Minutes

of

The Meeting of the FDIC Advisory Committee on Economic Inclusion

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

July 9, 2008 - 8:30 A.M.

The meeting of the FDIC Advisory Committee on Economic Inclusion ("ComE-IN" or "Committee") was called to order by Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation ("Corporation" or "FDIC") Board of Directors.

The members of ComE-IN present at the meeting were: Ted Beck, President and Chief Executive Officer, National Endowment for Financial Education; Kelvin Boston, President, Boston Media, LLC; Martin Eakes, Chief Executive Officer, Self-Help Credit Union, Durham, North Carolina; Lawrence K. Fish, Chairman and Chief Executive Officer, Citizens Financial Group, Inc.; Rev. Dr. Floyd H. Flake, Senior Pastor, Greater Allen AME Cathedral of New York; Ester R. Fuchs, Professor, School of International and Public Affairs, Columbia University; Alden J. McDonald, Jr., President and Chief Executive Officer, Liberty Bank and Trust, New Orleans, Louisiana; John W. Ryan, Executive Vice President, Conference of State Bank Supervisors; Peter Tufano, Sylvan C. Coleman Professor of Financial Management, Harvard Business School, and Senior Associate Dean and Director of Faculty Development; and Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School. Roberta K. McInerney, Designated Federal Officer for the Committee and FDIC Deputy General Counsel, was also present at the meeting. Committee members Diana L. Taylor, ComE-IN Chairman and immediate past New York State Superintendent of Banks; Ronald Grzywinski, Chairman, ShoreBank Corporation of Chicago; Wade Henderson, Executive Director, Leadership Conference on Civil Rights; Frederic S. Mishkin, Governor, Board of Governors of the Federal Reserve System; Manuel Orozco, Senior Associate at the Inter-American Dialogue, and Senior Researcher,

Institute for the Study of International Migration, Georgetown University; Maria Otero, President and Chief Executive Officer, ACCION International; Honorable Robert K. Steel, Undersecretary for Domestic Finance, U.S. Department of Treasury; and Deborah C. Wright, Chairman and Chief Executive Officer, Carver Federal Savings Bank, New York, New York, were absent from the meeting.

Corporation staff who attended the meeting included Alice C. Goodman, William A. Rowe, III, Tariq A. Mirza, Sara A. Kelsey, Robert E. Feldman, Robert W. Mooney, Luke H. Brown, Steven D. Fritts, Andrew B. Stirling, Rae-Ann Miller, Luke W. Reynolds, Debra L. Novak, Ruth R. Amberg, Carl J. Gold, Janet V. Norcom, Valerie J. Best, Gary A. Kuiper, Herbert J. Messite, Sally J. Kearney, Christine M. Davis, Alan W. Levy, Tiffany K. Froman, Elizabeth C. Boudris, and Christina A. Whatley.

Chairman Bair opened and presided at the meeting.

After welcoming ComE-IN members, Chairman Bair expressed her appreciation for the thoughtful presentations by panelists at the FDIC-sponsored Forum on Mortgage Lending for Low- and Moderate-Income ("LMI") Households, held the previous day in Arlington, Virginia, and her hope that the LMI Forum and the Committee meeting together would yield a Committee-approved report endorsing some of the better ideas for encouraging responsible LMI mortgage lending which could then be distributed to FDIC-insured institutions. Chairman Bair next provided updates on economic inclusion initiatives arising out of previous Committee meetings, including progress on the Corporation's affordable small dollar loan pilot; the status of plans for issuance of a policy statement addressing asset-building activities under the Community Reinvestment Act ("CRA"), the details of which she noted had been laid out in a July 2, 2008, memorandum to Committee members; and establishment of a working group to develop a pilot for lottery-linked savings accounts, the concept for which was based, in part, on information contained in a recent report by the Institute for American Values.[1]

Robert W. Mooney, Deputy Director, Consumer Protection and Community Affairs, FDIC Division of Supervision and Consumer Protection ("DSC"), facilitated the discussion by summarizing some of the key points made during the LMI Forum panel on "Back

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[1]The Commission on Thrift, *For a New Thrift: Confronting the Debt Culture*. Institute for American Values, New York, New York. June 2008. A copy of the report has been placed in the FDIC's Public Information Center (PIC) in Arlington, Virginia, and made available to the general public. Members of the public interested in reviewing the report at the PIC or in learning how to obtain a copy of the report should contact the PIC at (877) ASK-FDIC/ (703) 562-2200 or by email at publicinfo@fdic.gov.

to Basics: Reintroducing Standard Underwriting Criteria and Pricing to the LMI Mortgage Market." In particular, he noted the discussion on the return to basic underwriting practices, risk-based pricing for federally insured programs, and the need for more transparency at the loan level to enhance investor due diligence.

In response to Mr. Mooney's request for the views of Committee members on what they perceived as the more important of the recommendations made by LMI Forum panelists, Ted Beck, President and Chief Executive Officer, National Endowment for Financial Education, pointed to the importance of reactivating the securitization market to increase availability of credit and expressed support for the proposal to require a holding period for mortgages before they can be packaged into securities as a means of ferreting out loans that raise issues of fraud or nonperformance. Kelvin Boston, President, Boston Media, LLC, expressed agreement with the need to establish fiduciary responsibility to borrowers on the part of mortgage brokers, lenders, and/or investors, the need to be supportive of the Federal Housing Administration ("FHA") in its modernization efforts, both operationally and structurally, and the need for a financial counseling requirement tied to the more exotic mortgage products. Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School, cited the need to impose liability for bad loans on the funders of those loans, with better regulation of non-bank lenders, and possible regulation of mortgage products as a way to promote less complex and risky instruments. Peter Tufano, Sylvan C. Coleman Professor of Financial Management, Harvard Business School, and Senior Associate Dean and Director of Faculty Development, cited the need to address issues of responsible lending and responsible borrowing and their implications. In addition, he thought it important that there be a recommitment to providing home ownership opportunities to LMI families and that any solutions to the current general credit crisis and LMI mortgage lending be mindful of the current structure of the financial industry.

Chairman Bair, in follow-up to Professor Warren's expressed support for possible regulation of mortgage products, observed that regulatory approval of products has traditionally been limited to the securities industry, but that it may be time to consider such approvals for the banking industry. In that vein, she noted that the idea of establishing a 30- or 40-year fixed rate mortgage as the standard mortgage, accompanied by a requirement that consumers affirmatively opt-out of such instruments, had been raised during the LMI Forum discussion. In follow-up to Professor Tufano's comments on the need to be mindful of the current structure of the industry in efforts to

address LMI mortgage lending, Chairman Bair suggested that such lending could be addressed through regulation, economic incentives, or some combination of the two, and that, to the extent the economic incentives of the loan originator can be aligned with long-term loan performance and profitability, it would be beneficial to both investors and borrowers. John W. Ryan, Executive Vice President, Conference of State Bank Supervisors, agreed that incentives and disincentives can be created through legislation and regulation of products and broker compensation, but indicated that an initial approach to address problems in the mortgage industry might be to create an infrastructure that creates transparency down to the point of loan origination.

During the discussion that followed, in response to questions from Committee members, staff briefly explained the FDIC's *Guidance for Managing Third-Party Risk* and what examiners look for when reviewing financial institutional risk management principles and compliance with fair lending laws such as the Equal Credit Opportunity Act and the Fair Housing Act. Committee members and staff also explored, among other things, possible solutions to easing the mounting foreclosures arising from the subprime mortgage crisis and how best to prevent similar problems going forward.

Regarding possible solutions to easing the current crisis, Alden J. McDonald, Jr., President and Chief Executive Officer, Liberty Bank and Trust, New Orleans, Louisiana, suggested the marketplace should be encouraged to waive prepayment penalties that make it difficult for homeowners facing foreclosure to refinance and the development of a housing policy to offset the adverse impact of foreclosures on communities; Professor Warren suggested Committee support for S. 2136, the "Helping Families Save Their Homes in Bankruptcy Act of 2007", which would amend Chapter 13 of the Bankruptcy Code to allow modification of the principal on a residential mortgage loan to the stripped-down value of the home and extend the timeframe for repayment; Chairman Bair suggested the need to create economic incentives for loan modifications and explained the FDIC's proposal for Home Ownership Preservation ("HOP") Loans, pursuant to which Congress would authorize the Treasury Department to make loans to homeowners to pay down up to 20 percent of their principal; and Mr. Boston suggested that some thought be given to addressing the emotional and physical toll upon families that are unable to avoid foreclosure.

With respect to how best to prevent similar problems in mortgage lending going forward, Martin Eakes, Chief Executive Officer, Self-Help Credit Union, Durham, North Carolina,

Mr. McDonald, and Professor Warren expressed support for some combination of broker licensing, regulation, and liability; Mr. Eakes offered the possibility of net worth or bond requirements for mortgage brokers, which he argued would shift the policing function to insurance companies; Rev. Dr. Floyd H. Flake, Senior Pastor, Greater Allen AME Cathedral of New York, and Professor Warren advocated for regulation of the safety of products, with restrictions or outright prohibitions on features such as prepayment penalties and products such as interest-only mortgages; and Chairman Bair asserted that future pooling and servicing agreements ("PSAs") for mortgage-backed securities must include a fiduciary obligation to act in a manner that benefits the pool as a whole and a servicer fiduciary responsibility to modify loans, with independent oversight of compliance with those obligations. Chairman Bair also observed that some have suggested that existing subprime guidance, which requires, among other things, underwriting at the fully indexed rate and income documentation and which currently applies only to loan originations, should be expanded to also apply to loans that are funded as mortgage-backed securities. However, she acknowledged that such an expansion would be controversial and would be limited in its application to banks, which originate only a small percentage of subprime loans.

Committee members and staff also discussed the highly-anticipated final rule amending Home Ownership and Equity Protection Act ("HOEPA") regulations scheduled to be issued by the Board of Governors of the Federal Reserve System ("FRB") the following week, which also would apply to non-banks, and the extent to which the rule might address some of the current issues related to LMI mortgage lending. To facilitate the discussion, Roberta K. McInerney, Designated Federal Officer for the Committee and FDIC Deputy General Counsel, explained the enforcement mechanisms for non-banks under HOEPA. Ester R. Fuchs, Professor, School of International and Public Affairs, Columbia University, expressed concerns about the effectiveness of enforcement of the new rule as it applies to non-banks if authority is divided among the 50 states and suggested that long-term structural changes are needed.

Chairman Bair then announced that the meeting would recess briefly. Accordingly, at 10:28 a.m., the meeting stood in recess.

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The meeting reconvened at 10:48 a.m. that same day, whereupon Mr. Mooney advised that the focus of the meeting would shift to identifying ways to jumpstart responsible subprime

mortgage lending in LMI areas. He asked Rae-Ann Miller, Special Advisor to the Director, FDIC Division of Insurance and Research ("DIR"), to summarize some of the recommendations advanced by LMI Forum panelists at the previous day's meeting and requested Committee members' assistance in prioritizing the recommendations.

Ms. Miller noted that there had been a few common themes among the ideas presented by panelists, some of which were innovative and others of which represented a "back to the future" approach. She then identified the recommendations, citing an emphasis on 30-year fixed rate mortgages; use of more traditional underwriting standards, including underwriting at or near the fully indexed rate and on the basis of ability to repay; reaffirming characterization of a house as a shelter, rather than as an ATM; a down-payment savings program that allows withdrawals only through in-branch transactions and not at ATMs; 40-year amortizations to address affordability issues; and shared equity programs for consumers with down payment problems. She further cited alternative underwriting for clients with thin credit files; more face-to-face interaction with borrowers, including advance counseling and early intervention with respect to problems, in lieu of reliance on automated underwriting systems; rent-to-own programs, in some cases re-purposing foreclosed properties to facilitate the model; rebates of mortgage costs, interest-rate reductions, or discounted down payments for participation in financial education classes; use of covered bonds in the financing vehicle; and public-private partnerships to bring financing and motivated borrowers together.

Mr. Beck commented that knowledge of the borrower was a common theme running through many of the recommendations, but that trying to duplicate the face-to-face commitment in other banks would present a challenge because, as had been previously noted by Mr. McDonald most banks have moved away from mortgage lending except as a convenience for specific clients. There then ensued a discussion among Committee members and staff that explored the reasons so few banks engage in mortgage lending as a core business line. Steven D. Fritts, Associate Director, Risk Management Policy Branch, DSC, offered two reasons for the lack of mortgage lending by banks or, in some cases, their involvement only in limited mortgage lending programs designed to get the loans off balance sheet, noting that: (1) mortgage lending is a business of scale and, in the absence of scale, the cost factors make it difficult to lend profitably; and (2) long-term, fixed-rate mortgages pose an interest-rate risk that is difficult to offset on the liability side of the balance sheet, with most community banks lacking the expertise or resources to hedge risk. Lawrence K. Fish, Chairman and Chief Executive Officer, Citizens

Financial Group, Inc., advised that his institution offers mortgage loans only as an accommodation to good customers or as an enthusiastic component of the bank's responsibilities to underserved communities and offered as his reasons for believing mortgage lending is not a good business that: (1) mortgages are the most commoditized of all banking products, i.e., mortgage lending is a national, not a local, business; (2) mortgages are generally not a product that the consumer bundles, limiting cross-selling opportunities; (3) mortgages are incredibly expensive and complex to process; (4) although mortgages are very easy to refinance, it is difficult to include a prepayment penalty into mortgage instruments; and (5) most of the profit in mortgage transactions accrue to the best originators.

Chairman Bair asked to what extent, if the profits are so slim and the interest-rate risk is so significant that most banks are reluctant to engage in mortgage lending on any large scale, there are other, more altruistic objectives or incentives, under CRA for example, which would motivate banks to at least enter the mortgage market for underserved communities. Mr. Fish, in response, stated that one problem is that the government-sponsored enterprises ("GSEs") provide no liquidity for LMI mortgage portfolios and that, currently, the foreclosure crisis has adversely affected property values in underserved communities, making it difficult to underwrite loans in those communities.

Mr. McDonald, offering a different perspective, advised that his bank, Liberty Bank and Trust, is returning to mortgage lending as part of its business strategy despite the deterrents, partly because of decreased competition from the decimated ranks of mortgage bankers and brokers. Both he and Mr. Beck suggested that the Corporation convene a focus group of bankers to look at the incentives and disincentives to mortgage lending. Mr. McDonald also suggested that the Corporation and other federal bank regulators could sponsor a demonstration project to promote partnerships between community banks and other organizations, similar to what was done with banks and small-dollar loans for military personnel.

Chairman Bair acknowledged that although many aspects of the problem of LMI mortgage lending require legislative and regulatory action that are beyond the Corporation's ability to control, she nonetheless believes that there are banks, both large and small, which would like to provide more service to LMI communities and she wants to be certain that, as lending standards are tightened, banks do not get the wrong message. She stated that the message is not that banks should not engage in

lending to LMI households, but that they should adhere to certain best practices.

Mr. McDonald, revisiting the issue of bankruptcy reform raised by Professor Fuchs, stated that it would be a long-term solution to the problem of irresponsible subprime lending, the timing was right, and he would like for the Committee to issue a strong endorsement, a position with which Mr. Boston and Rev. Dr. Flake agreed. Chairman Bair, noting that a number of Committee members were absent, that the topic had not been scheduled for discussion, and that she was neither encouraging nor discouraging any action, suggested that after the meeting staff distribute to all Committee members a copy of the current bankruptcy proposal and any analysis proponents would like to share, that Mr. McDonald take the lead in polling members on their position, and that she be presented with a letter listing the names of Committee members in favor of the proposal.

Next, Mr. Mooney observed that, previously, the solution to little or no lending in LMI areas was to develop intermediaries, partnerships of for-profits and non-profits, funded by government, charitable foundations, and others to fund lending in those neighborhoods; that non-profits are not being funded to the degree that they once were; and that, if the intent is to increase efforts to stabilize those neighborhoods, there is a need to reintroduce those credit enhancements, counseling, financial services, and other activities for which credit is given under CRA. He then asked whether that continues to be a solution and, if so, what the Corporation can do to jumpstart those efforts. Mr. Fish answered that, although the natural inclination over the next 12 months would be for regulators to focus more intently on credit and capital, the Corporation should not lose track of CRA and, in fact, should increase CRA supervision during that period and bias CRA ratings in favor of programs that support advocacy and literacy. Mr. Ryan responded that it was his opinion that it is important to have a diversity of institutions at the local level and that the Corporation should consider policy broadly in terms of what encourages such diversity. He also suggested that more time be spent focusing on the role of securitization of LMI mortgage loans and how to provide consumer protections under those circumstances.

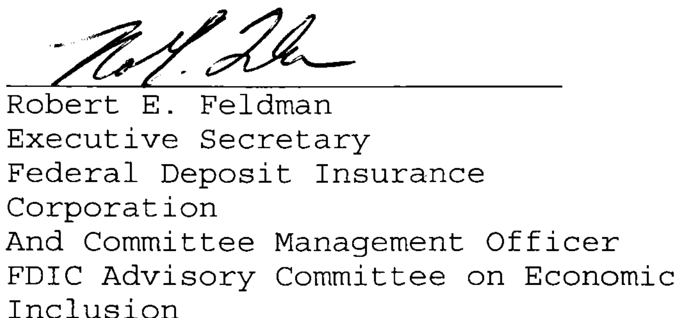
Offering other suggestions, Mr. McDonald stated that reserve-type funding of both non-profit and for-profit agencies could be a method of enhancing lending to LMI communities. As an example, he suggested that a portion of the proposed Treasury Department's bailout for the GSEs could be carved out for refinancing of LMI mortgage loans, which could then be securitized as a model for addressing future economic issues in

communities that lack access to credit or appropriate credit products. Mr. Eakes added that banks could contribute funds for reserves to some type of multi-bank LLC, which would count as an investment that does not have to be written off immediately, thereby leveraging their contributions. Professor Tufano suggested that, while it may be difficult to initiate programs at the national level, it is at the local level where financial literacy education is being taught, where counseling is taking place, and where a state's regulator is more relevant, and that the FDIC's Alliances for Economic Inclusion present a good opportunity to tackle issues associated with LMI mortgage lending at the local level.

Returning to Mr. Mooney's earlier request that the Committee help prioritize recommendations made by panelists at the previous day's forum, Mr. Boston expressed his support for, among other things, rent-to-own programs, use of covered bonds in financing vehicles, use of alternative evidence of creditworthiness in thin-file situations, and 40-year amortizations. Chairman Bair asked that a list of recommendations be circulated to Committee members and, if supported by the other members, staff would post the recommendations as best practices on the Corporation's web site and distribute them to banks. She also expressed enthusiasm for the Committee's recommendation for convening bank focus groups to discuss and encourage the various approaches to LMI mortgage lending and requested that staff develop an action plan to implement the recommendation.

Mr. Boston then observed that any HOEPA rule issued by the FRB could have a long-term impact on future discussions on LMI mortgage lending. In agreement, Mr. Fish asked if staff could circulate to Committee members a brief analysis of the rule once it was issued, in response to which Chairman Bair answered affirmatively.

There being no further business, the meeting was adjourned.



Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
And Committee Management Officer
FDIC Advisory Committee on Economic Inclusion

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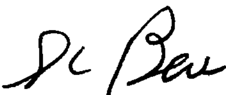
I hereby certify that, to the best of my knowledge, the attached minutes are accurate and complete.



Sheila C. Bair
Chairman
Board of Directors
Federal Deposit Insurance Corporation

and

Presiding Officer
July 9, 2008, Meeting of the
FDIC Advisory Committee on Economic Inclusion

Dated: October 31, 2008