing was between $250,000 to $500,000 homes, and 87 percent of the time we found racial steering. Whites were being discouraged from looking in integrated neighborhoods, African-American and Latino testers were steered to integrated neighborhoods or neighborhoods where their race or national origin predominates. And that fosters segregation, then which has an impact on schools, which has an impact on employment opportunity.

So, we're going to look at the lenders who are holding those REO properties, and continue our investigations of the real estate industry.

Barbara Rehm: That's interesting.

John?

John Taylor: Yes, thank you Barbara.

I'm John Taylor, I'm with the National Community Reinvestment Coalition and thank you John Reich and the OTS for inviting me, and for hosting this very important dialogue.

I spend a lot of time sort of pointing the finger and assessing the blame, because there's a role for that, and I personally think there will be plenty of time to continue doing that, but I actually think that we're in such a situation now with this mortgage foreclosure crisis and I don't think I need to talk to most of the people in this room about the magnitude of it, I think we've heard enough about that.

But, it's big enough that people are using the

"R" word, and some people are saying we're in it, some people say we're going to be in it. Bill Seidman seemed to think perhaps it wasn't quite as bad as the savings and loan crisis, but in any event it's very serious.

I think we need to look at two things. One is, I think it really behooves us, as a nation, to certainly create the kind of infrastructure that prohibits this from occurring again. I mean that would be a major mistake, a major failure on our part as advocacy wonks, policy wonks, and certainly of the Congress not to address this.

So, one of those things that unfortunately has to be happening contemporaneously with dealing with the immediate problem, which I will address in a second -- but we need to have a meaningful, strong, national legislation that really puts the stuff that Bill Seidman spoke about earlier, and others have spoken about, about that ethics in the industry, in the lending industry -- both in the securitization industry and elsewhere -- put that back in the system by ensuring that we don't go forward any longer with the kinds of activities that have occurred.

Because, right now a lot of the activities that did occur were legal, as long as they were disclosed. And we need to not be able to have the kinds of things occur that did.

So, having a national standard -- and we're almost there in Congress, some of you might think it's a strong law, we don't think it's strong enough and we don't have anything on the Senate side yet, but it really -- woe be this Congress with its 11 percent approval rating, that's less than George Bush, 11 percent -- that it doesn't address what this problem that has probably pushed us up to the brink of a recession.

And it's now that they need to pass legislation that considers ability to pay, cleans up the appraisal mess that we have in this environment -- the over-inflated appraisals that are rampant through the industry, deals with the steering and -- let me look at my notes here -- that have to be, obviously, we're all talking about the secondary market as part of the solution.

And you heard Bill Seidman say in the clearest of terms, the role that they played in looking the other way to create this problem and allow this to occur.

So, if we don't have a law that has some accountability on that level, I suspect that once the economy heats up again, we'll have the same problem.

So, I mean, there a number of other items that we all talk about as we talk about the legislation going forward. But speaking about the problem now -- I mean, I like the way it got phrased by a number of people today during the course of the day talking about trying to restore consumer confidence and create liquidity in the market. Because, we're not looking for companies to go out of business, we're not anti-capitalism, we're pro-capitalism, we just want it to work in a very democratic fashion, for all segments of the society that are trying to work hard.

Nothing would restore consumer confidence more than to pick up the newspaper and read that there was bipartisan support for a very strong anti-national predatory lending law that prohibited the kind of activities that have gotten us into this mess in the first place. And that's true for investors, too.

When I went to Paris and Brussels recently, all they wanted to talk about was, "How could these loans be made?" Because they have much better consumer protections over there, frankly. They couldn't understand how these loans could be made, and then they couldn't understand how the bond agencies could rate them, but that's a whole other problem.

So, nothing would restore confidence more than if people knew this Congress, this government, this leadership was cleaning up these, the problem of these lenders and brokers gone wild.

And the other piece of it is, clearly expanding on the liquidity side of the equation, expanding Fannie and Freddie's capabilities I think is very important. But let me just say, there's been a lot of applauding of Secretary Paulson's announcement, Hope Now -- I'm all for keeping hope alive, and I'm all for hope now, and hope from before and hope later, you know, I hope -- that what I really would like to see is the kind of action that's going to make a difference in all of our lives, in keeping people in their homes, and creating a more secure, safe market, and having, restoring investor confidence and liquidity.

And frankly, I do think we're in a situation where it's too big to fail. I think we are in an RTC solution that's going to -- RTC-like solution that's required. And frankly, Secretary Paulson suggesting local governments, State governments step up with their bonding capabilities, a lot of local and State governments which are already stretched -- why is the Federal government on a national problem with a possibly national recession and a national debacle not, itself, stepping up and saying, "Gee, let's see what we can do to prime the pump, to keep as many of these folks from falling into foreclosure as possible, and to restore some confidence in the market."?

So, I think we should applaud, but I think the applause is kind of like, you know, the team's coming onto the field, and let's all applaud the team, but there's a time for action, and we've got a game to win. And that means that folks are going to have to step up and the Administration is going to have to take some leadership on this, on trying to prevent things from going very badly, which I think they can.

Shanna Smith: Great, thanks, John.

John Taylor: Yep.

Barbara Rehm: Ken?

John Taylor: No question for me?

Barbara Rehm: I'm saving you.

Kenneth Wade: Well, thanks, Barbara, and I'm glad to be able to participate here in this activity.

No need to kind of scope out the problem, I think people have probably done a very good job with that, I was just at another event somewhere else, and someone summed it up this way -- it's bad, and it's going to get worse before it gets better. So, I mean, I think everybody's pretty much in agreement with that, there might be some quibbles about, around the edges about how big and bad.

Clearly, we're in a radically different place than where we were 30 years ago, when I first started in community development, where the struggle was getting lending into the communities. And I think that was what we did for a good number of years, urging financial institutions to come into communities that had been underserved.

And, you know, a few years ago, there was a sea-change with the whole financial services industry.

And it's across the board, not just in mortgage lending -- but the broad availability of credit is something that's a fairly new phenomena, actually.

So, today, it's not a question of whether you're going to get credit, it's the terms and conditions of the credit that you're going to have access to. And whether that be payday lending, whether that be the type of mortgage you get -- and you name the financial service, there are a variety of ways that people are attempting to meet the needs of consumers.

One of those things that we've struggled with as we've looked at this issue, is how do we help consumers in this vastly different arena, where they're being asked to make choices in some very complex areas that have significant impact on their life? So, if we just take the mortgage arena, just to focus on that, and we began looking at the foreclosure issue some 5 years ago, as members of our network began to bring this issue to us, and they were seeing consumers show up at their doorstep by and large, people who had not had the benefit of any pre-purchase counseling, or third-party advice, in various stages of foreclosure. So, it suggested to us that it's something we needed to look at, it had the potential to un-do a good amount of work that had been done in communities all over the country, essentially ending up losing people out the back door foreclosure as quick as you were creating new home ownership opportunities on the front end.

And one of the conclusions that we're increasingly coming to, particularly in the mortgage arena, that this area is -- and even though we will have likely changes in regulatory laws that help govern this activity -- there will probably be enhanced enforcement which is definitely needed. But at the end of the day is this area something that a consumer ought to be doing on their own? Because the vast majority of consumers, I think, are probably not well-situated to make informed choices in their best interest.

If you've seen a pricing sheet, particularly in the sub-prime market, where you have a dizzying array of options, there's no way a consumer is going to be able to -- and first of all the consumer doesn't get to see that pricing sheet, but in addition to that, even if they could, they would be hard-pressed to make a choice that would be, without fraught with some chances that it would be not in their best interest.

And I think there's been a lot of work that's been done with consumer choice. Some would suggest that there is a point at which variety and a vast number of choices, you end up with the consumer's choice being degraded at some point and not enhanced.

So we think that every consumer in America, and we want to think about it differently -- we don't want to call it counseling, because to a certain extent that's somewhat of a pejorative term in some people's mind, because you only need counseling if something's wrong with you -- we think every consumer need a mortgage advisor. Someone that they can go to -- whether that be an attorney in some states, I know that provide that as a way to do it -- we don't think lawyers are the only people who can play this role. But we think every consumer ought to have the benefit of a mortgage advisor. Whether they choose to take that option, it's up to them, but we think it ought to be broadly available, and we think there are some things that can be done with technology, as well.

Just like Consumer Reports, you know, 25 years or so ago, made a breakthrough by arming the consumer by helping them understand the cost of an automobile. Twenty-five, thirty years ago, unless you had an uncle that was a car dealer, there was no way you knew what an automobile cost. And most consumers went into that transaction hoping that they wouldn't get taken advantage of. And I think we're essentially in the same place in the mortgage industry today.

Barbara Rehm: I think that's a good analogy, and there is -- there's so much competition to get a car loan or to get a mortgage loan -- you'd think that it would be a lot easier. And I hate to keep picking on the North Carolina Commissioner Smith, but when he gave that example earlier about being, I think, in Boston and everyone was talking about their mortgage, I was sitting there feeling really, kind of pleased with myself that I knew when mine reset, I knew what the rate was. And then when he got to that part about, you know, like what would happen to it when it reset, like where it went, I thought, "I have no idea."

And I -- you know, so like product simplification is something we don't really talk about that much. We talk a lot more -- you know, dividing the issues into the things that we can do to prevent the next problem, versus solve the problem that we have now, I'd kind of like to solve the problem we have now far better, myself. But preventing it -- I think Ken made an interesting point about, right now it's not a question of whether or not you can get credit, it's just how much you have to pay for it.

And, maybe -- I sort of think you're saying that's not such a good thing. And kind of what Commissioner Smith was saying, it's not such a great thing we have so many different kinds of products. But, I don't know how you go backwards. Yes?

Susan Keating: I'd like to jump in, I actually think, we've talked about today that the fact that there are so many new products and innovative products, it really has helped many more consumers get into homes. And I think as a general, sort of, statement, most people would agree that that's a good thing.

The issue here is around -- I'm going to use the word that Ken used -- this informed decision making and disclosure and understanding what it is you are signing up for, and subscribing for. And so, that whole issue of financial education and an armed and knowledgeable consumer, making a decision for a creative product, I think is really key here. I don't think the issue is cutting back the number of products. I think the issue here is really getting to the heart of, what is it that you are subscribing for, do you understand the terms of that, and then moving forward.

Barbara Rehm: At the risk of being a complete devil's advocate, here, isn't it sort of in your responsibility to know what you're signing?

Kenneth Wade: Right, but I would say it is a consumer's responsibility, but they are totally at a disadvantage. Shopping for a mortgage is not a very transparent process, it's hard to comparison shop, and at the end of the day, you don't know the deal you have until you're sitting at the closing table. And that's --

Barbara Rehm: At that point it's kind of hard to walk away.

Kenneth Wade: It's hard to walk away. In fact, we have a staff person in our California office, her girlfriend calls us, this was a few months ago, sitting at the closing table, the loan was 2 points more than what she had on her Good Faith estimate, and she asked our staff person, "Well, what are my options?" Well, your only option is to get up and walk away.

Barbara Rehm: Right.

Kenneth Wade: Say you're not going to do that deal. And a few days later she caught up with her girlfriend, and she said, "Well, what did you do?" "Well, I went on ahead and signed." "Well, why did you do that?" "Well, you know, the moving van was already coming," I mean, you know, so the person was, in a sense unable -- it was very hard to walk away at this point.

John Taylor: I'm a little concerned about this informed decision making thing.

Barbara Rehm: Go for it.

John Taylor: Not that you shouldn't, but the truth of the matter is --

Susan Keating: Can you have uninformed -- ?

John Taylor: Well, you know, in the mortgage market, 15 years ago, when we didn't have all of these financial education, financial literacy, you know and banks having programs, the GSEs having programs, the regulators having programs -- there's financial education -- more than we've ever had in our history, and yet in that same period of time, we had this mortgage debacle occur.

So, I don't think American consumers have gotten any more ignorant about this stuff. I think what's really changed is the -- it's the matter of infectious greed and malfeasance. I don't think it's ignorance on the part of consumers. And infectious greed and malfeasance -- if you think those are harsh words, I'm stealing those from Alan Greenspan, forgive me, Mr. Chairman.

But, I think what we need to clean up is, when someone walks into a loan office, when my mother and father went into a loan office, for most of the people, looking at the grey heads in this room, when they went in, for the most part, it wasn't a matter of whether they were educated and could make the distinction for whether they're getting a predatory loan or not, they weren't getting a predatory loan, there was competitive -- and whether you walked into a broker, or walked into a loan officer -- there were issues of access, and fairness in lending, and discrimination and things like that -- but what you got was going to be something that Wall Street believed in and the lender believed that you had an ability to repay it. And it wasn't all this layered risk that contributed eventually, you know, reset points and all of that, that's going to contribute to your bellying up on that loan or having difficulty going forward. That's what changed -- it wasn't the ignorance of the

American public, it was the malfeasance of the industry, and that's what we have to fix.

Susan Keating: But, I think John, you're also describing sort of the levels of complexity that we're all talking about here. I mean, I think from a lender perspective, if in fact the loans are being underwritten at an -- and that consumer does not have the income level, ultimately, to repay if interest resets and interest rates rise, that's an issue.

So, the lenders are culpable in this, the consumer is, the investor community -- I think the level of complexities of this, of the whole situation here, is beyond anything that I've certainly seen in my many years of being in financial services. So, I think there's no one silver bullet, but I would still come back, that if we're representing consumers, most important from our perspective is to ensure that that consumer is educated and informed, and to work as partners with the lending community and do what we can to see some systemic change, so we aren't underwriting credit, whether it's sold off or not, with consumers that, there's no way they could repay that loan as the loan starts to reset and the interest rates rise.

Shanna Smith: Well, part of this is, who is your trusted advisor? Most people who are refinancing a loan are not going to go to a consumer counseling group, they're talking to a loan originator. And that's who they're thinking is their trusted advisor.

People who are buying their home look at their real estate agent as their trusted advisor. And what we need to have happen is when, as John was saying, you don't get to choose your loan product, your loan originator says, "This is what you've been approved for." So, you don't get a menu of, "Maybe I was approved for three products and the best product for me is the one you're not telling me about, because you get a higher commission on the one you have told me about." And so it has to go back to some legal liability on those loan originators, to make sure that they're letting you choose the product that's suitable for you, and if we don't have enforcement, we have what we have today -- these guys do this, they get away with it. Enforcement changes behavior.

And you can do all of the education you want in the world, but we're still going to have people who don't read all of their loan documents, it's very complicated, most of us trust the person who's giving us the loan. And if I trust you, then you have some duty to make sure you're providing me with a suitable loan.

Barbara Rehm: So, we're not going to roll back, we're not going to get simpler products, or --

Shanna Smith: Well, I think the array of products are appropriate for the appropriate niche that they are developed for. Interest-only loans are good for the people who meet the financial criteria for that. And there have been actuaries at these banks who've created the loan product, and defined the characteristics, the financial characteristics for the person for whom that product is appropriate.

So, I don't have a problem with the multitude of products. I have a problem with pushing an ARM on someone who it's not suitable for, pushing the IO, and the real estate agent saying, "Oh, you can get a four-bedroom house now, because I can get you into a three-year adjustable rate loan, and don't worry, you can just refinance in three years."

John Taylor: We need to roll back on practices that are really not in the interests of the borrowers. We don't want to cut off credit, but if credit is only available because you layer those risks knowing that the person, in two years, is not going to be able to afford the loan -- that's not home mortgage, that's just the most expensive rental housing there is.

Kenneth Wade: And I don't disagree with the need to put in place, either on the regulatory side or legislative side, changes to help reign in some of the more abusive things that we've seen.

But, I think in all of the data, it would suggest that even for some of the sub-prime loans that people would not consider abusive, there are people in those loans that probably could have gotten a better loan. If you look at credit scores and their credit quality -- they ended up either at the wrong channel, they ended up with someone who said, "Go this way, rather than that way."

And so it seem to me that just like today, most consumers who purchase a home -- particularly an old home, not a new home -- know that they need a home inspector, because they don't know enough about a house to make that choice on their own.

Now, the consumer bears that cost, so that's another thing we have to think about, how does that get paid for in the context of a transaction.

But it would seem to me that we may need to get to a place where every consumer has access to a mortgage advisor that plays that same role for them. That's the only person in that transaction that would be, in a sense, obligated to that consumer.

And, there are a number of ways you might be able to get there, I'm just talking about it conceptually --

Barbara Rehm: Right, well let's tease it out a little, you know, there doesn't a day go by that I don't get three releases on some financial literacy information of something or other.

Kenneth Wade: Right.

Barbara Rehm: I mean there is a ton of education out there about, in particular, the mortgage process.

How do you institutionalize this? How do you make it so that there is a trusted advisor for every person? You know, without it being –

Kenneth Wade: You know, all I can say is that the home inspection industry grew up because -- and I don't, you know, I don't know all of the history on this, but it appears that back in the old days, when banks did the inspections themselves, and that went away, there was some need to figure out how the consumer had a handle on the quality of the house that they were buying.

So, out of that, a whole industry grew up, almost overnight. I mean because home inspectors didn't exist 40 years ago, at least not the way it's done today. Where every consumer is -- even the realtors will tell you -- now, not that there aren't problems with home inspectors. Because we all know that there are sweetheart arrangements and all of those kinds of things, that the consumer ends up getting maybe not the best deal or the best service.

But nonetheless, a consumer knows that they don't know enough to look at a roof or a furnace and make a judgment about that. I think the financial products on the mortgage side are similar. I don't think most consumers in the -- I think, yeah, we need more financial literacy and we need to do it earlier, maybe starting in kindergarten, whatever, but this is one of the point in time educational things.

Barbara Rehm: Right.

Kenneth Wade: I think someone described it somewhere else where it was recently -- you know, I can be sick and I can know a little bit about the symptoms, but I really need to go to the doctor to help me understand what I have, I can't self-diagnose.

So, I think to a certain extent, the financial services industry -- particularly since we're not going to roll the clock back, the Genie's out of the bottle, there's going to be more innovation of products, probably rightfully so -- who is it that's going to ensure that the consumer gets what's best for them? And I think only the consumer can do that.

Barbara Rehm: Is there a role for the government there?

Kenneth Wade: Well, absolutely, no, absolutely -- regulatory, on the regulatory side, on the legal side, on the enforcement side, yes. But even with all of those done, again, we see people who don't have an illegal loan, they have a loan that's just not --

Barbara Rehm: They just have an inappropriate loan, correct.

Kenneth Wade: -- they could have gotten something better.

Barbara Rehm: Right. Susan?

Susan Keating: And Barbara, I'd really like to say, I find it just amazing about -- we spend a lot of time talking to financial institutions and talking with executives, and everybody talks about all of the products that they have available, to your point, there are all kinds of things. So, what's the issue with financial literacy and financial education?

The problem is we have a plethora of products, but we don't put the same, sort of, financial support to making sure that consumers are, you know, that there's a delivery and an actual education process that occurs. So that's why, I would still come back, Ken, and say I do think financial education and financial literacy is very important, it should start in the schools.

But, I do support what Ken is saying about a financial advisor, as long as that advisor is from the non-profit community and is an independent resource to the consumer, and doesn't end up being another layer of somebody else who's trying to make their, sort of, particular percentage take on the transaction for profit purposes. Because, then you just have another step in the cycle.

Barbara Rehm: Right.

Susan Keating: So, I think it's really important that that advisor be a non-profit.

John Taylor: Let's agree, financial literacy -- good thing -- let's do more of it. But, let's also agree that, as they're -- as people become literate, and I agree it should be in the school systems and we should all be out of the business -- banks and non-profits. You should be taught how to understand mortgages and credit and capitalism and all of that stuff, and really, you know, if you're going to be successful in this economy, you should graduate, at least, from high school knowing a lot of those basics.

But, let's say you have an educated consumer. What we also want to have is, of the array of products that they're considering, that none of them be predatory. And none of them be designed to be products that it's unlikely that borrower is going to be afford that loan. Because that's what we're dealing with today.

So, it's not either/or, it's both. I just don't want the financial education stuff to mask what is the bigger problem, and it's not that we've become more ignorant as consumers, it's that the industry changed on what those products are that are being offered. That's my point.

Shanna Smith: I would agree with that. But I also want to say that in this education, we have to be very careful about all of the discrimination that continues. So John, when your parents got a loan, being white, they were able to --

John Taylor: They actually didn't, I was –

Shanna Smith: -- go to a bank. But African-Americans and low and moderate income white families had to go to Household Finance, had to go to Beneficial, had to do land contract sales.

We're doing testing right now of banks, and you would think, at this point in time in America that if an African-American, Latino and white walk in, and the African-American and Latino are more qualified than the white, that they'll get the better interest rates, they'll get the better loan product. They're not getting it.

And, so when I think of the housing counseling that goes on, I have to look at, even a non-profit -- who's funding them? And do they know the Fair Housing laws? And if they do, and they identify lending discrimination against one of the lenders who's funding them, are they going to act in the best interest of the consumer, and tell the consumer that bank is discriminating? And, my answer to that is, probably no. Because, most of us don't bite the hand that feeds us, some of us do.

Susan Keating: Is HUD funding okay?

Shanna Smith: Not necessarily, you have to watch HUD's programs itself. You know, FHA, historically, had problems and we still see in some communities where FHA is the program of choice in the North for African-American communities, and then you have -- there was a, Flagstar Bank has been caught violating the Federal Fair Housing Act twice, and they're still a direct-endorsed lender with HUD.

So, no, you have to watch under the fair housing movement, everything, all the time. And the housing counselors at both of your wonderful agencies that do counseling, are not versed in the Fair Housing laws. So, you may be providing some information about a loan, they may call you about a loan they're getting, but you don't know what white person, what kind of loan terms they were offered in a similarly situated situation.

So, I'm back to enforcement changes behavior, we have to have suitability, and for the immediate fee, the bankruptcy bill would help a lot of people right now, because it would be turned over to the judge in bankruptcy to modify that loan.

Because if we wait now, Senator Dodd's not back, he's not moving, I don't see anything happening. And I see us having the same discussion a year from now, only millions of people in foreclosure.

Barbara Rehm: That's interesting.

Maybe shifting gears a little bit to the resolving the problem now, rather than the preventing it from happening again thing.

There so much attention being focused on, you know, the Paulson Plan and it's, you know, affects hybrid, sub-prime borrowers, and it just freezes their rates. They're trying to do some kind of blanket approach which, you know -- from the liners I talk to, they don't think that's possible, just because every loan is individual, but I think they're all willing to stand behind Paulson that day and say, "We agree."

But, I wonder -- you know, that is just a slice of the problem, and I'm not discounting the idea that, what Kerry Killinger said earlier about, you know, maybe it calms fears and promotes confidence, and people who were thinking about getting a mortgage now are actually going to pull the trigger and go ahead and buy a home, and sort of restart the market. You know, that may very well be the effect, I don't know. But, I'm kind of guessing that you guys think that's a drop in the bucket of what needs to be done, or what can be done, or what should be done.

So I -- just sort of your takes on where the government needs to go from here, or if it -- maybe I'm just assuming it's the government, but you know, what you want to see from the industry, from the investors, from the government.

Kenneth Wade: Well, let me take an initial shot at that, I mean, I think the notion of a -- for lack of a better description -- a programmatic approach, and I haven't seen anything other than what's been in the press, so I don't --

Barbara Rehm: And that's all true. Sorry.

[Laughter.]

Kenneth Wade: Right. So, I don't have a party that, anything written in this regard, but it would seem to me that we are going to have to come up with a programmatic approach to this problem. The scale and scope of it is so large, that working with consumers on a one-off basis is not going to get it done. The servicing shops all admit that they're behind the eight ball, they've got more consumers than they can handle, we continue to hear stories that people call the servicer, and they're not delinquent yet, and they're told, "We can't work with you because we've got our hands full with people who are already under the water," so if we can develop a programmatic approach that can address a significant slice of borrowers, it would seem to me it would help create capacity to focus time and attention on the consumers that might need more intense help.

Now, what the nature of that is, I think the ability to pay has got to be based on somebody's real income, has got to be a significant part of any kind of programmatic approach. And I think if you take that, you know, in some respects it's kind of like Underwriting 101, but you want to be assured that the consumer can pay the loan that they have.

And so anything you can do to create a situation where you can create an opportunity for someone to be in a loan that's sustainable at their ability to pay, it would seem to me would be a winner.

Now, you have to take into account, you know, property values, they're falling in places, I don't know how you address that issue, that seems to be a complicating factor. Some markets, you know, you assume Florida and California will rebound soon, what about Ohio, Indiana, they've been difficult markets for a long time, what do you do about trying to understand what the value is that a consumer might have, in terms of a property they're in, and how you make adjustments for that, I don't know.

Barbara Rehm: Right, exactly. I mean, that's the part of programmatic that gets hard.

John Taylor: First off, I would applaud Killinger at Wa Mu and Mozilo at Countrywide and any other institutions that are taking proactive steps, and in particularly, working with non-profits, I know Countrywide is working with NACA, and others, you know, to try to at least take what's on their, what they have supervision over, in their portfolio, and be able to modify or refinance those loans.

I think the problem is that so many of the loans that we're talking about, particularly the ones that are being reset, was a pipeline that was created by and for Wall Street and their investors, and the majority of the loans that are about to reset are sitting in these traunches that, you know, these SIVs that -- it's not even like the whole loan is there, it's even divided up. And I think the complexity of trying to look for resolution there.

I do think -- I'm not going to name names, but I do think that the Wall Street firms that built the pipeline and participated in this, have an obligation to work as aggressively and I support the Treasury Secretary's efforts to try to get them in the conversation.

But, the truth is that somebody in Norway who has a AAA-rated investment with an over-collateralized investment that is now being asked to reduce the collateralization and perhaps even reduce the rating -- I don't see, I think that's going to be a hard sell. I think it's saleable but I think it's just going to take some time.

And I really think that -- I do think we have to have the same response we had when we were facing the U.S. savings and loan crisis. And that is, the government needs to step in, in a temporary situation and, as Bill Seidman said -- you've got to make sure it's temporary. You know, people have jobs, and they want to keep their jobs, but be in there in a way which helps reduce these mortgages through a recapturable grant, or capturable loan -- that brings the mortgage down, but also brings in the private sector, Wall Street and others, who had a hand in those loans, to match that commitment to get this mortgage down to match the ability to pay.

And that way, what we're doing is creating a long-term, sustainable response to this problem -- not a temporary one. Freezing rates is great, but for how long? Three, four years? And the assumption is what -- their income grows and then everything's fine? Or the economy gets hot again? Or are we in the same position? Are we in the same struggle, or the same problem, only compounded, because we have more loans to deal with.

I don't know, but I think out of fairness -- because the system was asleep and because the Federal government was asleep, and because of the lack of regulatory oversight, because of the unfair and deceptive practices rules that never got generated, because of the guidance of the rules that came too little, too late after the market responded -- because of all of those reasons, this government needs to step up and say, "You know what? The American consumer wasn't protected, they were abused. What we need to do is temporarily fix this situation, recoup our investment," interest-free -- you've got to pay something, do something, but don't just turn around and say, "We're going to counsel people down into lower mortgages, and we're going to have the cities and towns create all of these bonds, and we'll get Wall Street to respond." Because all of those things are not going to solve this crisis.

And, you know, people don't want to hear this, because ideologies get in the way, "Oh, gee the government shouldn't do this, and the government shouldn't do that." If the government shouldn't step in to stabilize and prevent a situation like a recession from occurring, because as everybody seems to be experts on this, far more brighter people than I are saying -- the economy is being driven down, and Wall Street is being driven down, because of this mortgage foreclosure crisis -- does it really take a rocket scientists to think that money and time invested now, up-front to avert these kind of failures is going to produce the kind of, and get us back onto the liquidity and confidence in the market sooner, and therefore, perhaps, get out of this recession, or prevent the recession, depending on what side you fall on there -- wouldn't that make a lot more sense to everybody involved?

Barbara Rehm: You know, I hate to be a one-track pony and back to the programmatic versus case-by-case, but you know, like, assuming that that kind of a program where the government steps in, forgiving a loan by some amount, the lender or the originator or the servicer or the investor, whoever, coughs up that same amount of money, so that now this person has a sustainable mortgage -- that has to be case-by-case.

John Taylor: It probably does, but particularly to be saleable. Because, nobody wants to bail out people who are just speculators buying a bunch of houses –

Barbara Rehm: Or the person that just bought the luxury car that doesn't, you know -- you know what I mean? There are people who game the system like that.

John Taylor: I think the sale to most people is going to be, "There's foreclosure and you can do that route," and this is true for Wall Street and their investment, "We can foreclose on all these properties, we can sell the asset, and what you're going to get is a lot less than if you got that mortgage down to a realistic amount, given the borrower's ability to pay with competitive interest rates that they can afford." And now you have a performing asset --

Barbara Rehm: Right.

John Taylor: -- you don't have to go through the expense of foreclosure, you don't have to sell in a down market when property values are well below what they have been, and appraised values -- now we're finally -- I hate to say this, but we've done so many studies at the NCRC about the appraisal industry, and it's all coming back to bite us in the you-know-what. Because those appraisers -- 95 percent of the housing stock now had inflated appraisals on it, and now it's really coming home to roost. It's another piece that we've got to clean up.

Barbara Rehm: Right.

John Taylor: But, I just think it's a much more sensible, sound solution, and it's having the market work with the public sector to ensure that there's safety and soundness and a performing housing market. It just makes a lot of sense.

Barbara Rehm: Right.

Kenneth Wade: Well, let me just comment on the programmatic and how it might support a case-by-case review which you might have to do in any event to ensure that the consumer is getting something that's in their best interest.

So say, as an example on the affordability side, say we all agree -- just pick a number, just for the sake of discussion -- that debt-to-income 40 percent is sustainable, anything above that, isn't.

So that sets up a program approach --

Barbara Rehm: Right.

Kenneth Wade: Rather than every loss mitigation person making an independent judgment -- "I'm going to give this consumer -- "

Barbara Rehm: Yeah, but you've got to figure out who meets that criteria, though.

Kenneth Wade: Well, when you say, "Who meets it?" I mean, we're primarily talking about owner-occupants, right now, who have income. I mean if someone has no income, obviously there's only, you know, one alternative for that. Gracefully get them out in a way that -- but, provided someone's got income and they were an owner-occupant, and so we're not talking about the speculators and all of that, it seems to me if you establish something like that, then it's a question of documenting the income.

Barbara Rehm: Exactly, but that's my point --

you'd have to do that on a case-by-case basis.

Kenneth Wade: But, it seems to me that's a far more efficient thing to do, in terms of an approach than everything being a one-off, independent judgment. And I think it also will help mitigate disparate treatment, because at the end of the day I'm assuming that left to no program approach, those consumers who are in protected classes will likely be those who will get the less aggressive options made available to them -- for a whole host of reasons.

Barbara Rehm: Right.

Kenneth Wade: I mean, we know how the world works.

Barbara Rehm: Right.

Kenneth Wade: And I think that's one way to address that.

Barbara Rehm: That's good. Listen, I got the signal that I'm supposed to take questions, I think there's one over here.

Audience Member: I think we've been awfully polite today, and it's 3:00 in the afternoon, and I have not heard a single word mentioned today about mortgage broker. I've heard a lot about counseling and different kinds of programs, and this sort of thing. I run reasonable, successful banks, we try to get documentation, down payments. People went down the street to these people who were literally dialing for dollars and didn't give a damn about what happened to the loan after it was securitized and sold, so why don't we call a spade a spade and identify what the problem was here.

This counseling is wonderful, but Susan, I suspect when you do individual counseling with people, you end up talking to a master servicer, because these loans were securitized and sold -- I suspect you're going to run into the same thing I run into when I try to talk to a master servicer, either the phone has been disconnected, or I can't get anybody on the phone.

So, I think we ought to take the gloves off a little bit and understand how this happened. We never had mortgage brokers in any of our other cycles, and savings and loan crisis didn't even have -- we had mortgage bankers, but not mortgage brokers. We heard something about this fellow who was indicted this morning and got in the mortgage business, we had many of those people. And they're the ones that created an awful lot of these problem loans, and all of the counseling in the world is not going to help, we've got to break the log-jam at the master servicer level, get them to give up these mortgages, because you've got a borrower on this end that can be saved, you've got an investor on this end that's written it down that wants it sold, and you've got a master servicer in the middle who will not move.

Barbara Rehm: And Jim, how do we fix that? How do we get to those master servicers?

Audience Member: Either legislation or coercion or both to get the master servicers to move, otherwise they will hide behind the fact that their servicing agreement says they can't sell these loans at a discount or they're subject to lawsuit. They don't have any financial interest in getting the problem solved. Indeed they have a financial interest in having it go through to foreclosure, because they collect more fees that way. You've got to call a spade a spade.

John Taylor: I think we also need to have you probably -- Jim, you didn't hear my comment earlier about brokers gone wild -- I mean, I don't think there's any question about it that we have to have legislation that creates a licensing, accountability and liability that gets connected to that industry. And I'm happy to say in Barney Frank's bill which we see some bipartisan support, and all the Democrats support it, there is some language in there for that.

But the servicers, I agree. They work for the banks, and they work for the investment banks and their job is to minimize loss, today it's to minimize loss, and they don't operate in the interests of the borrower, so it's got to come from the people they work for, to -- the expanded capability of doing things that are going to really help that borrower be in a loan that they can really afford, long-term.

Barbara Rehm: What do you guys think the prospects for the Frank bill are? And are you putting any pressure on Dodd and --

John Taylor: Well, I think it's getting better every day, and I think as this crisis worsens, I do think we will see legislation. I think that Senator Dodd, I'm sure everybody who is involved in this kind of stuff is talking to his people one way or another, but we're hearing that a bill is forthcoming, and --

Barbara Rehm: As tough as the Frank bill?
John Taylor: I guess I can say I think so, from what I hear it's going to be tough, and hopefully, you know, I think we'll have learned our lesson on putting the integrity back in the industry by not allowing a lot of these practices to occur and holding the right people accountable so that we're not sitting here, you know, 10 years from now when the economy gets better and new products and new terms and new things have been invented that are still predatory, because people have nothing to lose in creating this kind of pipeline.

Shanna Smith: One of the problems with both legislation is the preemption sections, because the Federal government cannot keep pace, legislatively, as quickly as a local government or a State government can, and it's easier to identify the bad practices -- you look at Ohio and you see enormous foreclosure rates, and part of that was because the State legislature didn't have strong enough laws, dealing with the brokers and the way loans and consumer protection laws were put into place.

But if you -- but if these, if the Frank bill and the Dodd bill allow for preemption, and preempt these very good State and local laws, we're going to be in big trouble.

The Fair Housing Act, when it was passed in 1968, there were 400 pieces of local legislation, and the Federal Fair Housing Act didn't preempt any of those. And it was very interesting, because it took from 1968 to 1988 for the Federal law to protect people with disabilities and families with children, but there were States all over this country who provided those protections early. The State of Ohio actually had prohibited insurance red-lining before the Federal law did, because they recognized insurance red-lining against homeowners based on their race or national origin and the racial composition of their neighborhoods. So, those of us from the Fair Housing movement really oppose preemption, because we can only see strength at the State and local level. The Federal government is just too slow.

Barbara Rehm: All right, thank you.

Question?

Gina Angelo: My name is Gina Angelo, and I'm from E-trade bank. My question is posed to Mr. Wade. We know that you have serviced and provided home ownership opportunities on a national level to several harbingers of low to moderate income individuals. I would like to know your statistics to date on the type of phone calls or counseling services that you have been providing to persons who are now facing foreclosures throughout the country.

Kenneth Wade: Sure, let me just say we're doing that in collaboration with an organization called the Home Ownership Preservation Foundation. They're actually running and operate the hotline that we're partnering with, and the hotline is staffed by I think it's 6 consumer credit counseling agencies --

Susan Keating: I think it's 5, almost 6.

Kenneth Wade: Oh, 6 to be in, I think, December. And they are really staffing the telephonic counseling at this stage, and then Neighbor Works organizations are serving along with other HUD-approved housing counseling agencies as a referral network for those consumers who can't be helped by phone.

So, I know that very quickly, so we're supporting and coordinating the public education campaign that's part of that, that we're doing with the Ad Council to reach out to consumers.

And let me just give you a few points there, in terms of the scale and scope of people who have been reached, but I do know that obviously call volume has gone up significantly, and I can tell you right now that in the last quarter, nearly 57,000 people called the hotline. We've had more than 100,000 calls in 2007, in total. So, we're on a, obviously a growth curve in terms of the number of people calling. We know that there's typically a spike in calls whenever the ads get played, and to date we've had some good placement with the Ad Council ads and just on the TV side -- because they're in -- there are radio ads and print ads as well, but we know over 3 million people have seen the television ads, to date.

Lisa Rice: Hi, Lisa Rice, I'm with the National Fair Housing Alliance. The gentleman across the room said he was going to take off the boxing gloves, so I'll take off mine too, and raise an issue that we haven't talked about either, here today.

When I worked for a local, community-based organization in the State of Ohio, I was very surprised to hear from my colleagues who were community development corporations that they were referring many of their clients -- most of them, of course, low and moderate income consumers who were purchasing homes for the first time -- that they were referring their consumers to mortgage brokers as opposed to regulated banks and/or thrifts, prime lenders, low-cost credit lenders, despite our years -- literally decades -- of efforts in working under the Fair Lending laws and CRA to forge relationships and alliances between the community development corporation community and the prime lending community.

And my friends at the CDC said that they referred their clients to mortgage brokers because, A) the mortgage brokers were there. They actually came and tried to market them, for their clients, they would take them out to lunch -- they were very aggressive pursuers of those consumers, and B) because they actually would get the loans processed and closed in a fairly short period of time, whereas, when they went to the prime lenders it would take a long time, in some cases 3 to 6 months before they got an answer.

And so they were referring these customers to sub-prime lenders for those reasons. And one of the issues we haven't talked about is the lack of penetration, in some cases, the very dismal penetration of prime lenders in historically underserved markets. And I'm just wondering from the panelists, what you think about that? I mean, it's a longstanding problem that we've tried to cure, both through enforcement and through other mechanisms -- how much do you think that's still a problem today, and if it is, what can we do to address it?

John Taylor: I'd like to answer that. Lisa, I think it's a big problem, and I think it continues to be, and I -- as much as this is a, more of a forum, I think on the housing crisis -- but I have to say and as much as I criticize the bank regulatory agencies for the lack of enforcement, they're actually a lot more enforced, or regulated than the independent mortgage companies and the brokers.

So, you know, there's no question that over a series of decades, banks were allowed to close their branches, and in their place moved in these hybrid lending institutions that had less of a connection to the community, you know, they didn't have bank directors on the Board who lived in the neighborhoods, they didn't have the same obligations like the Community Reinvestment

Act.

In their place, when the banks moved out also, were the -- the new basic banking service of choice for people of color and working poor Americans, and that was payday lenders, pawn shops and check cashers. So there was this tremendous loss when the banks left those communities, and that happened under the watch of a lot of the regulatory agencies in spite of the fact that their CRA grade includes the service test -- 25 percent of their grade is, you know, what have you been doing to service these communities, what is your history of opening and closing branches?

So, I think this is an untapped, undiscussed, low-level discussed, need-to-be more brought up to the surface as to full-service bank branches and their absence from a lot of these communities, their contribution to this problem. But I think we, at the moment we have such a crisis on our hands, we've got to deal with this, you know, try to keep as many people in their homes who can afford to remain in them, as possible. And then focus back on them, and I'm glad you raised the point.

Shanna Smith: I would also just add that the Federal regulators examine the banks, and they're supposed to make referrals to the Department of Justice when they see something that violates the Fair Housing, Fair Lending laws, and that just hasn't been happening to the degree it needs to, and the Justice Department hasn't brought any major Fair Lending cases, I think the last ones they settled that were large were in 2002, and those were based on investigations that began in the late-nineties.

So, I think we have to look at the Department of Justice and the Federal regulators to make sure during your examinations when you find things that are not right, don't look right, seem a little wrong, to make those referrals, and allow Justice to start its investigations.

John Taylor: Can I reinforce this point, and put a little meat on the bone, just so we all know -- ?

Like, in 2006, the number of referrals, forgive me, but from the Office of Thrift Supervision to the Justice Department, the number of referrals of pattern of practices where they saw differences in treatment along the lines of protected categories like race and gender and whatever, the number of referrals --

they're required to make these referrals, right? The number of referrals to the Justice Department was zero. And that was true for the OCC. The FRB and the FDIC made the most, I think the Federal Reserve made four. This is in the period of time when we see this unbelievably disproportionate application of predatory, sub-prime predatory -- not all sub-prime is predatory, I get it, I know it -- but predatory sub-prime loans to African-Americans and Latinos, disproportionately along class lines, and no referrals. So, I'm just reinforcing Shanna's point there.

Shanna Smith: You can go to the Justice Department's website and look at the lawsuits that they brought, in Michigan, and you will see these red-lining maps, it's amazing how these lenders -- you know, it's just a donut hole, the City of Detroit is there, no home origination loans, very few refinance loans, and hardly any small business loans. But in the surrounding areas, hundreds and hundreds of those loans were made.

And if I were a lender, I would go to that site, and I would look at those maps and see what the referrals from the regulator showed, and what they found when they did their investigation. And if I were a lender, I would create these maps in my own office, to see where we're marketing, where the market penetration is happening, what areas are we neglecting, and see if there's a market there that you could do more business in, because there's business to be had in these markets.

Barbara Rehm: Excellent.

(Off the record at 3:11 p.m.)
(On the record at 3:31 p.m.)

Sharon Stark: Well, thank you all for staying for our last panel, which is last but definitely not least.

As I said earlier, when we put the Housing Conference together, we really tried to cover the issue from a lot of different perspectives, starting with the state of the housing and mortgage market this morning, the future of home finance, the impact on the consumer, the impact on the banking system, and then our next panel will look at the impact of the capital markets on housing and finance. We've heard a lot about liquidity, no secondary market.

And it's my pleasure this afternoon, to introduce Ron Insana, who will moderate this panel. Ron is another financial face in the financial news, I'm sure, to many of you here. He's currently the founder, managing director of Insana Capital Partners. He's also a senior analyst and commentator with CNBC. Many of you have seen him on in the afternoon, and certainly throughout the day on CNBC.

Ron has been a lot of cycles, and it's not to date you Ron, but Ron was reporting during the 1987 stock market crash. He has continued to follow the financial news, in addition to authoring three books at the same time. And as I said earlier, starting his own company, Insana Capital Partners.

So, please join me in welcoming Ron Insana.

[Applause.]

Ron Insana: Sharon, thank you very much. Good afternoon everyone. Thank you for sticking around for the last panel. As Sharon said, I know that's always sometimes a difficult proposition.

But I can't think, in the context of the conversations that are being had today, a more important component of the crisis we're going through in credit right now, than actually having a full-length discussion about the current state of the capital markets, not only with respect to mortgage finance, but also with respect to credit in general because they do seem to be fully interconnected at this point.

I would like to welcome my guests, and in the interest of brevity, I will give you their names and titles, but we'd really like to just jump right into this conversation and get to the heart of the matter.

Rod Dubitsky is managing director at Credit Suites. To my left, Marshall Haines, principal at TPG Capital. Michael O'Hanlon, senior managing director at Marathon Asset Management Company. And Thomas Zimmerman, managing director at UBS.

And it seems, with all the press that the mortgage market, the housing market has been getting of late, we still necessarily haven't gotten to the bottom of what's wrong with the credit markets at the moment, and exactly how we got there. And I'd like to, as my old boss Jack Welch used to say, do a deep dive on that in just a second.

But first, if I can, I'd like to get just an update on the current status of the capital markets, not just domestically, but globally, in order to frame the conversation that we'll have. And Rob, when we read the papers right now and we see that there are plans to help improve liquidity in the mortgage market domestically, there are also similar and equal, if not larger troubles going on elsewhere in the world, whether it's the UK, Germany, Spain, potentially Australia down the road.

Are the capital markets, at this point, functioning properly, in so far as once a bail-out, of sorts, is attempted, that it may actually take hold?

Rod Dubitsky: Well, I think, you know, covering the asset-backed market, which primarily has been sub-prime, we're clearly in the eye of the storm and there is definitely not what one would call a functioning capital market in sub-prime and across the entire asset-backed securities space. And take that on a global basis, and I think globally the structured product market is having difficulties to say the least. Commercial mortgages in the U.S., global mortgage markets are having trouble. We're reading about UK mortgage lender having difficulties.

The flip side of it is that there is still a dramatic, significant amount of global excess cash flow and capital and liquidity that, in theory, could snap this back pretty quickly. But the problem is, is I think one of the earlier panels had a alluded to, there is fear in pack, nobody knows where the losses are, nobody knows how deep the losses are, whether it's the U.S. sub-prime market or the UK residential mortgage market, or the German commercial mortgage market.

And so I think that's sort of the difficulty we're dealing with, lots of excess liquidity and capital to put to work there. A lot of distressed hedge funds that are out there ready to buy some of these distressed assets. We saw a transaction between E-Trade and Citadel, which may be the first of the pattern, but right now the capital markets in my sector isn't working, and I think that's, you know, visible across the globe.

Ron Insana: And Marshall, with respect to that, we don't know the extent of the losses, we have not yet had financial institutions, without casting dispersions, be entirely forthcoming about the extent to which they are exposed to a variety of different credits. So until we get our arms wrapped around the size, scope, and depth of the problem, will we have a capital market that functions properly, and then restore some liquidity to the housing market, which obviously is badly needed at this point.

Marshall Haines: Yeah, I think Rod, just to step back a little bit to set the context. If you think about what happened, you had a bunch of product that was being created through a value-chain, starting from the borrower, all the way up to the securitized security buyer. That happened very quickly and was done in a way that was relatively opaque to the end buyer.

At the same time, you had a bunch of new products getting created, low-doc loans, high loan-to-value loans, and those got bundled and packaged. And really the buyers of these securities used the rating agency as the proxy for visibility to the end market. You think back to the old days, a bank would lend to someone that they know. Bill Stevens said, "Always make sure you know your party." Today, that has been disconnected. And so it's very difficult for people that are sitting all the way across the globe, looking into the U.S. market, trying to figure out what actually is in the underlying security that they bought.

And so, until we have better transparency and better predictability of the underlying assets, it's going to be very, very difficult to unfreeze those markets.

Ron Insana: And Michael, it's interesting, you know, for the first time, certainly in the history of my career, but maybe in mortgage finance, we had a period during the latter stages of the real estate bubble, for lack of better description, where the buyer set the terms, as opposed to the lender. I mean, you literally could walk in and tell a lender what you wanted to pay on a month basis for your mortgage, and someone would customize that into a mortgage that would ultimately be securitized.

Was there a point at which the traditional benchmarks for lending were entirely abrogated and helped to create the situation in which we now find ourselves?

Michael O'Hanlon: That's definitely the case and, you know, the consumer advocates, you know, who came up, make a good point that the criteria that were put in place were basically too liberal. And, you know, when you have an 80/20 loan with the 20 percent second and very low FICOs, you know that a problem's going to be created and losses are going to be very high.

And, you know, so I think it's very clear that there were issues and that the capital markets, you know, really didn't focus on a lot of those issues, nor the rating agencies, as the securities were created. And that today, obviously is the problem. So, yes, simplistically. A lot of bad stuff out there.

Ron Insana: Now Tom, have we seen the worst or is there something else to come? I mean, we know that in the sub-prime space, mortgage resets are upon in the fourth quarter, unless the current plan goes through to freeze those resets for some indefinite period. We're reading in the paper this morning, for instance, that even credit worthy borrowers are now having a difficult time obtaining mortgage loans, maybe the simplest loan to get if you are indeed credit worthy. And we've read other things over the past couple days that are somewhat discouraging when it comes to the real estate market, not the least of which the new homes sales report out last week, showed a 13 percent year over year decline in median home prices across the country. Are we in the third inning, the sixth inning, or the ninth inning of the problem phase that we face right now?

Thomas Zimmerman: We know it's ninth or the sixth. I don't know if it's the second of third, but it's pretty early in the process. I think the panel we heard this morning, talking about another year or two of this, is probably right. There's very little you can do. It's already set in motion. And unless somebody wants to do a "Katrina" kind of bail out here, and there's now political will to do that, you can't stop it. I mean, it's already going to happen. So this is -- the die is cast, we're going to play this thing out and it will take a lot of people with it.

So I think, the way you started the conversation was about the liquidity. And as Rod says, there literally is no liquidity in the non-agency market. If you are a mortgage lender, you have a balance sheet, you can make a loan or you can find a borrower who fits the Freddie/Fannie guidelines. If it's neither one of those two, that loans not being made today, which means that even -- what's interesting, is even a prime loan, great FICO score, 80 percent LTV, et cetera, et cetera. If you originate that loan right now, a package and try to sell to the capital markets, they'd pay you 95 cents for it. So, you need 103 or something to break even. You lose seven, eight cents every loan you create.

You can not create a loan out there, good solid -- everybody agrees it solid, solid loan, and sell it into the capital markets. That's how dysfunctional it is right now. So, that has to cure. We have a long ways to go to cure that piece of it, but it's all sort of already set along this track, and unless something really major changes, I mean really major like a Katrina type, $100 billion bail-out of some kind, you really can only modify it a little bit.

I'm not saying we shouldn't try to do things to kind of help what this whole conference is about, but that will help a bit. Unfortunately, I think it will help marginally and not dramatically. It will help a little bit.

Ron Insana: Michael, let me ask you about that. I mean, I want to get into some of the root causes of this, but I want to kind of at least deal with some of the current headlines as we back into the story, if you will.

We have seen proposals -- I've discussed myself on CNBC on numerous occasions in the last month -- calling for a resolution trust style bail out mechanism, that unlike this SIV bail out that everybody's talking about for the major banks, for structured investment vehicles. In an RTC style situation, you come in and buy the low end of the capital structure to set a floor, to induce speculators to come in an make markets in lower rated securities so the top end will ultimately perform as expected.

This is a legislative undertaking probably, it's an undertaking that requires a great deal of political will. In an election year, will we likely see something happen along those lines, that at the day, what actually probably costs taxpayers money and would then lead to the usual allegations of bailing out speculators and wealthy investors rather than individuals. Is there the political will and the mechanism for this to happen?

Michael O'Hanlon: I think it's very unlikely. And part of it is that, you know, who owns these, first. With the RTC there was the benefit of the fact that all of the institutions were taken over by one entity. And so they really had the control over the flow of the product in and out, you know, kind of in because the institutions were taking over.

Today, when you look at the entities that have really taken the bulk of the losses, they're large financial institutions. The bail out will occur, you know, basically with names that are household names. And then for the folks that bought the mezzanine credit, a lot of those folks really are all over the place. They're institutional investors who buy BBB Securities. And to bail out a lot of those folks, I think is near impossible. So I think what really needs to happen is the price between where these assets will clear the market and the price at which they're being offered needs to come in. And that really is what will affect the circumstance.

As we look at some of the problem loans that were created, we say it's performing or sub-performing, and our price might by 50 or 60 because, you know, you look at real estate prices in certain markets falling by as much as 20 percent. And you need to price that into it. And the sellers, either they can't take the pain or don't want to take the pain, whatever, and so they're not going to get there in terms of liquidating a lot of these securities.

So, our view is that it's going to take a period of time, even with the accountants saying, "Look, let's perhaps mark these things to market better at the end of this year." It still will take a material amount of time for these assets to go into hands that probably want to own them and really work them out for the long-term.

Ron Insana: Marshall, it's interesting, Michael raises the point of mark to market, which has become almost a humorous expression in the financial markets, because no one at this point knows how to do that with not only mortgages, but almost any arcane credit derivative that's out there. I mean, we hear anecdotes from people with whom we do business who say, "Well, we'll call up a firm that's going to give us an external mark, and they'll say it's 70." And we'll ask them if they'll buy it at 70. And they say, "Absolutely not." So, that's exactly marking to market.

So, in the absence of an ability to mark securities to an actual value, how do you find a market clearing price that restores some liquidity to the marketplace?

Marshall Haines: I agree with everything Michael says. I think the challenge is, assets have to actually be sold. So, if you're an accountant -- these are the guys that are probably going to have the toughest job. If you're trying to figure out how to mark assets on a balance sheet today, very, very difficult to do. You really have to have a trade. And the problem is, very few of these companies want to trade. We saw E-

Trade trade its securities out. That was really the first time that someone did a wholesale marking, effectively, of those assets. But until you have that, unfortunately you know what the market is. And so, either people have to get into deeper dire straits unfortunately and have to unload these assets, or there has to be some external mechanism that comes in and forces them to sell to drive that mark.

Ron Insana: But that's effectively what happened with Citadel, right? I mean, they knew that E-Trade was either gone or owned by them.

Marshall Haines: That's the only scenario where I think you see that mark. But the good new I think is, there's lots of capital, including our own, out there that's looking for opportunities like that. So, I think on the supply side, Mike's fund, our fund would love to buy at the right price some of these assets. The question is, how to get a buyer and seller together when there isn't duress on the owner's part.

Ron Insana: And Rod, it's interesting, when you look at spreads, whether they're junk spreads or whether they're mortgage spreads, or whether they're commercial mortgage spreads, you know, they've widened out an enormous fashion relative to where we've been. Where earlier this year, they were the tightest on record. And people think now that because junk spreads are 500 or 600 basis points over comparable treasuries, you have a buying opportunity.

But when you look back at recent history and the prior two recessions, spreads have gone out to 1,200 or 1,400 basis points. And there a lot of, maybe less experienced distressed buyers right now who are licking their lips and getting ready to buy. And if there is an adverse economic environment, they're going to get killed. So, how do you know at which point, both from a market perspective and from an economic perspective, it's safe to begin this distressed buying process without blowing your fund our your investors up, before we've seen, as was indicated earlier, the worst of this cycle.

Rod Dubitsky: I think that's a good point, and I think if you look at what was happening -- and I'll throw out a term there that maybe you're not all familiar with, it's the ABX index. It's an index of synthetic sub-prime, BBB, A, AA, AAA bonds. And that is traded on a daily basis, and there are prices and that can be used to benchmark portfolios.

But if you look at that index, as it was selling off dramatically, you had really money coming in saying I think now is the time to buy. So for example, when the BBB traded from 80 to 70, some real money came in and started buying there. Then it traded it down to 60, more real money. Eventually, a lot of this real money came in, and it went all the way up the capital structure, all the way to AAA, all this real money kept coming in all along the lines and kept getting burned as the index kept selling off. And you have investors out there who bought AAA bonds. And still AAA's looked like they're going to be money good at this point, the sub-prime, not the CDOs.

And that's been the problem, is so much of the real money that's come in has gotten burned, but we can sort of bound the problem. Most of the market consensus on the losses in sub-prime, range from 10 percent on the low side to about 20 percent cum losses on the high side. Now the actually losses to date is only 1 percent. So all of these government programs are coming on line. We talk about RTC, but to me the losses are so early in their incipiency. What the government's doing on the loan side, workouts, FHA secure, getting these borrowers refinanced, can move that needle from 20 percent, which is where the market's pricing and higher, down to closer to that 10 percent level. And for investors who have confidence that some of these workout programs will be effective, some of these securities at current trading levels are pricing at such high losses, that assumes none of this will work, none of these workout programs will be effective at all. And at that point, you might get some this distress money that's on the sidelines coming in.

Ron Insana: Rod, let me ask you about that though, because I've been trained to believe that the market sends an important message and you get a price signal from something like the ABX, which has traded down to about 16 or so. The only people who have made money are those who have been short the ABX, like Mr. Paulson, not our treasury secretary, but the other Mr. Paulson, the Hedge Fund man who's made something like $8 billion being short the ABX. And as you say, other people were selling to him or were buying from him as he was selling it down.

At what point do you take the ABX at its word, if you will, that this situation is far worse than most people realize? Or is this just a bear raid on a misunderstood index?

Rod Dubitsky: Well, and that's, those who sort of have taken the ABX index as being largely a technical sell-off were sadly mistaken when they stepped into it. And there really is no way to know. You've got, again, 1 percent losses versus a market assumption of over 20 percent, and the only thing is, you can compare it to history.

And we look at an issuer, for example, Guardian Savings & Loan, which maybe some of you remember back in the early '90s. I was a former regulated, and looked at them as a regulator, and their pools were sure 100 percent California and maybe 60 percent Southern California, originated at the peak of the real estate market in 1990-91. Those deals had 20 percent cum losses, much lower loan balances, 100 percent concentrated in not only a real estate recession, but an economic recession, at least as far as California was concerned. And those loans suffered 20 percent losses.

So if you look at the 20 percent losses suffered in this sort of environment, where the economy is still relatively benign, and we're still early in the process of this workout environment. Are we going to get to those 20 percent losses? And the AAAs, I think, are priced even higher assumption of losses. Well, maybe you can kind of benchmark it to history, and say, "Well, maybe we won't quite get there." But it is extremely difficult and again, those who have gotten in early have really gotten burned. And it's hard to know where the bottom will end up. But eventually somebody will be right buying at some point, and we may be close to that point.

And again, some of these workout programs, not enough detail to know whether they'll be successful, but it's definitely moving the momentum into helping borrowers get out of their trouble loans or at least be able to afford them.

Ron Insana: And Tom, let me ask you about that historical analog. When we had the last big real estate recession that started in Southern California in 1989, hit Boston, hit New York, hit Chicago, hit the major cities. Even though it was a real estate bust of some historic proportions for the localities involved, it was very much regional. Whereas this time around, we have a effectively a national -- despite arguments that I've had both publicly and privately with people like Alan Greenspan -- we have had a national real estate bubble and a national real estate bust. Even those areas that have not gone up that much have already started to come down. Is this a different phenomenon, and then by definition, will the loss profile be different than the one that Rod just described?

Thomas Zimmerman: Well, the first part of that, yeah, this is different. I mean, if you take a look at the price movement from different States over the past 30 years, historically you'll see part of the country is going up and some is going down, as you suggested. It wasn't always in synchronization. You start about 2000, maybe even '96, '97, every State, Ohio even, let alone California and Florida, put Ohio is a positive HPA. It may be a disaster in some respects, but not in terms of where real estate has gone in the past -- I'm not talking about the last year -- but up until like the beginning of 2006.

So it was a very -- and we wrote about this two or three years before the deluge, so to speak. We have those graphs showing that, in fact, all these States are moving together, which is really unique and unusual about that. And I think that's why when people talk about a housing price decline, in terms of 15 or 20 percent nationwide, that's kind of scary, because normally you might see that kind of a contraction in prices in California during the great recession in the mid-90's or in Texas or in Boston, when bad things happened, or in '89, '90 problem.

So from that nationwide point of view, this is really unusual. And I just want to add one other thing -- I don't think anybody mentioned this yet today -- was that there's that wonderful chart that Robert Shuler puts out, in terms of real prices, in terms of home prices. If you look at that chart, you don't care about sub-prime, you just say this whole this is crazy and we're all going down. Because this chart that he put together shows real home prices, dwarfs the post-World War II increase in real prices.

And historically we used to talk about the great housing market that was created after World War II when the GIs came back, GI Bill et cetera, et cetera. You take a look at the chart and real prices really jumped dramatically in that period right after the war. And then we saw nothing like that until this period we're in right now. This is the most incredible housing bubble ever.

And so, it's not just a sub-prime problem, this clearly is not just a sub-prime problem. Even if the sub-prime guys had not done what they did, we'd still be sitting here. This is an enormous, you know, real estate correction is going to take place.

Rod Dubitsky: What city in the world can you say real estate prices are cheap and a great bargain?

Ron Insana: Buffalo, but I'm from there so –

Thomas Zimmerman: But in terms of losses, the last part of your question. And that's interesting, because the numbers we're talking about is a recession for sub-prime, these are like really deep recession kind of numbers already in the sub-prime world. Unfortunately, I don't think everybody thinks we're having a recession. I don't think everybody betting on the ABX, where it's at now, makes the assumption we're going to have a recession.

And if in fact, in the next six months, this thing does turn into a recession, then I don't think that 20 percent number, regardless of what kind of programs come along, people will think is unrealistic. So I don't think it's over with yet in terms of people's bad expectations about how bad this thing can be.

I mean, people only started talking about a recession a couple months ago. Once it finally becomes embedded and you take a look at -- up until this last cycle, if you were to ask me back in '04 what drove the faults in the sub-prime market, I would say two things, unemployment and HPA. So now it's all just HPA, we've got no unemployment. But if you factor in a one or two percent increase in unemployment, then these numbers really get really bad. As if they aren't bad enough already.

So I think we're far away from really understanding exactly how bad this thing can be, either in terms of prices or in terms of losses. That's why this uncertainty is out there. No one can mark these things to market because they don't know what the hell is going to happen in the next sixth months. And depending what happens, that valuation can be very, very different.

Marshall Haines: Tom, you've hit the nail on the head. As an investor, if I go in front of my investment committee, the first thing they're going to say is, "Are you thinking that the recession is going to happen or that it's going to be benign?" Because those two states in the world will lead to a very different pricing and return profile. And so until investors out there can have a point of view one way or the other on which way the economy is going to go, it's very difficult to price these assets because it's really binary between those two states of the world.

Ron Insana: And Michael, with respect to contagion, and I'm not just talking about geographic contagion, which we already know is, in a sense, underway. I mean, we've experienced Northern Rock in the United Kingdom. We've seen two German banks get taken out. We know their problems in Spain.

But with respect to other asset classes like sub-prime credit cards or sub-prime autos. Sub-prime autos we saw earlier this year become somewhat problematic, but we haven't seen the credit card experience yet manifest itself, because consumer spending has held up relatively well and their ability, to a certain extent, to service debt has held up relatively well. Does this problem invariably lead to other problems in the credit space that we haven't yet experienced, even commercial mortgages, for instance? We've seen spreads blow out there and we thought commercial had decoupled from residential, and that may not either be the case.

Michael O'Hanlon: Well, I think it varies by asset class. You know, when you look at sub-prime auto, there are issues coming. And it's not only because credit moving over, but also because a lot of the sub-prime lenders rely on Wall Street financing. And that Wall Street financing is more difficult to get. So, the supply -- first there's going to be more credit problems with the paper itself, but second they'll be less lending against it.

With regard to the credit card market, our view is that there will be significant issues coming. When you look at the stock prices of some of the major credit card lenders, they're lower and they should be lower, because those issues are coming.

With regard to commercial real estate, the view there is really more liquidity, that when you look at our anticipation of where commercial real estate values are likely to be, our sense is that unless there's a recession, that they're likely only to fall by 10 percent. What the issue is, is liquidity, that again, that's a capital markets issue because the capital markets have replaced a lot of the bank thrift sources of lending. That market has shut down and so spreads on real estate loans have gapped out enormously. And so, as people look at that, you know, the ability to refinance, if somebody can't get new money, then that in and of itself creates defaults.

Ron Insana: Yeah Marshall, let me ask you about that. I mean, lest we drive the audience towards pulling razor blades out and opening their wrists.

When Sam Zell, the largest landlord, both commercial and residential, in the country, decides to sell $38 billion worth of commercial real estate to a very smart group of people at Blackstone. Knowing Sam as a value investor and as well as I do, when he sold his entire chunk of commercial real estate holdings in a single shot, to me I didn't think there was any other question to ask at that point about what was going to happen in the commercial market, because he is, in the history of his career, never mistimed a move that large.

Is that the type of signal that, for someone in your business, would make you worry, regardless of whether or not Blackstone made money on the transaction?

Marshall Haines: Well, I think you have to answer the second part, right? So, the first part is, is Sam Zell selling a harbinger of the doom and gloom and the world's going to fall apart? Possibly, but the guys at Blackstone are very, very smart guys. And I think so far they've done reasonably well with that investment, in fact. So, I think I would put it as a cautionary note, as something to put into your mental model of risk and return, but I wouldn't say it signals the peak and that henceforth everything's going to go down from here.

Ron Insana: Rod, how did we get here? I mean, we know that there's plenty of available capital for a period of years, post-9/11, post the bursting of the stock market bubble, the Fed reduced interest rates to historic lows, we had a $1.4 trillion tax cut, all of which was in response, justifiably so, to the feared dislocations that would come out of the double events of a burst stock market bubble and 9/11. But you also had rising wealth pools created all around the world, higher oil prices, burgeoning trade surpluses for countries like China. We had liquidity everywhere you looked. And we also have now, $750 trillion worth of credit derivatives outstanding, knowing that that's the notional value, not the value at risk. We still had a lot of money, a lot of leverage, and very little transparency in the entire process that took us to this point. Is transparency the issue, is it credit that was too easy, was it relaxed lending standards, what's the genesis of the problem that we find today?

Rod Dubitsky: Yeah, it's all of those issues. The transparency -- you can say transparency is an issue, and it absolutely is, but if you look at the level of disclosure that you get in the U.S. residential mortgage market, most issuers will report loan-level data in extreme detail. And you don't get that in any other ABX sector and I don't think you get that in any other residential or consumer asset anywhere else in the world. So if the disclosure in the U.S. residential market was insufficient, it's probably worse in every other market.

But I think there are gaps in what the rating agencies do and what the market expects them to do. For example, they don't do due diligence, and they view themselves -- as a former colleague at a rating agency I used to work for said, "We're just a little old publishing company." Well, they're the most powerful publishing company in the world and they're probably among the most powerful unregulated entities in the world, and they have enormous challenges. And generally throughout cycles they generally done a good job. They obviously missed it here. They were late in adjusting credit enhancement levels.

And also, it's not just the sub-prime market. You alluded to the synthetic market. The sub-prime bonds that are most at risk are maybe $50 to $100 billion, let's say BBB, A bonds. But those were multiplied in manifold by the synthetic market. So if you had $30 billion or $40 billion sub-prime BBB cash bonds, maybe you had $400 billion created synthetically, those then went into CDOs, most of which is rated not just AAA, but super-AAA, super-seniors you've probably heard. And so there are investors who thought they bought bonds that had very, very little risk that were entirely backed by BBB bonds. It was all based on the CDO model, and how do you create 80 percent AAA bonds on collateral that's entirely BBB. It's this notion, well, they won't all move together, all of these 2006 BBB bonds won't really move together, the notion of correlation and diversity.

Well, once that broke down, and as we see with 80 percent of sub-prime bonds being downgraded, those AAA bonds effectively collapsed from being AAA to converging to the rating of the underlying bonds, which is really, at this point, at best B and probably CCC.

So, the problem is, when the rating agencies make a mistake -- and we saw it in manufactured housing and franchise -- when they make a mistake, they artificially create extremely cheap capital. And when artificially cheap capital is created, a flood of liquidity goes towards that. And so there was demand from the liquidity globally, the rating agencies created this, and the models were reasonable, and the thought process was reasonable. It clearly did not work out at all. And when you created the cheap capital, a flood of origination was created. One sub-prime mortgage lender when asked, "Why did you make these stated income loans?" They said, "Well, Wall Street kept asking for them."

And so, it was not just one point in the food chain, it was from the broker, which we heard about earlier. It's from the banker, the dealers to the rating agency, and there were problems all along that process, that chain. Links were missing from the chain, the due diligence chain didn't connect from the buyers of the loans to the rating agencies. So we need to, I think, enhance the standardization of due diligence, have the buyers of loans, who securitize, disclose the results of some due diligence, at least in summary level.

We rarely as -- and we're on the research side, so we're on the public side of the loss, so I kind of really stand in the shoes of investors. Investors rarely got to see the results of due diligence. So one firm might say, "Well, we do 100 percent due diligence." Well, what does that mean? Does that mean you reviewed every loan and you bought every loan? Did you kick out some loans? If so, how many did you kick out and why? So saying you reviewed 100 percent or even 20 percent doesn't tell me what you did with the loans. You can review 100 percent, hate 20 percent of them, buy them all and just pay a lower price.

So, I think that kind of the due diligence process, to the extent it's standardized and disclosed and made more transparent and that there's some other cop other than rating agencies acting in the due diligence role. I think that will help tremendously.

Ron Insana: Tom, did somebody drop the ball here. This is fun part of the conversation where we get to find somebody to blame. The rating agencies obviously are paid by the issuers of the securities that they are rating, which is, to some people, an inherent conflict of interest. We have had arguments publicly about whether Mr. Greenspan's very famous statement at the top of the housing cycle to take an adjustable rate loan encouraged some of the behavior. And I think he may have been misunderstood in that statement, and I've known him for a long time and we've talked about it.

The Office of the Comptroller Currency tried to tighten lending standards at the top of the cycle, but arguably failed in imposing that discipline. Did somebody drop the ball here along the way, that allowed for bad behavior, for lack of a better description, to continue?

Thomas Zimmerman: Yeah, we've talked about this, and it's kind of an interesting, to dissect what happened, but everybody's to blame, there's no one person, we're all to blame -- I mean, the consumer, obviously he thought he'd roll the dice on the housing market -- everybody I knew in 2003 and 2004 when I'd mention this is a really unusual housing market, "Oh, it's the place to put your money," and now we're going to try to figure out, I heard comments this morning about, "Well, what we're going to do, we're not going to bail out the speculator." I would love someone to talk to all of their friends and figure out how many of them did or did not speculate on real estate in the past 10 years. I mean, come on, this is like dot com all over again. You have a bubble, we all get involved in it, it's a lot of fun, it's not much fun when it's over, and it hides all of these bad things on the way up, whether it's dot com, whether it's housing -- those all get hidden, there's never investigations on the way up, there's never any crying on the way up, there's only hand clapping, and the only investigations happen on the way down. So, here we are again, we've all been through it several times.

So, consumers were, you know, in many respects, didn't understand some of these very complicated loans, there's no doubt about that. There are also many consumers who did, or didn't, but didn't care, because they knew the housing market was only going to go up, because that's what they had been told, or they believed. We were in a laissez faire Administration that really didn't believe in very much regulation, and when regulators thought about trying to clamp down a little bit, they had to face the fact that their President and their Chairman of the Federal Reserve and most Chairmen of the Congressional Committees, all of us applauding the 69 percent housing ownership, going up from 63 percent, so that's a good thing, right? So, it's pretty hard to come out, if you're a regulator and say, "Oh, I think this is going a little to far."

And there was discussions in late 2005 and early 2006 about sub-prime being kind of out of control and we should do something about it, but it was pushed back by the industry and by some members of Congress and elsewhere. And so, what could have happened in December of 2005, happened in July of 2007.

It's kind of interesting that the freezing of the capital markets took place in August of 2007, not in January or February or in March, but like literally a month after that reg came out.

So, I talked to people across -- not the universe -- but certainly many investors in America, many investors in Europe, all the way from March through June of 2007 saying, "You know, I think because the way the Federal Reserve has been beaten up before the Dodd Committee and the Frank Committee, they are going to kill the 228." And many, many major investors, and many, many major originators didn't believe that. And I don't know why they didn't believe it, but they didn't believe it.

So, going into June of this year, June of 2007, they were still creating 228s. Now, we try to -- I tried to tell a few people, "This is not going to go on," because the pressure these bank regulators are under, it's going to happen, they will stop that 228, 327 -- it's going to stop. But people kept originating loans, right up until the very end. And boom, it happens and guess what? A month later the whole thing breaks down, because now you can't say, okay, gee what? There is no sub-prime market anymore, it's gone.

Well, you sort of had a hope in February and March and April, that well, yeah, it's got problems, it's going to work its way out, we'll figure out a new kind of loan to kind of keep it going, but after that regulation came out, it was over. Everybody knew it was over. So, all of a sudden, what was sort of a proposition that maybe bad things will happen, it's in their face. And so, all of a sudden everybody starts to re-value what all these sub-prime bonds are worth -- they weren't what they were the day before -- and boom, it shut down.

So, we're all involved, we all got involved, we all had a good time, and now we're just trying to figure out how to put it back together again, without creating, without, you know, totally destroying the mortgage market going forward.

Rod Dubitsky: I don't know if Tom would agree, but if you plot the affordable mortgage, and it's not just 228s, it's interest-only, 40-year mortgages, 80/20s, option ARMs -- if you plot the percentage of the total market against real estate prices, I think you'll find that, if you look at 2003, real estate prices -- although they were running up were kind of reasonably fairly priced, relative to, on a global basis, relative to history. They were kind of in the ballpark, maybe a little bit expensive on the coasts.

And if you look at the -- when the Feds started to tighten again from the easing cycle, proliferation of these affordable mortgages were created, artificially inflating the affordability of homes, and it propelled, created a second leg to the home price appreciation that, absent these products, I don't think you would have seen, I'm pretty sure you wouldn't have seen -- if it was just hybrid ARMs and fixed, you wouldn't have seen anywhere near that kind of appreciation.

Ron Insana: Marshall, let me ask you about the securitization process, and what that did to mortgage finance, traditional mortgage finance. Alan Greenspan and I, for three years, had an intellectual debate over whether or not you could have a national bubble. His argument was that because of national banking and securitization, risk in the residential real estate arena was diversified to such an extent that there would be no kind of after problem.

My argument was that both set the stage for everybody in the country doing the same thing at the same time and securitization, rather than offering diversification, effectively became the transmission wire for risk, and it's like lighting a fuse. That once that fuse gets lit, the problem passes much more quickly around the financial community than would otherwise have happened. What's your take on that?

Marshall Haines: Yeah, I would say that's true if, if the models don't work. And I think what happened here is the models didn't work. Because you had new products introduced that people hadn't priced before. Again, remember the way the rating agencies, the buyers of these loans, the buyers of these securitized products priced them, is they looked off of history, and they said, let's look at the last six years, and see how these loans have reacted, and let's see what the min/max has been on cum losses and defaults and severity. And the reality is, these new products that got created over the last couple of years didn't have any historical precedent, so people didn't know how to model them.

I actually believe going forward, the securitization market will work just fine for these products, because people will know, "Okay, I know I'm got to -- " if they ever come back, "I've got to ask about the 228 mortgages, and I'll price them appropriately."

And quite frankly, for some consumers, 228s a perfectly fine product. It's not for everybody, it's a very, very small slice, but they have to be appropriately priced, and they can't go to everybody.

And so, I think the change is -- the securitization market certainly accelerated the problem, but I think as -- it's a learning ecosystem, and as they learn what the risks are, they will appropriately price the risk, and as you said, if you'd had that intel in the models to begin with, I think you wouldn't have seen the problems. If people had known -- if there had been 228s in 1990 --

Ron Insana: But you know, this is the black swan problem that Naseen Taleb talked about in his book about unexpected events in finance or any other arena. That, if you expect the problem, you'd never create the security that would cause the problem in the first place. So, Michael, with that said, the models invariably never work for new problems because you can not stress to the point at which they would factor in a fat tail event, an unexpected events, something, six, seven, eight sigma event as they like to say in statistics -- isn't that inherently part of the problem?

Michael O'Hanlon: That's definitely part of the problem. And, you know the -- but I also think it's also a little bit of common sense, you know, that a model is a model. And that, you know, people just took what came out of the models as the answer. You know, and that, you know, when a lot of the investors, you know, looked at, you know, what was happening in the market, and it was pretty clear, I think, to most folks, you know, what the practices were in the industry. And yet, you know, a lot of these securities, you know, were purchased, you know, particularly the, you know, kind of low BBBs, you know, by lots of folks who still had a clue as to what was going on.

You know, with regard to the people, kind of BBB and above, I think most of those people really don't have the expertise, you know, to undertake the due diligence, you know, on the securities. You know, so, you know, what they did was they, you know, they just trusted the rating agencies, as everybody knows, and, you know, it's a matter of confidence. But it's very clear that, you know, that the models were, you know, obviously wrong.

Ron Insana: Marshall, I want to go back to, we talked about this when we were prepping for this conversation, there was a feeding frenzy going on. I mean, you know, people earned money based on the creation of collateralized debt obligations, I mean there were these warehouses in which any structured finance shop could blow these things out in a matter of months, take in enormous fees, the rating agencies get paid, Wall Street gets paid for brokering the sale of these transactions, and it feeds into the bonus pool. You know, and not surprisingly last year was a record bonuses. Surprisingly, this year there's going to be another record on Wall Street, $38 billion, even as brokerage houses have lost $72 billion in equity and individual homeowners are struggling. And I don't blame Wall Street in a sense that there's -- in a moral sense -- but I mean, this was a money-making machine. If you were in credit derivatives, whether they were based on mortgages or not, this was a real killer app, if you will, in the financial community.

Marshall Haines: Absolutely. The question is, should somebody have done something about it? And I don't have an answer to that, but clearly it went too far, and people will make money up to a point, and then you've got to, someone has to come in and control that or, in fact, what we've seen happen will happen, which is that you break the machine, and investors and consumers will, unfortunately have to pay the price.

Ron Insana: Rod, that's almost a philosophical debate, though, do we let the machine break, because that's the way our machine works? Is that we, you know, we swing in that pendulum from greed to fear and fear to greed, or is there some intermediary that -- you know, even if our goal is 100 percent home ownership, we may not be able to get there naturally, we may not be able to get there without too much cumulative risk, so should there be some intercessor who stops the thing before it's too late? Or can you even do it?

Rod Dubitsky: Well, I think it's, if you look at, you know, for example the CDO is, they were so widely-distributed on a global basis, there was not -- if you're talking about where is the regulators in this, and who are the buyers of this while it went -- Northern Norway, Germany, Asia, I mean, there were 50 different countries with 50 different regulatory regimes there, how do you -- you know, and they say, "Well, this is a risky product, how come you didn't, weren't aware of it?" And they could say, well, this was a AAA bond subordinated by another AAA bond, so it was super AAA, so in theory I wouldn't have to look at it if I trust the rating agency.

So, I'm not sure where the regulators -- and regulator or not as in the OTS sense -- but who are the --

Ron Insana: Deftly done, I might point out.

[Laughter.]

Rod Dubitsky: Who were the policemen who would have stopped this? Again, there's so many different regulators who are at the different touch points, and I don't think at this conference at all we've mentioned the monolines, but they were, obviously have been in the eye of the storm to the extent that they brought this stuff.

So, there's not one single point on a global basis -- you look at these instruments that are being created, and it goes back to the rating agencies, and again, rating agency as publishing company probably doesn't make a lot of global regulators feel too comfortable, but when you introduce a new product and you create this regime -- and once you create it, it's really hard to stop. If you're a rating agency and you realize you made a mistake on the CDs, it's really hard to stop, because then you have to downgrade everything you've rated before.

So, once you create this new product, maybe there ought to be some sort of -- you know, some sort of formalized process during which the process of rating it, the methodology is reviewed by other than just the rating agencies themselves and the Wall Street firms themselves. Because frankly, you know, investors don't second-guess the rating agencies enough, and neither do the Wall Street firms. So, rating agencies create a process, it's cheap capital, done, let's originate more of this stuff, and that's it.

And somebody's got to, I think, look at that process, particularly for new products which is -- or where there's lots and lots of growth of a particular product. Well, why is this growing 50 percent a year? What changed this year? What happened? Any macro change that justifies or explains this growth? And if not, then somebody ought to step back and look at it.

Ron Insana: If I may, I'd like to take some questions from the audience because we do have some time. As you know, I believe there are microphones moving around the room, so if you can wait for the delivery, I'll start right there. Go ahead, please.

Audience Member: Thanks, first of all Tom, I'd like you to stop an urban legend before it starts. You didn't really mean that the Fed caused, that the getting rid of the 228s caused the freeze-up in August, did you?

Thomas Zimmerman: They were closely related, I think. I think there was a period where people were still naively believing that they could produce a 228 for the rest of their lives. And, if you could still do that, then you would not have this inability for these 228 people to refinance their loans.

Audience Member: I should have remembered my legal training and not asked a question I didn't know the answer to. But is the implication that the regulators should not have acted?

Thomas Zimmerman: Absolutely not, they should have acted sooner.

Audience Member: Here's my real question which is that --

Ron Insana: That wasn't your real question?

Audience Member: No. You talked about --

Ron Insana: That was the easy one, just to start us off?

Audience Member: Yes, right, just to set it up, right.

[Laughter.]

Audience Member: Marshall and Michael, in particular, talked about this issue that there is a lot of money ready to buy, the prices just have to get low enough so that people can sell. This morning we heard a lot about why it was a good thing to do loan modifications, because there are all of these embedded losses and this will help you reduce your embedded losses. If you buy cheap, you don't have those embedded losses. Now, one might say you have a whole lot of leeway to do modifications without losing money, but on the other hand one could say, "It's all potential gain, why should you bother with the modifications?" Which way would it go?

Michael O'Hanlon: I'll start. Well, first, we own a servicer, okay? That's Merrick Servicing, and it is a special servicer with the explicit intent, you know, to try and work-out these loans, so that they don't have to go into foreclosure. And our sense is that, well, our argue is that it is best to work out a loan, and we will be much more active, I think, working them out, because we are the owner, we have control, as you mentioned, there is a price at which these are being purchased that gives us more flexibility to work them out, you know, so, you know, I think it's very clear that the folks who buy these at a distressed price really have yet more of an incentive, you know, to make sure that things work from a homeowner's perspective.

Marshall Haines: I'd echo that, I think it's just two paths to the same end result, which is you can either give people relief now, which obviously hurts the value of that loan today, but may make it more valuable over time, or you can buy that deep discount today, such that the next investor in that loan can work with that consumer to re-craft and re-cast the loan that will allow them to stay in their home, and continue to make payments and hopefully see some equity appreciation. But they really both get to the same end result, through different means.

Ron Insana: Over here, yes sir?

Audience Member: The panel began addressing this, but were we looking at, as this proceeded, a much greater regulatory failure than really ahs been put on the table? Maybe starting with the Federal Reserve system?

Let's go back to the conversation that the moderator had with Chairman Greenspan, and wearing his monetary policy hat, okay, Federal funds rate of 1 percent carry forward through June 2004, then going up by one-quarter increments over 17 OFMC meetings, denying that there was a housing bubble in any way, shape, form or manner, and then putting on the regulatory hat of the Federal Reserve system, remember they fought for the death for umbrella super reg authority in Graham-Leech-Bliley, you had Enron Special Purpose entities within Enron which was a clear signal to the world -- watch out what you take off balance.

And then a few years later, CitiCorp SIVs and the rest with absolutely no Fed oversight of SIVs and what was created. I mean, aren't we looking at a root cause, and the root cause is, as a panelist said, laissez faire regulators who really weren't there regulating, and you end up with what is approaching systemic risk.

Ron Insana: Rod, if I could just modify the question a little bit, because I think in -- from my point of view, the 1 percent funds rate was a appropriate response to the fears of deflation that we had in 2002, which given the bursting of the stock market bubble and the effects of 9/11 was absolutely called for. Whether or not that went on for too long is a kind of economic and academic debate we could have for quite a long time, and the unwinding of that was probably appropriate, because rates were so low -- so dramatically low -- for so long.

With respect to the oversight issues, however, how important were those, with respect to what the Fed did or what the OCC did or didn't do, that may have aided and abetted the process?

Rod Dubitsky: Well, I think it's difficult to talk about the regulatory process, again, because there's so many different arms, and a lot of these securitization process was not necessarily under the regulated institutions that we kind of commonly think of.

So, for example, you start with a broker, and I think most people, even the brokers themselves recognize that there's insufficient regulation, licensing, net worth suitability requirements for mortgage brokers, and I think the gentleman mentioned the ABC, PSIV issues, and there's the contingent liability issue that we've seen going back a number of years, and some of these liquidity puts that cause a lot of, billions of dollars to go back on the balance sheet. You know, I guess there's issues from a regulatory capital accounting there that's kind of beyond my area of expertise, but again -- and Tom alluded to it earlier. Is when the first interest-only regulatory guidance came out that had an impact, and at the time I had wondered, "Well, why is this not applied to a 228 hybrid ARM, because there's a lot of interest rate risk to the borrower embedded in that product," and then they did come out with the product a year later, and maybe at that initial guidance of interest-only -- if at that point they had brought in the 228 and maybe they would have killed it sooner, and that contributed to their, the elimination of 228s, rating agencies were making changes as well, but the combination of the two killed the 228, and definitely, sort of, accelerated the downturn.

But, I think that if you look at from a regulatory standpoint, if at that point they had said, "228s, whether it's IO or not, if there's a big teaser in it, that has to be underwritten to the fully indexed rate." And I'm not sure that fully indexed rate is the right way to go, I think there's a more nuanced way to do it, but if it had brought in at that point in time, I think at that point you would have slowed the 228 regime, and maybe eased, you know, you would have taken another year off of the housing price appreciation. At least, contributed to a slower appreciation at that point, maybe.

Ron Insana: Marshall, let me get your take on that before I go back to the audience.

Marshall Haines: Well, I think it's there's no doubt that the regulators could have done more, but as many of the panelists have said -- everyone could have done more. And so it really was a breakdown broadly across the CDO buyers, the rating agencies, the regulators and so forth, and I do think to Tom's point, it was probably tough to be a regulator back in the you know, 2006 timeframe when everyone is having the dream of buying a home, and home ownership went from 63 percent to 69 percent, to come out and put the brakes on that.

So, I think you really have to step back, quite frankly, probably not now, but once the dust is settled in a month or two or three or six, or whatever it ends up being, and carefully re-think what the role of the regulator should be, carefully re-think what the role of the rating agency should be, as opposed to rushing to some -- first of all, lay blame at everyone's door, because I think you need to fix the problem first, before you start laying blame, and then think about how you can constructively attenuate, because you won't solve cycles -- but at least attenuate the problem from happening to the degree that it did in the future.

Ron Insana: Yes, sir? We have time for two more so this gentleman right here will be next.

Alan Mendella: I'm Alan Mendella with Tom on the Federal Housing Finance Board, and we went for about three-quarters of a century without problems of suitability, ability to repay, et cetera, cropping up in the housing finance market. And the reason why, I think, was we had a system where you had a proper alignment of interests. First, the savings institutions funded mortgages, they had a vested interested in doing good underwriting, and making sure the borrower could repay, because if there was a loss, that institution suffered the loss.

When the savings institutions collapsed under the weight of interest rate risk that they couldn't manage, they were replaced by Freddie and Fannie, who also ensured there was good system of credit underwriting, because they held 100 percent of the credit risk. If there was a failure to pay on a loan that was purchased by Freddie or Fannie, they bore the credit risk, and so they ensured -- they were the gatekeepers of credit quality through the system.

What replaced that when Freddie and Fannie were pushed into a corner was a system with such fundamentally misaligned interests, that no regulation in the world could possibly fix it. There basically was a system that arose -- not because everybody was to blame -- but because the structure and the incentives in the system were so fundamentally flawed. So, no one held the credit risk, in a sense. No one in the chain of origination through disposition into the secondary market ever held any of the credit risk.

The only thing the originator, who was a broker, was concerned about was an early payment default. If the borrower took two payments on the mortgage, they were off the hook, they took their commission and went to the bank.

So, I would say how about looking at this from a systemic perspective, look at it from the set of interests and incentives that were laid out there, and think about how to fix a system that is flawed because the incentives are all misaligned.

Ron Insana: Michael, let me ask you about that, or Tom, do you want to go first, did the market outrun or end-run the regulators, then?

Thomas Zimmerman: Well, I don't know about that, but back at this point where the securitization market really, because there was no skin in the game, that these guys, companies originated these loans, misbehaved because they didn't have any vested interest -- that's just not true. Many of them had massive amounts of residuals on their books, many of them went out of business because of this. You know, and also if you're in a business, and you view this business as an ongoing business, and you create lousy loans, you're not going to be in business. I mean, I don't care who's got the risk. If you shed the risk to somebody else, and you create a bunch of lousy loans, who's going to buy your loans tomorrow? I mean, I don't -- I agree there is some truth to what you say, but I think there's also truth to the fact that there is self-evident things in the business world, that if you just create lousy loans, you can get by with it for a short period of time, it doesn't last very long, for instance when the housing market turns around.

But, I mean, you could have created anything in '02, three, four, five and got by with it, but you know, you can not create those kind of loans in a normal, quote -- if there had been no asset bubble in that period, they couldn't have done that. Because, they would have created a loan, and the next thing, we'd be watching this crazy loan self-destruct, and nobody would buy those loans the next day.

So, the background environment of hyper-housing inflation allowed them to do this. So, it wasn't just a matter of not having any skin in the game.

Audience Member: [Off mic, inaudible.]

Ron Insana: Tom, the question is, does financial engineering at a certain point, with abundant leverage, sufficiently create an environment that will get out of control regardless of the regulatory restrictions that have been previously in place.

Thomas Zimmerman: I don't think so, I mean, I think you have to have a liquidity system here that's creating -- with 1 percent Fed funds rate and a housing bubble that takes care of that. If you wouldn't have had the housing bubble, you wouldn't have had -- you know, there's certainly a cause and effect here that we've talked about, but I mean, it wouldn't have -- just by itself, I don't think that would have caused the problem.

Ron Insana: Mike, do you want to make a quick point?

Michael O'Hanlon: I think there is a couple of things. I mean, first, I think that loans tend to be more regulated than securities. You know, and that securities are regulated, to a large extent, based upon ratings and things like that. So, as this market, you know, developed, there still may not have been quite enough on the loan side, but I think it's really looking at the securities, and whether the securities were safe.

And, the problem is that when you look at the ratings, and originally what the mark to markets were, you know, they looked like they were okay. But, you know, to really go through and to look at those securities to say, you know, if you looked at the underlying loans, and the provisions, you know, from a banking regulatory perspective, would the underlying asset have been okay? And, you know, I think that, you know, that's where, you know, I think there may have been more focus. You know, I think on, you know, my sense is that for most of the banks and thrifts in the U.S., you know, not the big guys but below that, you know, is when you look at their levels of delinquencies, the levels of delinquencies aren't so bad, you know. So, you know, I think it's really concentrated, and you know, and a number of financial institutions which had, you know, larger exposure, and really were more securities-oriented.

Ron Insana: Yes, sir?

Audience Member: I thought I heard Rod say that you could create a AAA, super-AAA backed by BB or BBBs -- if you could explain that to the audience? And then second, but more importantly, I want to hear from all of you about what you think makes sense in terms of changing the regulatory regime for the rating agencies, if that's appropriate.

Ron Insana: Rod, the silk purse analogy, if you will.

Rod Dubitsky: As soon as somebody explains that to me, I'll explain it to you.

No, essentially, the concept was you've got all of these BBB bonds, and you have to assume that, if they're all perfectly correlated, the best rating you can create by packaging them up is BBB. They're all BBB bonds, you can't create more than -- you can't create a dollar of A, let alone AAA. So, you have to make an assumption that there's less-than-perfect correlation across all these BBB bonds, they're not all going to default together.

So, they have these models that basically will assume some inter-asset, intra-asset correlation across sub-prime, and between sub-prime and mid-prime, and sub-prime and prime, and you mix up these asset classes in this CDO model, and all the rating agencies had similar concepts in there, and you run it through this model, and you run probability defaults, correlation assumptions, and you get out from their models this 80 percent AAA. But if you just double the correlation or quadruple the correlation, which is, I think the real numbers the correlation was quadrupled what the initial assumptions were, you couldn't create any AAA, let alone, super-senior AAAs.

So, I think the assumptions and correlations that went into the model is what enabled all of these BBB bonds that were essentially the same vintage to be created.

Now, there was some structural diversity, issuer/servicer diversity, different geographics, et cetera, so you could argue there was some real, you know, less-than-perfect correlation in there. But, the number in the model was so dependent, and you know, was there enough transparency? I'm not a CDO guy so I can't say. But I think that's -- you know, if you talk to every investor who's familiar with sub-prime market, looking at the CDOs and say, "Wow, that's a little bit of a stretch, all of those AAA bonds, I don't think -- somebody has to explain those correlations," but it's the correlation is the magic.

Ron Insana: Yeah, Rod, let me ask you about, before you go any further -- with respect to correlation, the one thing we have learned over the last many years when we've had any kind of unexpected event in the financial markets -- correlations, even for different asset classes, under duress, go to one. So that everything becomes perfectly correlated on the downside, even if it's not in any other environment.

So, why wouldn't that have been taken into consideration in the modeling process for something like this?

Rod Dubitsky: Yeah, that's a good question -- the models are a little bit of a black box to me, and I'm not sure where in the model that correlation would be -- if correlation itself was a dynamic variable, and they had enough scenarios where the correlation goes to one -- but I'm not sure if that, or where that was taken into a model, and you can argue that the CLOs and commercial mortgage CDOs -- where is that convergence in these extreme scenarios? And a AAA, what does a AAA mean, really? And, you know, again, as a former colleague explained it, it's basically you take out a picture of a bread line during the Great Depression -- that's what it would take to break a AAA. And we're seeing so many of the CDO AAAs at risk, clearly this convergence concept in a down market -- now, I would argue that this environment -- a lot of AAAs would default. This is a severe distress from a real estate standpoint, and BBB home equity should default in this sort of environment. They're not structured to withstand much more in this. But AAAs, backed by these loans, should not default in this environment, and it's the correlation, and I'm not sure where the convergence is –

Ron Insana: Can I just ask Marshall first, I just wanted to ask what it means, the fact that AAAs are being downgraded when they're not supposed to be, and when you take that bread line picture out and say, "Well, you know, what happens when a AAA defaults, this is the definition," is the market telling us that we're facing something that's even more serious than what we're going through right now?

Marshall Haines: I'd say that, I think the implication of the AAAs being downgraded is the destruction of confidence on the part of investors in the rating agencies. And this gets back to, when will investors come back in the marketplace? Well, how as I, an investor, if I’m relying -- I'm sitting in Germany since everyone seems to like that as a locale -- I'm sitting in Germany, I'm trying to decide if I should buy one of these CDOs or pools going forward, how on earth am I going to have conviction, you know, in the next time, when the market does come back, that I can buy and trust that a AAA is, in fact, a AAA. I think that's the problem with these downgrades, is you've just -- it's a further erosion of confidence in their proxy for the underwriting, the underlying underwriting standards in these loans has been wrecked.

And I think the question of how we should regulate the rating agencies -- I don't have an answer to that question by the way, but it seems to me, the more transparent you can make their process, and so you can understand how their models work, and how they're building these assumptions, is the only way you can let investors have enough knowledge to know what constitutes a AAA investment, versus what constitutes a BBB or even further down the credit spectrum.

And things like, what does go in the model, how much correlation are you assuming, so that each individual investor can make a market in those securities, as opposed to relying simply on what the rating agencies said.

Ron Insana: Yeah, Tom, go ahead, please.

Thomas Zimmerman: Well, I was just going to say about the CDOs and how you create AAAs out of BBBs, is that they borrow this technology -- I'm not a CDO expert, I think this is correct, though, that they borrow this technology from a corporate world where, in fact, the correlation between different industries during a recession are not always correlated and certain industries don't just suffer in a recession, so in fact, you can do a correlation across recessions, so you can actually turn BBBs into AAAs in the corporate bond market. They borrowed that technology and put it into the sub-prime market, and it didn't work.

Ron Insana: Go ahead, Michael.

Michael O'Hanlon: The other thing that I question from a regulatory perspective is the ability of regulators to really understand the black boxes that financial institutions to govern their own risk. You know, it's now so complicated, you know, in terms of -- and I think this is what you were trying to get at, Ron, you know, it's so complicated, you know in terms of analyzing the overall book of business, you know that I'm not sure how you take that apart. If you're a simple financial institution, it's different, you know a small community bank, you know, you understand that if that economy goes up or down, you live with the economy. But as you get larger, you know, and you say, well, you've got China and you've got the coal industry in the United States, and that your, you know, the loans to companies in all different parts of the world have different levels of correlation, I'm not sure how anybody really understands that.

Ron Insana: Yeah, Rod, this degree of complexity becomes a vexing issue, because we went through this in the 1980's in the stock market, and although people -- the academics -- would deny that some of the technology created portfolio insurance, program trading and the like, were responsible for the crash, clearly we had a mechanical failure in the market, because the technology, the financial engineering got too far ahead of the participants, so that they didn't understand how it would respond during periods of difficulty -- is this at least partly a mechanistic problem, not just an economic problem that we're experiencing? We're digesting the advances in finance that we can't fully appreciate at this moment in time.

Rod Dubitsky: You mean, what are the advances in technology on the ability of participants to understand?

Ron Insana: Yeah.

Rod Dubitsky: Yeah, and if you think about it, everyone says, "Well, these AAA investors, they didn't understand the product." And, if you're a AAA investor, normally you don't have the staffing and the resources, and if you're a small Norwegian municipality in Northern Norway there's no way --

Ron Insana: You keep picking on Northern Norway, is there a reason, or -- ?

Rod Dubitsky: They were in the paper recently.

Ron Insana: Well, there's a picture of the guy walking in the dark and his home was being repossessed, and we're in a period right now where Norway has nothing but night, all day long, and not only that, but they're losing their houses.

Rod Dubitsky: It feels like here, nighttime.
But, the level of expertise for a BB investor is far higher. So, you can't expect that every single investor in AAA aspect understands all of the infinite details. So, you basically have to be sure the rating is right, you can't say it's "Buyer beware," because there's no way that most money market investors -- and we see this in the municipalities and money markets -- there's no way that they have the resources and expertise to replicate, re-engineer, reverse engineer all of these ABC, PSIV conduits, all these complex -- so whatever the process is, it has to be right at the ratings level. And, by the way, they did get a fair amount right, as this sub-prime crisis was unfolding, they were raising credit enhancement levels over time, but it should have been a 20 percent increase, maybe they raised it 10 percent. So they were reacting and responding to it, it just turned out that it was a hindsight, obviously now, it was dramatically inadequate. But they were reacting to it, it wasn't like they were lowering credit enhancement levels, as things were getting riskier, they were catching up and raising it a little bit late, and clearly, as we see with the performance, not enough.

So, on the sub-prime side, itself, I would say that they were kind of making a game effort, but it was clearly, they significantly missed the risk of this.

Ron Insana: I'm going to have to wrap this up, but I just wanted to quickly come down the panel, as quickly as possible and just -- for better or worse, in the next 12 months, Tom, where do you think we're going to be, will this be a bigger problem, or a smaller problem? I'll start down with Tom.

Thomas Zimmerman: Well, it gets worse first. Further, by 12 months now we're coming out of it, I think we'll bottom out 12 months from now.

Ron Insana: Mike?

Michael O'Hanlon: I agree, you know, that there's more pain to go, you know, but that I would say probably a little longer than 12 months, just because the problem is just so hard to fix, you know, that it will take longer for the problems to flow through.

Ron Insana: Marshall?

Marshall Haines: Well, back to my, sort of two states of the world -- first of all, worse, two states of the world, it could be really worse if we get into a recession, and it could be just worse if we don't get into a recession. Twelvish months if there's no recession, and who knows, if we're in a recession.

Rod Dubitsky: The natural aging of the sub-prime loans and mortgages, it's going to be another 24 months before we see the peak of the foreclosures because it takes time to go through that process, but it's -- relative to expectations today -- what the market is expecting today, given that we're on the early stages of these loan modifications, FHA Secure, we just heard some data today, I think we'll be happier a year from now, but delinquencies will keep rising, but I think the perception will be better in the market a year from now.

Ron Insana: All right, gentlemen, thanks very much, I'd like to thank Thomas Zimmerman, Michael O'Hanlon, Marshall Haines, and Rod Dubitsky --

[Applause.]

Ron Insana: Let me turn it over to the Honorable John Reich, Director of the Office of Thrift Supervision.

John Reich: An outstanding discussion that I hated to see come to an end, you guys really did a fabulous job, and thank you, Ron, for moderating this panel.

You all have been sitting here for about 7.5 hours, off and on today, I'm not going to keep you here much longer, and I for one, need a bit of time to digest the input that we've heard today.

I concur with Jim Montgomery that it's been a polite discussion, and that's probably a good thing, but

I think it's also been a healthy discussion. We have on our hands a difficult set of circumstances that, I think, defy a simply solution.

Different approaches to resolution have been discussed, with some believing it's a private sector problem, some believing that the government needs to offer, perhaps, an RTC bailout-type solution.

Obviously, I think the solution is going to be a multi-pronged one, with a combination of things that we've heard discussed today -- the effort currently led by the Treasury Department to establish a consensus approach to modifying loans, still a strong belief that there's a role for the GSEs at some level in this situation, a role for FHA is likely to be a significant part of the solution, efforts by State and local governments and non-profit organizations, a role for Wall Street, and last but not least, a role for the 8,000 community banks across the country, who are beginning to step up to the plate in this situation. They had -- not a role, not a part of the problem, not a part of the creation, but they can, indeed, be as part of the solution.

Well, I want to give appropriate recognition to the issues that were raised by our consumer panel and the last panel, which discussed issues pertaining to legal liability for mortgage originators, the need for potential government bail-out, RTC-type solution, as John Taylor suggested, the important roles for financial education and counseling for would-be homeowners.

I will tell you that we at OTS will be reviewing, discussing, analyzing the comments and views and ideas that have been expressed today, and may -- underline may -- offer a synthesized summary and perhaps our view of the world, with a set of recommendations.

In concluding, I want to thank our panel moderators, Maria Bartiromo, Kathleen Hays, Barbara Rehm, Ron Insana, for an outstanding job of moderating these discussions. I also want to give thanks to two OTS senior employees, Claude Rollin and Sharon Stark for their jobs in planning, organizing, inviting both the panels that have participated today, and you the audience who have been here today, and for making the arrangements --

(End of audio.)

(Off the record, 4:47 p.m.)

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