TESTIMONY OF

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Before the

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Introduction

Good morning Chairman Dodd, Ranking Member Shelby, and members of the Senate Banking Committee. I am Sandy Samuels, Executive Managing Director at Countrywide Financial Corporation. Countrywide is predominantly a prime lender that offers the widest array of products available in the market place. While the subprime market represents over 20% of the overall U.S. mortgage market, it constitutes only 7% of Countrywide's loan volume. Founded in 1969 on the principle of lowering costs and barriers to homeownership, Countrywide is the largest mortgage provider in the country and the leading lender to low- and moderate-income and minority families. Offering subprime products was a natural extension of this commitment. Regardless of what channel a customer uses to come to Countrywide, every qualified borrower has access to our full range of both prime and subprime products. This paradigm gives us a unique perspective on subprime lending.

Rising delinquencies and foreclosures in the subprime market have created tremendous concern about the state of the mortgage and housing markets. I want to share with you our perspective on the importance of subprime mortgage lending in the overall housing market, our insight into why subprime delinquencies and foreclosures are increasing and our views on the recent proposed regulatory guidance covering subprime loans.

Importance of Subprime Lending

For a quarter century, from 1970 to 1994, the nation's homeownership rate remained stuck at 64%. For the most part, borrowers either met FHA, VA or GSE prime market standards, or were served by the so-called hard money lenders. In the mid-1990s, the development of a subprime secondary market made it viable for mainstream mortgage lenders like Countrywide to offer subprime programs that paralleled the prime market. Over the next decade, the combination of low interest rates and prime and subprime product innovations helped boost the homeownership rate to 69%. In 2006 alone, first time homebuyers comprised almost 40% of Countrywide's purchase originations, and 25% of those borrowers were able to buy a home because of available subprime products. Without having subprime products to meet their needs, this recent homeownership expansion would not have been as robust.

What Happened in the Market the Past Two Years?

A convergence of factors explains the growth in the subprime market and current circumstances. In the past few years, housing appreciation increased at rates far exceeding income growth causing housing affordability issues. Lenders responded by expanding underwriting guidelines to allow borrowers to qualify for loans on increasingly more expensive homes. By 2004, as interest rates began to increase from their 50 year lows and the refinance boom began to slow, there was significant overcapacity in the mortgage originations market. Competition for declining volumes was exacerbated by the cooling of the housing market in 2005 and 2006. This resulted in further expansion of credit guidelines as lenders vied to retain volumes and increase market share. At the same time, this entire period was marked by significant liquidity in the global capital markets creating an increasing demand for mortgage assets. All of these factors together contributed to the dramatic liberalization of underwriting guidelines.

So long as home prices continued to rise, there were very few market forces to counter the push toward credit liberalization. Things started to change in 2006 as appreciation began to flatten and many markets began to see home price declines. In the absence of appreciation, delinquencies have begun to increase dramatically. In response to declining home prices and increasing delinquencies, in the last several months, the market has begun to self-correct. Countrywide and the industry have made significant changes to materially tighten credit guidelines, reversing much of the liberalization that occurred over the last few years.

Where Does the Subprime Market Go from Here?

First and foremost, it is important that we preserve access to credit for those who cannot qualify for prime loans. The ultimate solutions must be based on study and analysis of all relevant data about their impact on the housing market, particularly before imposing restrictions on lenders' ability to offer affordable product options. An appropriate balance must be struck between maintaining affordability and lessening payment shock. Wherever you draw the line, someone will be shut out of the market. Every effort to raise the start rate, lengthen the fixed rate period, reduce caps and lengthen reset periods will raise the price of the loan product to the consumer.

With respect to the banking agencies proposal, we cannot agree that underwriting to the fully indexed rate is the correct standard in all situations. First, such a requirement will further worsen the current situation for borrowers seeking to refinance subprime loans in a market where values have declined and underwriting standards have already tightened. Many of the homeowners who will need to refinance will not be able to qualify under such a standard. Second, we believe that many first time homebuyers who can currently purchase a home will no longer be able to qualify for a mortgage under the proposed guidelines. This could materially reduce housing demand, especially among first time homebuyers, and delay the housing recovery. We believe that the guidance should preserve the significant affordability benefits of products that reduce payments in the early years of the mortgage in order to lower the first rung of the homeownership ladder, or help borrowers address short term financial objectives.

We do not believe that the hybrid ARM product structures are to blame for the current problems in the subprime market. In fact, our experience with hybrid ARMs demonstrates that these products have provided a critical bridge for our customers reducing costs for homeowners experiencing temporary financial challenges.

We reviewed our hybrid ARMs originated between 2000 and 2006, and tracked those who refinanced their loans with Countrywide to determine what kind of loan they received. We found that:

- Historically, 80% of our subprime borrowers refinance within 36 months of loan origination. Interestingly, this number is approximately the same for both our fixed rate and our hybrid customers.
- For these subprime refinances, of those borrowers that stayed with Countrywide, 50% received a prime loan and 25% refinanced into a subprime fixed rate loan. The borrowers moving to prime loans improved their FICO scores by an average of almost 50 points and benefited from lower interest rates on their new loans, sometimes significantly.
- However, the remaining 25% of borrowers refinancing out of a subprime ARM did refinance into a new subprime ARM and we need to be cautious before we take any actions that would eliminate that option.

- Over this time period, we have seen the proportion of hybrid ARMs used for home purchases gradually increase. In the fourth quarter of 2006, almost half of our subprime hybrid loans funded home purchases, with 70% of those going to first time home buyers.

Our experience suggests that these loans are a valuable tool for our customers to afford a first home or as a bridge to overcome temporary financial setbacks. In the past 10 years, Countrywide has originated over $100 billion in subprime hybrid ARM loans. Over that period, cumulatively we have had only 3.4% of these loans go through foreclosure. The worst single origination year was 2000, for which the cumulative foreclosure rate was 9.89%. We believe that declining home prices and the other factors I've discussed may produce foreclosures numbers on 2006 originations approaching or exceeding those on loans originated in 2000. But even if this were to come true, we cannot lose sight of the reality that more than 90% of Countrywide's subprime borrowers will not lose their homes to foreclosure and will have had the opportunity to enjoy the benefits of homeownership as a result of the availability of these products.

And for our borrowers that experience difficulties making timely payments, Countrywide has invested substantial financial and human resources to our ongoing home preservation program to help them get back on track. We have been successful in helping many homeowners preserve their homes so long as (1) the borrower responds to our communications; (2) the borrower wants to remain in the home; and (3) the borrower continues to have a source of income. In light of the difficulties many of our borrowers are currently experiencing, we have also implemented additional outreach efforts.

- We conduct aggressive loss mitigation in communities experiencing high delinquencies, sending home retention teams into the community to meet face-to-face with customers to implement workout plans.
- We provide free access to counseling, including third party counseling from community organizations like Neighborworks.
- We work with groups like ACORN to help us reach out to borrowers who are too scared to call their lender.

- We are also a founding supporter of the Homeownership Preservation Foundation, which provides 24/7 access to housing counselors through a national toll free number.

Another important concern with the proposed guidance is its limited applicability solely to federally regulated institutions. To be effective, the regulatory guidance must apply to all lenders in the market. We support the efforts of CSBS to extend the guidance to those entities not covered by the federal guidance, provided it is adopted uniformly and the application is targeted to those not already covered by the federal guidance.

We are very supportive of other parts of the agencies proposal.

- On the issue of **impound accounts**, Countrywide agrees that lenders should qualify borrowers based on the full payment of principal, interest, taxes and insurance and this has long been our practice. Currently, however, mandatory escrow accounts are not permissible in all states. Interestingly, the FHA program mandates the use of impound accounts, and we would support legislation that allowed lenders to require such accounts on all subprime loans.
- On the issue of **prepayment penalties**, Countrywide's subprime Hybrid ARM originations do not have prepayment penalties that are longer than the initial reset period. In addition, we support the agencies' proposed recommendation to provide hybrid borrowers with a window period prior to the payment reset to refinance without penalty.
- We strongly support efforts to improve the quality and readability of **disclosures** associated with hybrid ARMs. Borrowers need to understand their choices so they can determine what is best for their unique circumstances. We believe all borrowers, regardless of what lender originates the loan, should receive the same information about their transaction and we believe the regulators should amend Regulation Z to greatly enhance disclosures for these products.
- With regard to **stated income loans**, we continue to believe there is a valuable role for reduced documentation especially for those borrowers that have difficulty documenting all of their income. For example, members of immigrant populations, for a variety of reasons, may have income from sources that are not reportable on a W-2. For some borrowers, W-2s may not accurately reflect earnings because of items such as tips or the

timing of bonuses and raises. We fully recognize there is room for abuse with the use of reduced documentation and we agree with the agencies that when underwriting such loans, other mitigating factors should be present to minimize the need for direct verification of repayment capacity. This would include, for example, cash reserves, larger downpayments and higher credit scores. We also strongly support requiring a disclosure to the borrower that states there is an increased cost to stated income features and requiring the borrower to acknowledge that the amount of income being used to underwrite the loan is not overstated.

- We believe informed **consumer choice** is critically important. The guidance should encourage lenders to make multiple product options available to all borrowers so they can decide what is best for their individual circumstances. We support requiring that all subprime borrowers be offered the option of a fixed rate loan if they could qualify for one.

The prescription for helping subprime borrowers in today's market is not higher effective interest rates for qualifying borrowers. Careful consideration of the macroeconomic impacts of new laws or guidance is required so that we preserve the availability of financing options for subprime borrowers and avoid making the current subprime issues even worse.

I would like to thank the Chairman and the Ranking Member for the opportunity to share Countrywide's perspectives on the mortgage market and would be happy to answer any questions.