

—EDITED TRANSCRIPT—

HUDSON INSTITUTE'S  
BRADLEY CENTER FOR PHILANTHROPY AND CIVIC RENEWAL AND  
CENTER FOR HOUSING AND FINANCIAL MARKETS  
*present*

# The Community Reinvestment Act and the Subprime Mortgage Crisis: Is There a Connection?

Thursday, October 23, 2008 • 12:00 to 2:00 p.m.

Hudson Institute • Betsy and Walter Stern Conference Center • 1015 15th Street, NW • Suite 600

The Community Reinvestment Act (CRA), enacted by the Congress in 1977, is intended “to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound operations,” according to the Federal Reserve Board. The CRA rating is one of the criteria for Federal Reserve approval of bank mergers and branches; a higher rating goes to banks that fund inner-city and low-income mortgages and real estate development projects. CRA was substantially strengthened in 1995; since then banks and other depository institutions have expanded their CRA lending.

In the aftermath of the subprime mortgage crisis, questions are being raised about how “safe and sound” were the operations of banks subject to CRA. Critics have charged that banks have been compelled to make risky loans to unprepared borrowers and in neighborhoods with declining property values. Advocates have responded that the coverage of CRA was relaxed for smaller financial institutions in 2002, before the subprime crisis, and that lenders not covered by CRA have been making a disproportionate share of subprime mortgages. Is there a connection between the subprime mortgage crisis and the Community Reinvestment Act?

On October 23, 2008, two Hudson Institute centers, the Bradley Center for Philanthropy and Civic Renewal and the Center for Housing and Financial Markets, co-hosted a panel of experts, including the National Fair Housing Alliance’s **DEBORAH GOLDBERG**, **HOWARD HUSOCK** from the Manhattan Institute, **RUSSELL ROBERTS** of George Mason University, and the Consumer Federation of America’s **BARRY ZIGAS**, to discuss these and other questions. Hudson Institute’s **JOHN WEICHER**, director of Hudson’s Center for Housing and Financial Markets, moderated the discussion.

## PROGRAM AND PANEL

12:00 p.m. Welcome by Hudson Institute’s **WILLIAM SCHAMBRA**  
12:10 Panel discussion  
**DEBORAH GOLDBERG**, National Fair Housing Alliance  
**HOWARD HUSOCK**, Manhattan Institute  
**BARRY ZIGAS**, Consumer Federation of America  
**RUSSELL ROBERTS**, George Mason University  
**JOHN WEICHER** (moderator), Hudson Institute  
1:10 Question-and-answer session  
2:00 Adjournment

## FURTHER INFORMATION

THIS TRANSCRIPT WAS PREPARED FROM AN AUDIO RECORDING and edited by Krista Shaffer. To request further information on this event or the Bradley Center, please contact Hudson Institute at (202) 974-2424 or send an e-mail to Krista Shaffer at [Krista@hudson.org](mailto:Krista@hudson.org).

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# Panelist Biographies

Currently the director of the Hurricane Relief Project of the National Fair Housing Alliance, **Deborah Goldberg** has thirty years of experience working with community-based organizations to increase the availability and affordability of financial services for low-income people and people of color. Previously, Goldberg served as co-director of the Neighborhood Revitalization Project (NRP) of the Center for Community Change. NRP provided training and technical assistance to local, grassroots groups on financial services issues, and helped them understand and develop strategic responses to the fundamental changes underway in the financial services world. Goldberg was also involved in the Project's public policy work on community reinvestment, financial services and fair lending. She began her professional career doing fair housing, fair lending and community reinvestment work at a local Washington, DC nonprofit organization. She has served as a consumer representative to the National Association of Insurance Commissioners, was a member of the joint HUD-Treasury Predatory Lending Task Force in 2000, and is a former member of the Consumer Advisory Council of the Federal Reserve Board.

**Howard Husock** is the vice-president for policy research at the Manhattan Institute, where he also directs the Institute's Social Entrepreneurship Initiative and serves as a contributing editor to *City Journal*. Prior to joining the institute, he served from 1987 through 2006 as director of case studies in public policy and management at the Harvard Kennedy School of Government, where he was also an adjunct lecturer and a research fellow at the Hauser Center for Nonprofit Organizations. Husock has published widely on housing and urban policy and is the author of *The Trillion-Dollar Housing Policy Mistake: The Failure of American Housing Policy* (Ivan R. Dee, 2003) and *Repairing the Ladder: Toward a New Housing Policy Paradigm* (Reason Foundation, 1996). His work has appeared in the *Wall Street Journal*, *New York Times*, *Washington Post*, *The Public Interest*, and *Society*. A former television journalist and documentary film producer, Husock's work for public television (WGBH, Boston; 1978-87) won three Emmy awards.

**Russell Roberts** is a professor of economics at George Mason University, the J. Fish and Lillian F. Smith Distinguished Scholar at the Mercatus Center, and a research fellow at Stanford University's Hoover Institution. His latest book is *The Price of Everything: A Parable of Possibility and Prosperity* (Princeton University Press, 2008). He is also the author of *The Invisible Heart: An Economic Romance* (MIT Press, 2001). His first novel, *The Choice: A Fable of Free Trade and Protectionism* (Prentice Hall, 3rd ed., 2006) was named one of the top ten books of the year by *Business Week* and one of the best books of the year by the *Financial Times* when it was first published in 1994. Roberts is the host of the weekly podcast series, *EconTalk* and co-blogs at *Cafe Hayek* with his colleague Don Boudreaux. He is a frequent commentator on National Public Radio's *Morning Edition* and *All Things Considered*. He is a founding advisory board member of the *Library of Economics and Liberty* website. Before coming to George Mason University, Roberts was at Washington University in St. Louis, where he was the founding director of the Center for Experiential Learning at the John M. Olin School of Business and a senior fellow at the Weidenbaum Center on the Economy, Government, and Public Policy. Roberts has also taught at the University of Rochester, Stanford University, and UCLA.

**Barry Zigas** is director of Housing Policy for Consumer Federation of America. Zigas also consults with foundations, nonprofits and others through his firm Zigas and Associates LLC. Prior to founding Zigas and Associates LLC in 2006, Zigas was a senior vice president at Fannie Mae where he led the corporation's community lending initiatives, including specialized mortgage product development to increase homeownership opportunities. Zigas was president of the National Low Income Housing Coalition from September 1984 until joining Fannie Mae in 1993. In this position, Zigas led the policy development and advocacy efforts that resulted in the low-income housing tax credit in 1986. He played a leading role in the creation and enactment of the National Affordable Housing Act of 1990, particularly in development of the HOME program. He testified frequently before committees of both the U.S. House of Representatives and the U.S. Senate, and was a member of the Rouse-Maxwell Housing Commission from 1988-89 and the Mitchell-Danforth Tax Credit Task Force in 1987.

# Proceedings

WILLIAM SCHAMBRA: Good afternoon! I'm Bill Schambra; Krista Shaffer and I comprise the Bradley Center for Philanthropy and Civic Renewal here at Hudson Institute. It's our pleasure to co-sponsor today's panel with another Hudson center, John Weicher's Center for Housing and Financial Markets.

The title of our panel today is "The Community Reinvestment Act and the Subprime Mortgage Crisis: Is There a Connection?" We got the idea for today's session a few weeks ago in the midst of the Bradley Center's previous panel, entitled "Mr. Obama's Neighborhood." That event, covered by C-SPAN and available on Hudson Institute's web site, featured four scholars and journalists with strong views pro and con about what community organizing is, what community organizers do, and how one should assess presidential candidate Obama's brief career in that practice.<sup>1</sup> As the panelists chatted beforehand, it was clear that they also had very strong and conflicting views about the role the Community Reinvestment Act (CRA) may or may not have played in today's subprime mortgage crisis; the CRA was in many ways one of the first and most important victories for modern community organizing in America, and subsequently a focus of a great deal of nonprofit community activism.

So we determined to focus another session directly on this issue of CRA while the question is still agitating public opinion and indeed playing something of a role in the presidential election. We're grateful to today's panelists for coming together on such short notice!

I now turn the panel over to John Weicher, who will be today's moderator. Before he returned to Hudson as a center director in 2005, John served as assistant secretary for housing and federal housing commissioner at the US Department of Housing and Urban Development, so he knows a thing or two about the issues before us today. John will introduce our other panelists.

JOHN WEICHER: Thank you, Bill! It's a pleasure for the Center for Housing and Financial Markets to be co-sponsoring this discussion with the Bradley Center, and it's an additional pleasure to be the moderator.

As Bill said, the idea for this event came from a conversation he and I had in passing a couple of weeks ago after his previous event. CRA has been in existence for over thirty years, and there have been various studies of its impact in local communities and for individual banks and other depository institutions. I think it's fair to say that there has been recurring controversy over its effect on communities and on banks.

In the last few months there has been a further controversy about CRA – whether it has contributed to the subprime mortgage market situation. Critics have argued that CRA has forced banks to make loans to people who clearly aren't good credit risks, particularly over the last dozen years or so, and that once prices stopped rising those bad loans came home to roost in the

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<sup>1</sup> Further information, audio and video recordings of the discussion, and a complete transcript of "Mr. Obama's Neighborhood" can be found on Hudson Institute's web site at:  
[http://www.hudson.org/index.cfm?fuseaction=HUDSON\\_upcoming\\_events&id=609](http://www.hudson.org/index.cfm?fuseaction=HUDSON_upcoming_events&id=609)

form of very high default rates and people losing their homes. Defenders of CRA have argued that CRA had no such impact: No depository institution is required to make bad loans. Most subprime loans had been originated by lenders who aren't subject to CRA to begin with.

I have two small but growing stacks of paper on my desk, one on each side of this issue. I think I am not alone among our panelists in that respect. The role of CRA in the current situation, if any, is certainly an important question; this is a timely discussion; and we certainly expect a lively discussion.

Someone asked me as we were planning this event if we were going to have people of different points of view. The answer was and is, yes, very much so! We planned it that way, and we have it that way. We have a distinguished panel of analysts and practitioners who have very different thoughts on how CRA is working locally and nationally, and beyond the panel we have with us today a knowledgeable and distinguished audience with widely divergent points of view as well. So this afternoon should be fun and informative.

I've asked each panelist to talk for about ten minutes; then we'll have some discussion among the panel if they wish; and then we'll throw it open to questions. I will briefly introduce each panelist now, and for the rest of the session I will keep time, referee the question-and-answer discussion, and preserve the Marquess of Queensberry rules (of boxing) as best I can – that's for you in the audience; I'm not worried about the panel. (Laughter.)

We'll start with two speakers who will focus mainly on the longstanding question of CRA's impact in local communities, and conclude with two who will talk about the current controversy over CRA's role in the mortgage market meltdown. The questions are certainly interrelated, but we think it's useful to try to keep them distinct to start with.

Our first speaker, Deborah Goldberg, has thirty years' experience working on fair housing, fair lending, and community reinvestment issues, working with community-based organizations to increase the availability and affordability of financial services for low-income people and people of color. She is currently the director of the Hurricane Relief Project of the National Fair Housing Alliance. She previously served as co-director of the Neighborhood Revitalization Project (NRP) of the Center for Community Change. And she was a member of the joint HUD-Treasury Predatory Lending Task Force in 2000.

She will be followed by Howard Husock, who is the vice-president for policy research at the Manhattan Institute. He also directs Manhattan's Social Entrepreneurship Initiative, and is a contributing editor to *City Journal*. Before joining the institute, he served as director of case studies in public policy and management at the Kennedy School of Government at Harvard University. He has published widely on housing and urban policy, including a paper in 2000 on CRA entitled "The Trillion-Dollar Bank Shakedown That Bodes Ill for Cities."<sup>2</sup> Early in his career he was a documentary film producer for the public television station WGBH in Boston, where he won three Emmy awards.

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<sup>2</sup> Howard Husock, "The Trillion-Dollar Bank Shakedown That Bodes Ill for Cities," *City Journal*, Winter 2000. Online at [http://www.city-journal.org/html/10\\_1\\_the\\_trillion\\_dollar.html](http://www.city-journal.org/html/10_1_the_trillion_dollar.html) (last accessed October 28, 2008).

Our second pair of speakers will focus more on CRA and subprime mortgages. Barry Zigas has been director of Housing Policy for Consumer Federation of America for about three weeks, now, I think. Between 1993 and 2006 he was a senior vice president at Fannie Mae, with responsibility for Fannie Mae's community lending initiatives, including specialized mortgage product development to increase homeownership opportunities. He is a member of the board of the National Housing Trust and the National Housing Conference. And if you live in Northwest DC, you may be interested to know that he is on the board of the Avalon Theater Project. I first knew Barry when he was a staff writer for the *Housing and Development Reporter*, and I was chief economist at HUD. That was so long ago that at the time, there was no Community Reinvestment Act! (Laughter.)

Finally, our last speaker, Russell Roberts, is professor of economics at George Mason University, the J. Fish and Lillian F. Smith Distinguished Scholar at the Mercatus Center, and a research fellow at Stanford University's Hoover Institution. He has written numerous popular and scholarly articles – you may have seen his recent article in the *Wall Street Journal* about CRA.<sup>3</sup> But in addition he has written three novels. So Howard has three Emmys, and Russell has three novels! The most intriguing, to my mind, is entitled *The Invisible Heart: An Economic Romance* (MIT Press, 2001). As an economist, I have never used “economics” and “romance” in the same sentence, and so I think that novel is worth reading to begin with – and that ends my short commercial message for it! (Laughter.)

RUSSELL ROBERTS: I appreciate it!

JOHN WEICHER: So, we have a distinguished panel, and with that, I'll turn the podium over to Deborah Goldberg.

DEBORAH GOLDBERG: Thank you, John! It's a pleasure to be here. I thought twice about coming, because when John told me that the discussion was going to address this question of whether there is a link between CRA and the current subprime meltdown and economic crisis worldwide, my response was that it would be so hard to make that link that I wasn't sure we could have a credible conversation on it. But I am confident that we'll be able to actually do that today.

My short answer to John's question, mentally, at least, was, no. There is no link between the Community Reinvestment Act and the current subprime crisis. My flip answer is, if only! by which I mean, if only so many loans had been made under the Community Reinvestment Act over the years that anything that happened with them could have the impact that the subprime meltdown and unfolding economic crisis has had – which it has not, but if only! And if only so many players in the mortgage market and in the financial markets were covered by the Community Reinvestment Act, which they are not.

I think that in order to really understand whether there is a link here, you need to know something about the Community Reinvestment Act – and I see that probably a third of our audience was likely born after CRA was enacted and may not have had the opportunity to read it,

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<sup>3</sup> “How Government Stoked the Mania,” *Wall Street Journal*, October 3, 2008. Online at <http://online.wsj.com/article/SB122298982558700341.html> (last accessed November 5, 2008).

and many of the others of you in the audience – although I think we have some experts out there – may also have never had the opportunity to read it. I brought a copy, in case anybody is interested. I’m not going to read it. But I’m going to give you a little bit of background.

So, CRA was passed in 1977. It was, as Bill (Schambra) pointed out, a major victory for neighborhood groups around the country that were working really hard to improve conditions in their communities – looking to increase home ownership, to help people who already owned homes have access to credit to be able to repair and maintain their homes, looking to stabilize things, looking to expand jobs and business opportunities in their communities.

It’s kind of hard today to remember what the financial services market was like in the 1970s, because things have changed so dramatically. In 1977 you could actually open a bank account – almost anybody could open a banking account – in an insured depository institution, which is not the case today. But what neighborhood groups around the country found was that when it came to getting that money out in the form of a loan, it was a much harder effort if you were low or moderate income, if you were a person of color, or if you lived in an inner-city community. And so groups worked really hard to get this law enacted, and it was passed in 1977.

It’s very simple. At its heart, it affirms that insured depository institutions, by which we mean banks and savings and loans, have a continuing and affirmative obligation to serve the credit needs of their entire communities, including low- and moderate-income neighborhoods; that the banking regulators that oversee the performance of those institutions – the Federal Reserve Board, the FDIC, what was then the Home Loan Bank Board and is now the Office of Thrift Supervision, and the Comptroller of the Currency – have an obligation to evaluate a lender’s performance under CRA; and then they are supposed to take that evaluation, that performance, into account when making a decision about whether institutions could expand or not. In the early days of CRA, that was mostly whether they could open a new branch somewhere. These days it’s whether one bank holding company can acquire another bank holding company.

CRA states clearly and explicitly that the loans to be made under the Act are expected to be “safe and sound” and profitable. And there is a little more detail, but that’s really the heart of what the Community Reinvestment Act says.

What it has done is to afford the opportunity for community groups and banking institutions around the country to come together to learn each other’s business, to learn each other’s community, and to craft loan products and marketing efforts to reach into previously underserved or unserved communities and make credit available.

I want to be really clear. The loans that have been made under CRA – the kinds of things that I have seen in CRA agreements between banks and community groups all around the country over a very long period – are not the kind of subprime adjustable-rate loans, the 228s and 327s with piggy-backs and prepayment penalties and all sorts of other features that make them unaffordable. They are not those types of loans. They tend to be at a fixed rate, with reasonable fees and no prepayment penalties. They may have lower down payments, which were common at least in 1977-78; so when the typical down payment for a mortgage loan was 10 to 20 percent, CRA programs often called for slightly lower down payments. They might have had slightly

higher debt-to-income ratios in the days when ratios of 25 and 30 percent were the industry standard –

(Cross talk. Panelists agree.)

DEBORAH GOLDBERG: The CRA programs bumped those up to 28 and 36 percent, recognizing that low- and moderate-income people paid 28 or more percent of their income for rent – consistently, over years – and so allowing them to pay 28 percent of their income for a mortgage did not represent an undue risk on the part of a lender.

And I want to say that a big part of CRA was helping lenders understand that you couldn't take the credit model that was used to evaluate the credit-worthiness of a middle-class, white, white-collar person and apply it to someone who is low-income and expect it to work. You needed to actually look at how people managed their money and what kind of credit they had access to, their history of being financially responsible in the way that they were – not in the way that many bankers were. Because it wasn't the same. Just because someone didn't have a credit card, didn't mean that they weren't credit worthy. Just because someone might pay more than 25 percent of their income for housing didn't mean that they didn't make their housing payment every month, month after month, year after year.

Another thing that CRA really helped to do was to get past some of the bad experiences that people in underserved communities around the country had had with mainstream financial institutions. When I was doing CRA work here in the District of Columbia in the 1970s and 1980s, and I would go into neighborhoods and talk about the kinds of things that we were trying to get banks to do, and name certain banks in this city – none of which exist anymore – people would laugh. People would laugh because they had had so many bad experiences or knew so many people who had had bad experiences with those institutions that they didn't believe that those institutions could turn themselves around and really be willing to make credit available. And that was a very big hurdle to overcome, but CRA has been very effective in helping to overcome that hurdle in places all across the country over the years. It helped lenders who otherwise were really unable to effectively reach into underserved communities and get people to listen to them, get people to come and apply for credit.

The result was, as I said, that both sides – community-based organizations and lending institutions – came to understand each other much better. I think these days you would no longer have the kind of conversation that I once had in an elevator with a lender. We had been talking about how you could craft a program to make credit available to nonprofit community development organizations, and she turned to me and said, “But if they're nonprofit – if they can't make a profit – how are they ever going to pay the loan back?” And I don't think you'd have the kind of conversation anymore where you'd have community groups and bankers sitting around a table, and the community group would talk about a CDC – a community development corporation, an important vehicle that exists in a lot of neighborhoods around the country to help rebuild communities – and have the bankers think they were talking about the Centers for Disease Control. (Laughter.) There was a real language barrier to overcome!

Really effective partnerships have been built up between banks and community groups over the years, and those partnerships have opened up access to credit. Current estimates are that something on the order of \$4.5 trillion have been committed to previously underserved communities since CRA was enacted.

I want to take a minute and just talk a little bit about one particular program – in Massachusetts, the SoftSecond program, which originated in Boston and then expanded statewide. It was developed in 1991, the result of a joint effort between the Massachusetts Bankers Association, the Massachusetts Housing Partnership, and the Massachusetts Affordable Housing Alliance. It is funded by the state and administered by some state agencies. It provides down payment assistance and interest-rate subsidies for low- and moderate-income borrowers. The SoftSecond loans involve a 3 percent down payment on the part of the borrower; a 77 percent loan from a private lender; and a 20 percent “soft second” mortgage contribution from the state. Since 1991 more than ten thousand of these loans have been made across Massachusetts.

Some recent analysis shows that between 2004 and 2006, the median income of the borrowers for these SoftSecond loans was \$45,000, which is below 80 percent of the median for the state, as I understand; 25.6 percent of the loans have gone to Latino borrowers, who make up 5 percent of the population in Massachusetts; almost 17 percent have gone to African-American borrowers, who make up under 5 percent of the population statewide; and 7.3 percent have gone to Asian borrowers, who are about 3 percent of the population statewide. So these loans are going to communities that I think many would consider underserved.

\$51 million in public funds have been put into the program since its inception. That money has leveraged over \$1.4 billion in private mortgage financing. So it has been a very effective program. They’ve taken a little bit of public money, matched it with a lot of private money, and made it possible for an awful lot of people who might not otherwise have been able to become homeowners buy homes.

The delinquency rate on these loans as of last year was 1.8 percent. Compare that to 5 percent statewide for all loans in Massachusetts. So they have a much lower delinquency rate than others. And they have been a real boon to communities all across the state, and particularly in Boston.

But while groups in Boston and Massachusetts have been working hard to use programs like SoftSecond and others to open up access to credit, what they have found is that other forces have been at work, particularly in recent years. As the subprime market and subprime lending began to explode, it made really unfortunate inroads into communities had been flourishing under CRA.

In Boston, subprime lending really got a foothold, like in many parts of the country, in the late 1990s mostly with refinance loans. In recent years it has expanded into the home purchase market as well – again, this is something that I think we will hear about nationwide. So in 2006 the high-APR loans, as we call them under the Home Mortgage Disclosure Act, represented 20 percent of the home purchase and 25 percent of the refinance loans in Massachusetts – and higher in some particular places. These loans have been targeted to black and Latino borrowers;

just like the SoftSecond loans have been used heavily, the same communities have been targeted by subprime lenders with high-APR loans.

In Boston, 49 percent of blacks and 48 percent of Latinos while only 11 percent of whites had high-cost, subprime loans in 2006. As income goes up the disparities increase. When you look at people who are above \$165,000 in income – twice the area median income in Boston – 55 percent of blacks, 49 percent of Latinos, and 7 percent of whites got high-cost loans. They are also concentrated in neighborhoods that have lower income levels and a higher percentage of minorities, when you look at the geographic distribution of the loans. If you're familiar at all with Mattapan and Roxbury, two predominately minority communities in Boston, 54 percent of the home purchase loans in Mattapan in 2006 were high cost; 49 percent in Roxbury. If you look at the predominately white Charlestown, the rate was at 3 percent. In predominately white Fenway-Kenmore, the rate was 2 percent.

In Boston and Massachusetts, we see that non-CRA-covered institutions – in other words, mortgage companies and institutions that may be covered by CRA but not in these communities, because they are based elsewhere, don't have a branch there, and therefore are not evaluated under CRA in those communities – account for three quarters of all home-purchase loans that were made statewide in 2006. And local mortgage lenders – so, not the affiliates of an insured depository, but rather independent mortgage companies – made 70 percent of all of the high-APR loans in Boston in 2006. These are the loans that are foreclosing.

Foreclosure rates are skyrocketing. They're skyrocketing among the subprime, adjustable-rate arms. And they're having a really big impact on communities that had been benefiting under the Community Reinvestment Act. I talked recently with Tom Callahan, who is the director of the Massachusetts Affordable Housing Alliance and one of the masterminds behind the SoftSecond program. He is very active in counseling low- and moderate-income home buyers in Boston and elsewhere in the state – I should have added that in order to get a SoftSecond loan, you have to go through a counseling program. He told me that many of their borrowers now live in neighborhoods where there are surrounded by foreclosures, and their property values are plummeting. They are still paying their mortgage loans regularly, but they are under water; the value of their property is now less than the loan balance on their property. And so while they are paying their mortgage they have lost the equity, the wealth, that they had accumulated by being able to get that loan in the first place.

That result is not from their (CRA) loans. It's from the subprime, adjustable-rate loans that have flooded their neighborhoods. And so the bottom line for me is: not only is CRA *not* responsible for the crisis we are facing now, but this subprime tsunami that is taking over so much of the United States and the world threatens to wipe out all of the progress that we have made under the Community Reinvestment Act over the last thirty years. And we must figure out what to do about it.

Thank you.

HOWARD HUSOCK: Thank you very much. The title of this discussion, which raises the question of whether there is a connection between the Community Reinvestment Act and the

current crisis, is an apt one. It would be a foolish overstatement, in my view, to assert that the CRA is somehow the cause or main cause of the current crisis. Exceptionally low interest rates, high levels of available capital, and the advent of mortgage securitization combined – it's clear in retrospect – to spur an overinvestment in housing, an underinvestment in the sort of due diligence which once typified lending. These are huge changes in the financial industry, and I think that they must be considered the key precipitants of the current situation. But as for the question of whether the CRA is at all linked to our current problems, I would answer in the affirmative.

It's a long way from the world of the original act to the role it played in the housing crisis, but let me try to connect the dots. At the time of the passage of the CRA, as Debby (Goldberg) alluded to, the world of banking was – as Monty Python might put it – “something completely different.” Banking was largely a local industry; indeed, interstate branch banking was not permitted.

Mortgage lending, moreover, was largely the province of thrift institutions – local savings and loans – which had a kind of a deal with the government. They would pay relatively low rates of interest to their many small depositors, but they would charge relatively low rates of interest of mortgage borrowers. This limited spread strongly discouraged risk. Combined with the lack of bank competition, it undoubtedly led many neighborhoods to lack access to credit.

The term red-lining developed to describe that situation, and it led many advocates of the poor at the time – and believe it or not, I was a young left-wing journalist at the time, and if you look at the records of the Boston *Phoenix* newspaper you can find an article by me called “Neighborhood in the Red” describing exactly this problem – to conclude quite plausibly that only a legislative mandate could guarantee that those of modest means living in struggling urban areas could get access to credit.

Until the Clinton administration, CRA compliance was not a difficult matter. Banks could get what amounted to an “A for effort” by advertising in certain newspapers and certain neighborhoods. But the Clinton Treasury Department changed matters a good deal through 1995 regulations requiring banks that wanted “outstanding” CRA ratings to demonstrate numerically that they were lending both in poor neighborhoods and to lower-income households.

In my view, this new era of strict enforcement was a response to conditions which no longer existed. The bank deregulation of the 1980s had put us on a road to seeing sharp competition among mortgage lenders. A paper by the Dallas Federal Reserve Bank entitled “Redlining or Red Herring?” published in 1999 put it this way: “The CRA may not be needed in today's financial environment to ensure all segments of our economy enjoy access to credit.”<sup>4</sup> Competition – market forces – had changed the landscape tremendously.

But the ramped-up enforcement of the Clinton administration had powerful effects, in no small part because banks were engaged in a frenzy of mergers and acquisitions, and in order to obtain

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<sup>4</sup> “Redlining or Red Herring?” by Jeffery W. Gunther, Kelly Klemme, and Kenneth J. Robinson, *Southwest Economy*, a publication of the Federal Reserve Bank of Dallas, May/June 1999, p. 8. Available online at <http://dallasfed.org/research/swe/1999/swe9903.pdf> (last accessed October 28, 2008). See also Husock, “The Trillion-Dollar Bank Shakedown.”

the permission of regulators for these deals “outstanding” CRA ratings became coin of the realm. And what’s more, nonprofit advocacy groups including the now very famous ACORN and the Neighborhood Assistance Corporation of America, based in Boston, came forward to demand – successfully – that banks seeking regulatory approvals commit large pools of mortgage money to them, in effect outsourcing the underwriting function to groups that viewed such loans as a matter of social justice rather than due diligence. Bruce Marks, founder and still head of the Neighborhood Assistance Corporation, told me when I visited his office in Boston in 2000, “Our job is to push the envelope.” He specified that he would use his “delegated lending authority” – that’s the term – to make loans to households with limited savings, significant debt, and poor credit histories.

The sums at the disposal of his group and others were nontrivial; when NationsBank merged with Bank of America and took the name “Bank of America,” it committed \$3 billion to Bruce Marks’ group. ACORN Housing received a similar \$760 million from the Bank of New York. So it is that we begin to see an indirect connection between CRA and our present troubles. Quite sizeable pools of capital began to be allocated in a new way. Rather than lending on the basis of an individual household’s demonstrated ability to repay, regulators were pushing for lending to occur on the basis of other criteria. Bank examiners at the Office of Thrift Supervision began to use federal home loan data broken down by neighborhood, income, and race to rate banks on their CRA performance. This starts to stand traditional lending on its head. The key difference? In sharp contrast to the traditional regulatory emphasis on safety and soundness, banks were now being judged not on how their loans performed, but on how many loans they made.

I spoke to a staff member at the Neighborhood Housing Services of Chicago, Michael Traynor (ph), who put it to me this way – he was a former Harris Bank vice president: “You just had to make sure you didn’t turn anyone down. If anyone applies for a loan, it’s better just to give them the money. A high denial rate is what will get you in trouble with the regulators.” And this is from a housing advocacy group in Chicago.

I would assert – and I did in *City Journal* in the winter of 2000<sup>5</sup> – that this is ill-advised social policy. The risk of the consequences of default is greatest for lower-income households that are paying their bills on time but find that they are living next door to a house on which a lender has foreclosed. Poor neighborhoods, in order to build both social and economic capital, must rely not on an open tap for credit, but on the frugality and prudence of their residents. A line of credit based on other criteria concerns me – not because I’m concerned about the banks or the bankers, but because this is my understanding of what can hurt low-income neighborhoods and borrowers.

And I agree quite with Debby (Goldberg) that it is heartbreaking to visit neighborhoods – for instance one that I’m very familiar with, Back of the Yards in Chicago – and see on one street of maybe twenty houses four foreclosures. In Back of the Yards, the woman who was the head of the neighborhood association said, “This is just killing us. Gangs are moving into these houses. Our property values are plummeting.” But the community organizer who actually showed me around there also connected the dots to loans made in a thirteen-block area there to major banks – not to unregulated lenders.

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<sup>5</sup> Husock, “The Trillion-Dollar Bank Shakedown.”

Now, were those loans CRA eligible? Well, there were national markets that traded in CRA loans; you could buy CRA loans through *American Banker* ads on any day of the week. It was not a strictly localized phenomenon. Was there a high enough level of CRA lending to spark our current crisis? Again, I think such lending played a supporting role, but it wasn't just because of the CRA. It's also important to look at the government-sponsored housing enterprises Fannie Mae and Freddie Mac.

Beginning in 1992, Fannie Mae and Freddie Mac set affordable housing goals and subgoals. They were pressured, in other words, by the Congress to buy loans made in low- and moderate-income neighborhoods. By 2005, Fannie and Freddie were to strive to buy 45 percent of all loans from those of low and moderate income, including 32 percent from central cities and other underserved areas and 22 percent from very low-income families or families living in low-income neighborhoods. As one banker from a major bank in New York put it to me just a few weeks ago, "Fannie and Freddie came up and scooped up all of our CRA loans." Did they buy only CRA loans? Of course not. Was there a wide open, Wild West market? Of course there was.

CRA advocates today assert that CRA-qualified loans made by regulated institutions were high-performing and should not be implicated in our current troubles. But small samples are unconvincing. There has been no systematic study either by the GAO or the Federal Reserve of the performance of those loans cited by banks in their CRA filings. Many such loans were actually not even underwritten by the banks themselves, which often purchase CRA-eligible loans advertised in publications, as I mentioned. The emphasis was on showing regulators that loans were being made, not on how they were performing. How could such a system not lead to problem loans and high delinquency and foreclosure rates?

It's worth noting that when I met with Bruce Marks, he told me that his organization's loans in Boston had an 8.2 percent delinquency rate at a time when the national rate was 1.9 percent. He was rather proud of it! It proved that he was pushing the envelope.

Looking ahead, how should we think about our financial system as it relates to Americans of modest means? That's the broad issue that we're grappling with. It seems clear, in retrospect, that we have as a matter of national policy pushed too many households toward home ownership. Both political parties are guilty. Democrats, I believe, were largely responsible for Fannie and Freddie and their affordable housing goals – not entirely, but they've emphasized them in recent years and expanded them. But the Bush administration, for its part, promoted the idea of, for instance, using a Section 8 housing voucher – held by *very* poor households – as a down payment on a home loan.

We have in place tools for both a fair and effective housing policy. Fair housing and anti-discrimination laws must be enforced to ensure that prospective borrowers are not turned away for non-financial reasons. Credit scoring, which did not exist at the time of the original passage of the CRA, is a revolution that allows lenders to differentiate among households of similar income but different levels of frugality and thrift. The shame of it is that lenders in recent years – because they could just resell those loans to a go-go market – weren't using the credit-scoring tools to adjust credit to the specific capacities and thrift habits of individual households to reward those people who are saving and to encourage those who are not saving to do so. Let's let these

market mechanisms operate rather than to rely on regulatory mandates and the political risk that they introduce into financial markets.

Thank you very much.

BARRY ZIGAS: Good afternoon! This is an important topic, and one that is generating much more heat than it is light. I hope today we will do more of the latter and less of the former.

*EDITOR'S NOTE: Slides from Zigas' PowerPoint presentation are incorporated below where appropriate.*

I actually agree with a lot of what Howard (Husock) said. I get off his bus at a certain point, as you might expect. But I think his pointing to much bigger, underlying economic forces that drove increases in home ownership and increases in the availability of capital is absolutely true, and I think that for a great deal of the 1990s that was a hugely salubrious effect which led to increases in wealth and many other things for many low-income people who did not have access to them before.

I do get off the bus, though, when the analogy is extended to saying, well, CRA was in place; bad things ended up happening; ergo CRA is a contributor to the problem. I suppose that's true, but then I will posit that gravity is also a contributing factor to the subprime mortgage crisis. After all, everything that goes up must come down; we're all subject to gravity; and it has been there ever since we've been doing lending, so it must have something to do with this.

The real issue here is to try to disaggregate the effects. We should ask, if it were a contributing factor to the current crisis, where is the evidence for it? What would we look for? Can we find it? And, again, I actually agree with some of the things that Howard (Husock) has said, but I want to put them in perspective because I think it informs a larger discussion.

First, to build on what Debby (Goldberg) said, I think it's really important to recollect that the agitation and policymaking that led to the adoption of, first, the Home Mortgage Disclosure Act in 1975, professionally known by all of us as "Humdah" (ph), and the CRA two years later was actually a response to the last gigantic subprime lending crisis in urban neighborhoods. It was lending that looked very much like today's lending in its time. It was facilitated by the Federal Housing Administration in central city neighborhoods. There were tons of foreclosures. The federal government ill-advisedly pushed deeply into home ownership for very low-income people with a system that was subject to very poor regulation and oversight, and it led to massive foreclosures among people who had been victimized by a combination of unscrupulous real-estate brokers and real-estate professionals, lenders and brokers, and the people providing them with the money.

In fact, when CRA was being developed, what neighborhood organizations and advocates were looking for was to bring conventional credit with conventional credit standards back into neighborhoods that had been abandoned and left to today's version of subprime lenders. I think that's a *very* important point for everybody to keep in mind. The neighborhood organizations and the advocates who represented them did not come to Washington to ask the Congress to require

depositories to meet the credit needs of their communities because they somehow felt that they needed *bad* credit. They were coming to Washington to say, we know all about bad credit; it's the only kind of credit we can get, and it's destroying our neighborhoods. We need the discipline of sustainable, economically viable lending to come back to our community. This is something that is very easy to forget, and very easy to lose track of, but I think that it's an important fact as we sort of look back on the antecedents of the act.

Second, when CRA finally did get regulations put behind it, the emphasis was on things that I think of when I think of "conservative" in the sense of "conservative about government intervention" – things that I think of conservatives actually being great fans of: It was performance based. It was not prescriptive. It did not tell people what to do. It told them, your obligation is to meet the credit needs of your entire community, and there are ways we will measure that. You tell us what your service area is. You tell us – in many cases – how you want to be judged and what you expect the results to look like. And then we will assess where you fit on a scale.

Lenders were given wide latitude in designing efforts to meet community credit needs – and I should add that community credit needs in the CRA are broadly defined. They do not include simply home mortgage loans. They include small business loans, community development lending, and others. And today, the tests that lenders are subjected to to get their ratings including lending, investment, and community service. Three factors. Direct lending is clearly the most important of those, but the others can play a role and are important in thinking about how lenders think about the neighborhoods in which they work.

CRA did in fact generate, as Howard (Husock) said, real changes in how business was done in urban communities. One of the first was in marketing, which Debby (Goldberg) talked a little bit about. Prior to this and prior to banks being on the hook, if you will, for demonstrating the service they're providing in their communities, it was quite common for banks to ignore completely neighborhoods with working families, low- and moderate-income families, and people of color. They didn't advertise their services. They did nothing to extend their services to them in an effective way, thereby in effect shutting them off from conventional credit.

I remember as a reporter – as John (Weicher) said – going to Chicago to a meeting that Gale Cincotta was running, and one of the things that struck me, as a reporter who was a newcomer to the scene, was the observation in many of their neighborhoods that you could get deposits – people were handing out matchbooks that said, "Put your money in our bank" – but they wouldn't advertise at all that you could come *get* money from the bank, that they had mortgage loans available to people in this community. So marketing became a huge issue, as well as the placement of branches, the outreach to communities, and the informing of communities about the availability of credit on favorable terms.

Second was product design – and Debby (Goldberg) has talked a little bit about this, and so has Howard (Husock). This got to be the question of, what really are the standards the lender is imposing? What are the standards they are utilizing? What ways might there be to increase access to credit by people who have previously not had access to it? And certainly in the beginning a great deal of this simply revolved around – to Howard's point about credit scoring –

alternative ways to understand people's ability and willingness to repay loans. It was about getting away from cookie-cutter models that were based on a very specific, middle-class, suburban model of how housing and how income is managed, and instead beginning to try to fit the banks' lending ability, its traditional underwriting responsibilities, into the markets they were being asked to serve. And certainly other features began to emerge: lower down payments, more flexibility on liquid assets, and as Debby (Goldberg) said, higher ratios.

Third was borrower relationships. Lenders in this process were not typically responsible – in fact, to the contrary, one of the big developments that emerged out of the success of the CRA implementation and enactment was the development of relationships between lenders and the trusted advisors in the community organizations that had fought for it, which very often focused first and foremost on preparing borrowers to borrow. Because people in these communities were not interested in more of what they had already seen lots of, which was loans that would fail because people were not ready. This led to banks imposing requirements for housing counseling, funding housing counseling and financial literacy, and lots of other outreach that was all designed to create a bankable population if it didn't exist in the past, and to prepare people who didn't have any experience with home ownership or finance for taking on what would be the largest debt in their lives.

I think those are interesting characteristics of what banks moved forward to do. And as you think about this conversation, think about this difference – between finding ways to make loans responsibly, economically, and sustainably and what we've come to understand the model has been in the last five years in the subprime world. What are the characteristics of the subprime meltdown?

First of all, it's very important that a lot of new entrants were coming into the mortgage market. And they didn't come from nowhere; they came from the asset-backed lending industry, which has been around a long time and focuses on making loans based on the value of the underlying assets – and much less on the credit characteristics of the borrower. This is the loan where I say, if I know I'm going to get my money back whether you fail or not because your assets are solid, and I'm putting very little against it, I can do a loan like that. That is the essence of subprime lending. And it's not a new thing; it has been around a long time, and it is – was – a highly profitable segment. And the movement of these lenders into mortgage lending at the end of the 1990s and in the early 2000s is one of the key characteristics of this.

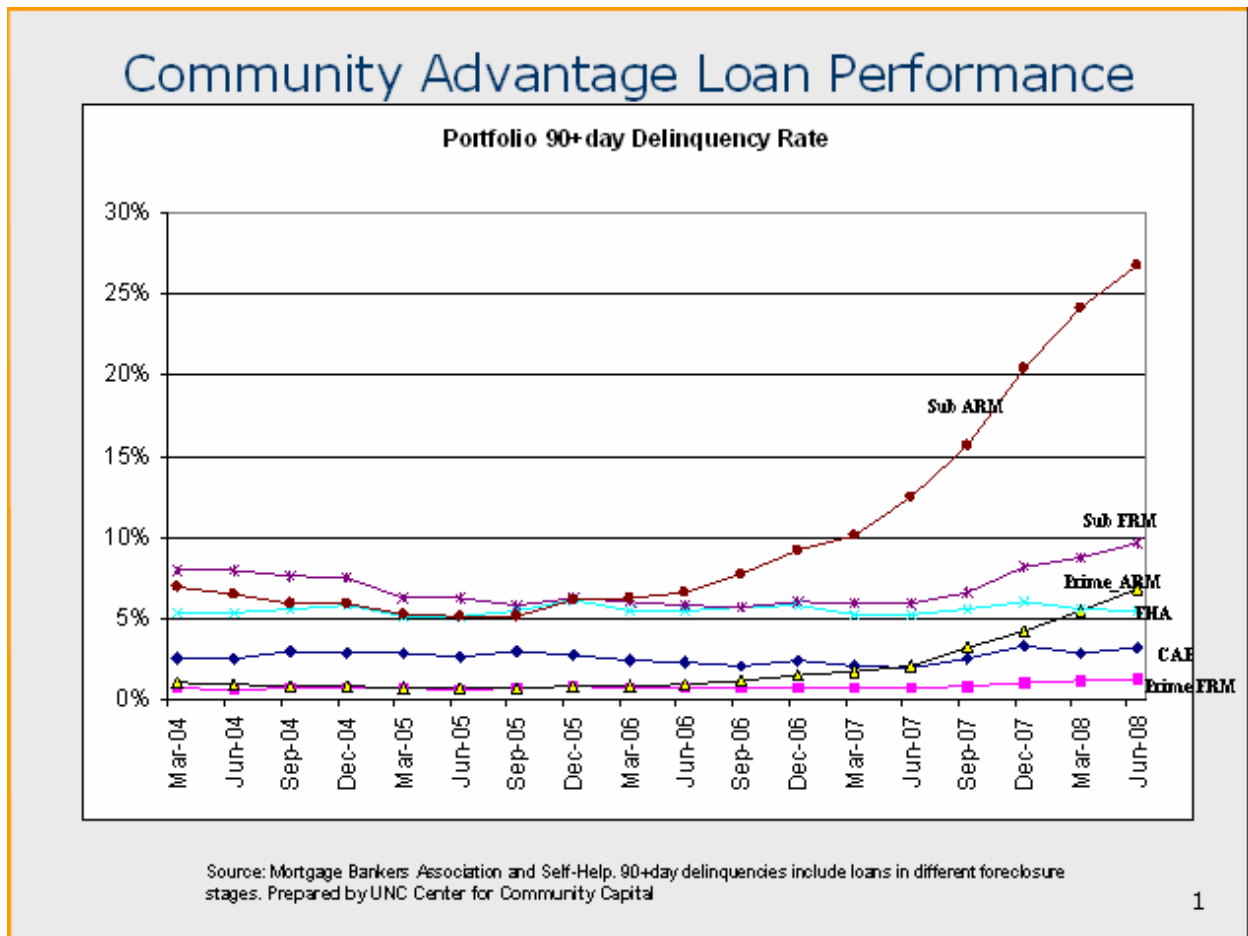
Second, equity-stripping features in the loans. There has been a lot written about this. Prepayment penalties that keep people trapped in high-cost loans. Higher costs. Higher up-front fees. Features like single-premium credit life insurance, a feature of almost all subprime mortgages when they first came out.

These are very different from the kinds of lending that were being done by depositories who were trying to fulfill their CRA responsibilities. These are higher-cost, higher-risk loans, and – as Howard (Husock) did say – there developed in this system a lack of credit risk by practically everybody involved in the participation. And that's, I think, an important lesson for all of us as we look forward.

So what evidence would you look for to implicate CRA in the meltdown? We've talked about how it started. We've talked about what changed when subprime lending started to get en vogue and move into the mortgage space. So what evidence would you look for to say, well, CRA must have been a driver behind all of this. One question would be, to what degree did CRA-covered lenders participate in the lending that is causing the fuss?

Everybody from the Federal Reserve to independent law firms to others have concluded, not much. In a study by the Fed in 2006 using Home Mortgage Disclosure Act data, they found 19 percent of conventional first-lien mortgage loans originated by depositories were high-priced, compared to 40 percent by independent mortgage companies who were *not* covered by CRA. Very, very big difference.

Second, you would look at the performance of loans that were typically considered to satisfy CRA requirements or were brought forward into the marketplace in order for banks to be effectively meeting the obligations they had under CRA. This chart is, to me, one of the most powerful pieces of evidence we have.



In 1998, when I was still at Fannie Mae, Fannie Mae, the Ford Foundation, and the North Carolina-based Self-Help Ventures Fund entered into a partnership to create a new mortgage product that would be originated by banks, would be purchased by Self-Help, and would be

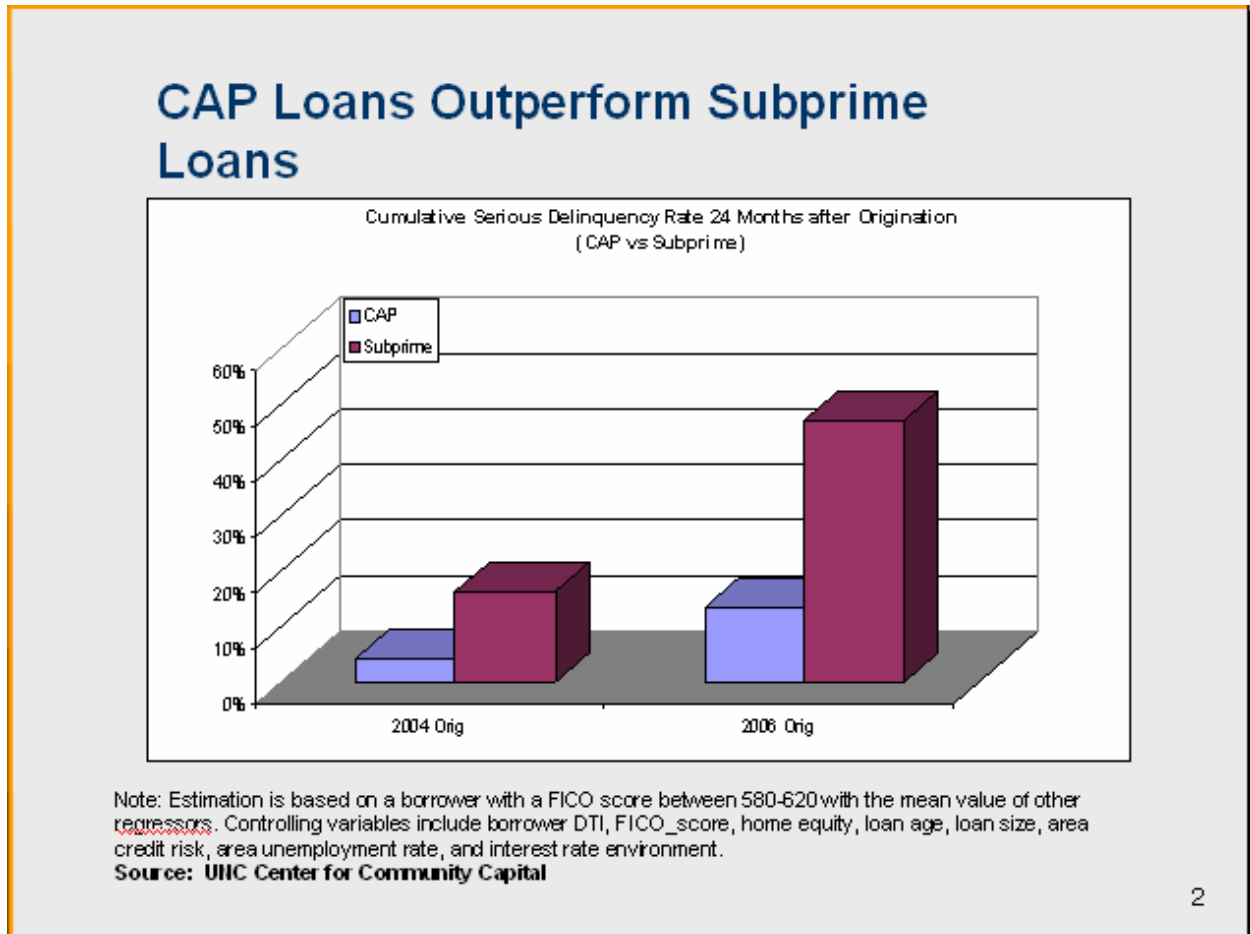
securitized in Fannie Mae mortgage-backed securities by Fannie Mae. This was called the Community Advantage loan program. There is over \$5 billion of this lending out on the street. So as Howard (Husock) said, these are often not trivial amounts. This is over ten years, now, that we have experience with this lending. And if you look along this chart (above), at the very bottom you'll see a hot pink line for prime fixed-rate mortgages. The yellow line with the triangles is prime adjustable-rate mortgages. And the dark blue line that is running right between zero and 5 percent, very steadily all along, represents Community Advantage Program (CAP) loans. Do they perform less well than prime loans? Yes, they do. Do loans with lower down payments, alternative credit, and lower liquid reserves perform less well? Yes, they do. And this was a fact that was known at the time, and it is a fact that no one has disputed. What's more important here is that in comparison to fixed prime loans, they perform pretty well, and in comparison to subprime loans, which are what's driving this crisis, they perform *fabulously*. From the start, subprime fixed rate and subprime ARM loans perform two to three times more poorly than the CAP loans. And in the middle of 2006 you start to see that line climb in a way that is no way coincident with the changes in loan performance of the Community Advantage Program loans.

I hasten to add that the Community Advantage Program loans were purchased from banks specifically under terms that would qualify for all of those lenders for CRA purposes. Borrowers were below 80 percent of area median income; they typically had very low wealth; and a high, high proportion were minority borrowers, and these were in minority and low-income neighborhoods. So here is evidence that these loans did not perform spectacularly badly. They are weaker than prime loans, but they do not perform anything like the way that subprime loans did, and those are the kinds of loans that were being made by lenders who were subject to CRA.

Now, another question you might have is, well, what in the heck happened? Because there certainly is lousy performance! The Center for Community Capital at the University of North Carolina at Chapel Hill has separate funding from Ford to track the Community Advantage Program over a long period of time to develop real, longitudinal data about the performance of the loans, the behaviors of the home buyers, and the success or failure of the program. This is the summary slide (below); there's a lot of other stuff behind it. But it shows basically the two origination years – those that originated in 2004 and those that originated in 2006 – and what are the cumulative serious delinquency rates twenty-four months after origination.

What the center did was take 9,000 of the CAP loans, which is what they had access to the data for, and match that with borrowers and loans from a private database, proprietary database that has the same information about borrowers generally, along with the kinds of loans that they received. Now, the paper has lots of formulas that I don't pretend to understand, but it's a powerful, powerful study because it's the first real, disciplined look at borrowers with the same circumstances to see what happened to them over time, with the kind of loan they got as the only variable. In the Community Advantage Program, the kind of loan the borrowers got was a thirty-year, fixed-rate mortgage, typically with a very low down payment, typically with credit scores that were not great but okay. The other borrowers got typically higher-cost ARM loans, often with resets. And all you can conclude from this evidence is that the problem has *not* been with the borrowers, although surely in 2006 performance is not as good as it was in 2004. It's with the

products the borrowers got – because the same borrowers with different products ended up with very different results.

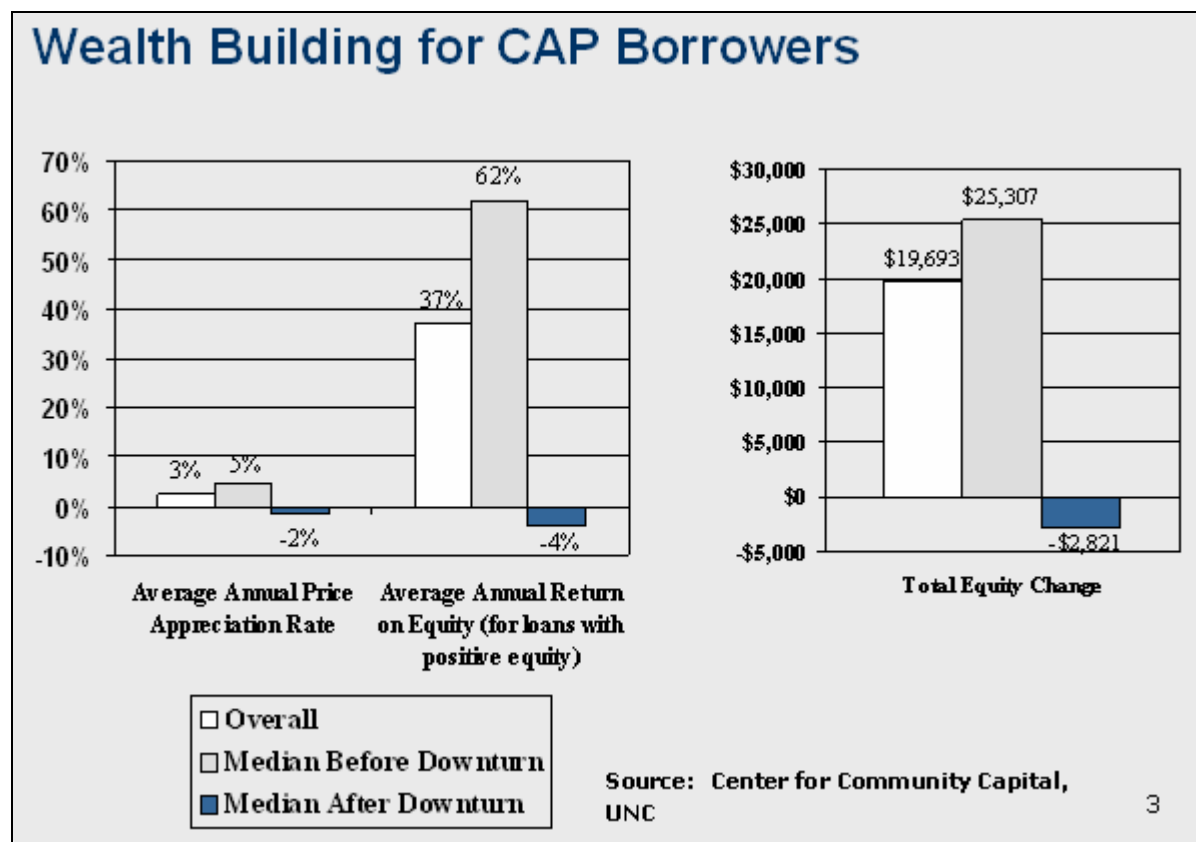


Another question you'd ask about CRA is, did it reach one of the principle objectives it was trying to reach – did it build wealth or, as in the case of subprime lending, which we're very concerned about today, has it had the effect of stripping wealth?

And again, this is from the Center for Community Capital, looking at the Community Advantage loans. (See slide on next page.) If you look at the second set of bars on the left-hand chart, the average annual return on equity – even after the downturn – is 37 percent overall. That's after the downturn; before the downturn, it was 62 percent. And if you look on the right-hand side, you can see the total mean equity change of these borrowers before the downturn and after the downturn. Some have lost value since the downturn, but they still remain with a significant amount of equity value.

Now, if this is lending that was poorly done, with no advantage to the borrower, you would not expect to see this kind of positive result emerging from it. You might expect to see only negligible increases in home ownership over time, because after all these loans are programmed for failure. In fact, home ownership rates peaked, as the Harvard Joint Center (for Housing Studies) has documented, well before subprime lending reached its maximum. In fact, subprime

lending is probably one of the principal reasons home ownership rates are declining – because so many people who had homes got suckered into refinancing them with bad products and have lost their homes as a result.



Now, I want to say a couple more things about this, and then I'll sit down.

Howard (Husock) made an extremely important point. I think this is an extremely compelling set of data, but I am the first to admit that it's an incomplete set of data. And it is critical for us to find out if these findings, which are provocative and, I think, persuasive in their own right, can be applied across the board to the vast inventory of Community Reinvestment Act-type lending that we made over the years. I've gone to the Comptroller of the Currency and urged them to do it, and I hope others will do so as well – because this is an important fact to get some bigger basis on. I think 9,000 loans is pretty good, but it's not perfect. Entities like Fannie Mae and Freddie Mac, which became the secondary mortgage source for much of what was characterized as CRA lending, have a tremendous amount of data on this. Now that the government pretty much owns them, perhaps there will be an opportunity to find out how their loans performed over a long period of time.

To the point that banks under CRA outsourced lending and underwriting, I can only say that having worked in this field and worked with those lenders, that sounds good and it may be what (inaudible), but it's just not true. All of these programs negotiated their parameters with the people, with the groups or the third parties doing the lending for them, just like they do with brokers, and those were the criteria that were used to make the loans. None of these groups got to

go out and make it up as they went along. They had a box they had to work in. And it's true that in many cases lenders felt that this was kind of the bleeding edge of the lending they were going to do, and they thought it was important to do; they had other reasons to do it. But to suggest that banks just gave up the keys to the kingdom is, I think, just not correct.

Finally, once again, we can't have our cake and eat it, too. Either 9,000 loans and \$5 billion worth of lending presents a persuasive case for the performance of these loans, or \$3 billion to NACA is not a significant amount of lending in the overall scheme of things. To keep these numbers in perspective, when I worked at Fannie Mae in the last ten years I was there, we would do an average of \$700 billion a year of financing. In that scheme of things, \$3 billion actually is a relatively small amount of lending. The question really is, what happened to all the rest of it, the big underlying lending that was used to meet most of the CRA requirements?

It's an important data question to answer.

RUSSELL ROBERTS: When we look at this mess that we're in now, I often think of the blind men and the elephant. Do you know that story? One blind man has his arms around the leg of the elephant, and he says that an elephant is like a column. One blind man has the ear of the elephant, and he says that an elephant is like a leaf. Another guy has his arms around the trunk of the elephant, and he says that an elephant is like a hose. So one of the lessons of this experience for me as an economist is how pitiful are our tools for evaluating what has gone wrong and what we can do to fix it. It's an indictment of aspects of my profession of economics. It's also an indictment of our ability to grasp complex subjects that have multiple effects and causes.

My answer to the question of whether there is a connection between the CRA and the subprime mortgage crisis is something like Howard (Husock)'s. There is a connection, but it's not the standard one. There are really two competing narratives for us blind men out here in the world. One is the anti-market narrative, which is that Wall Street greed, deregulation, and predatory lending created the crisis. The pro-market narrative is that government manipulation of housing markets created this mess. I think they're both right, and the question is, what's the balance, and what do we learn from the mess to go forward?

I see the mess as an example of government's attempts to engineer housing outcomes combined with Wall Street innovation, and the result is what we're living with. Milton Friedman once observed a deep truth, and the more I think of it, the more important I think it is: "People spend other people's money less carefully than they spend their own." Now, politicians have the privilege of spending other people's money all the time, but they also have the privilege of borrowing other people's money, and it's very hard for politicians to say no.

It used to be that the budget deficit would rein in eventually the politicians' urge to spend other people's money. We seem to be in a period where that is not the case anymore. We can't say no to the war in Iraq; that's a few hundred billion dollars a year – maybe more. We can't say no to bailing out Fannie Mae and Freddie Mac; that's \$200 billion – at least – committed. We can't say no to the bailout; well, we did at first. Now it's \$700 billion, but we'll add \$100 billion of special rewards for people to make sure that it passes. And now we have a stimulus plan on the table, as

if we haven't stimulated a \$3 trillion budget – and growing perhaps by another trillion dollars? It wasn't a sufficient stimulus? So I'm a little worried about our ability as a body politic to say no.

Politicians, when they do run up against that budget constraint of deficits or taxation or borrowing can also regulate. And by regulating, they can spend other people's money without having to give up the projects they already have going. So when politicians want to increase the rate of home ownership in the United States, they aren't limited by the various federal programs – which are extraordinarily large; I've never seen a comprehensive list – it would be quite complex – of what the government does to increase home ownership rates in the United States. But they can go beyond that spending; they can regulate. They can require Fannie and Freddie to purchase more loans from low- and moderate-income borrowers. In 1995 under President Clinton, HUD began to require that Fannie and Freddie buy at least 12 percent of their mortgages from especially low-income borrowers. By 2005, under the Bush administration, that number climbed to 22 percent. This year it was set for 28 percent. They're not going to make it. It was tempting for politicians to steer Fannie and Freddie; it looked like they were spending other people's money, and it wasn't taxpayer money. It was Fannie's and Freddie's investors' money. Of course, now it turns out that they were spending your money and mine.

Politicians did the same regulatory slight of hand with the banks. The CRA, although passed in 1977, was given more teeth in 1995, increasing the pressure on banks – as we've heard today – to make loans that they wouldn't make otherwise for the good of the local community. It was a way for politicians to spend the money of the bank's investors without having to go through the normal tax or borrowing strategy. It was a way for politicians to say yes to voters who wanted more home ownership than the market produced. It was a way for politicians to fund those houses without having to say no to other projects funded by taxpayers. Now, Fannie and Freddie were part of that story, too, as we've heard. They securitized CRA loans. How much is unclear, but they played a role.

The urge of politicians to achieve the goal of greater home ownership helped push up the demand for housing. So we have the Fannie and Freddie pushing up home ownership among low-income folks. We have the CRA doing the same, and also real estate – because it wasn't just home ownership. We had a change in the 1997 capital gains tax which made it easier to not pay capital gains on investment property, vacation property, and second and third homes. We had the lowest interest rates that the Fed has set in forty years, which helped bring down to historic lows the adjustable rate starter rate, which of course made those ARMs that were shown on the slides a few minutes ago much more attractive. All of that helped make housing prices double over about a ten-year period, from the mid-1990s to the mid-2000s. That made any results of Wall Street innovation ineffective: the risk packages that they had hoped to be risk-free through a combination of perhaps credit-rating agencies' misbehavior – we don't know; the lure of easy money, which was coming true for quite some time. Those worked together to make the popping of this bubble extremely unpleasant and part of the mess that we are in.

If I were to learn one lesson from the mess, it is the importance of transparency. Fannie and Freddie and the CRA were not and are not transparent. Politicians used them to achieve socially desirable goals without making it clear who was paying for it. That is not the way to run a democracy. It is a recipe for disaster.

Even now, I have no idea – and we have a distinguished panel that is confessing the same thing, and I’m relieved that I can confess it in company (laughter) – of how extensive Fannie and Freddie’s roles were in the CRA. I found a 1997 press release where Bear Stearns proudly announced the securitization of Community Reinvestment Act loans, and that there was no risk because Freddie Mac was going to be guaranteeing them. That was a small amount of money. In this area it really is a small amount of money – I think. I don’t know.

It’s remarkable that it’s not easy to discover that answer. I do not know how much the CRA mattered in pushing up the demand for real estate in the United States. My suspicion is that it was just a contributing factor. Probably a small one. But I do not know. I do not know the role CRA has played, if any, in hurting the balance sheets of financial institutions. The Bank of America in its recent conference call on earnings revealed the CRA loans make up 7 percent of their portfolio and account for 29 percent of their losses this last quarter. Is that common? How big is that? I have no idea – I don’t know.

So the first point is, we need social policy that has desirable goals of increasing home ownership, if indeed that is a desirable goal – and I’ll talk about that in a second; it *seems* like a desirable goal. If we have that goal, we should achieve it in ways where the costs and benefits are transparent and clear.

I would add that we need to be honest about this American dream of home ownership. It is not the American dream; it is the dream of *some* Americans. It is always the dream of the National Association of Home Builders – so not surprisingly, they’re going to be pushing for the romance that we have about home ownership. If we want more home ownership than emerges out of our voluntary decisions, let’s subsidize home ownership transparently so that the people who create the mess can bear the responsibility.

Another lesson, I would add, is the challenge of expecting businesses to function as charities and to do it well. That’s not what they are designed to do. Charities are designed to be charities. Businesses are designed to make money. When we put them in the ambivalent role of doing both, which is what Fannie and Freddie did – and they’re basically dead, now – and what banks are under stress for in complying with the CRA, we create a socially unsustainable system where institutions are expected to be schizophrenic, to maximize profits and at the same time give up those profits when some goal is deemed to be socially desirable. I would argue that the way to achieve socially desirable goals is through charity or, if you’re government, explicit subsidy.

Finally, I would add that it is easy to blame politicians, but in America – most of the time, at least – they simply do what makes them popular. They do what we encourage them to do. We as voters go along with the charade that political good deeds can be purchased at a zero price, but every once in a while we are forced to confront reality. Unless we recognize the dysfunctional nature of our political culture, we will sow the seeds for the next meltdown. To prevent that, voters should act like adults and encourage politicians to do the same. That means saying no sometimes, not just in our private lives where we often have to because we will eventually pay the price, but in our role as voters.

I just want to make one footnote to the bailout bill – how many people have read it? (Not one hand is raised.) Yeah. Most of the people who have read it are outside this room. Maybe no one has read it! But it's 450 pages, and I didn't read it, either. All I know is that it was "improved" to get it passed a week after it had failed the first time. There is a provision in there – and this is the only one I know about, although there are probably many like this and I think it's instructive as to the state of our democracy – that subsidizes electric cars. How many people can name an electric car?

FROM THE AUDIENCE: The Volt.

RUSSELL ROBERTS: Yes. How many people have heard of the Volt? It's a Chevy product.

(Small show of hands from the audience.)

RUSSELL ROBERTS: It's supposed to come out in about a year. GM has spent about a billion dollars – GM is teetering on the brink of bankruptcy and dissolution, as you probably know, so it's a big roll of the dice for them. So, they spent a little over a billion dollars, and they might end up with \$2 billion in research to create a battery for the Volt that will work. The problem is that the car is really going to be expensive for them to cover the costs of that R&D and the production costs of that battery. So (Roberts lowers his voice to almost a whisper) in this bill is a \$7,500 tax credit for electric cars. That's pretty cool for GM; I'm really happy for them.

(Laughter.)

When I heard about that, I began to wonder if they figured out a way for buyers of Prius, another electric car you may have heard of – but a hybrid, to also get the subsidy. But it turns out that the car has to be a *plug-in*. The Volt is a plug-in; it's going to plug into your garage at night, or into a station at work. The Prius, alas, is merely a hybrid. So the plug-in gets the subsidy, but not the Prius. Then somebody told me that Toyota is working on a plug-in that is going to compete with the Volt – and wouldn't you know it, they found a way to exclude those buyers from the subsidy, too. The \$7,500 tax credit is only for a certain kind of plug-in, and it won't be Toyota's – it'll be the Volt.

Now you may argue that it's good social policy that Americans contribute \$7,500 towards the future of General Motors. I don't agree. I think that's bad social policy. But I wish it were just a bit more transparent so that you and I, whether we buy a Prius, an Accord, a Lexus, or a Volt, are going to have to pay for the choices made by the people buying the Volt. It seems to me that's corrupt, dishonest, and it's kind of despicable that they had to shove that in to get people to vote for it when supposedly we're on the verge of the next Great Depression.

If you want to subsidize housing in the United States for poor people, let's fund it out of tax revenue so that it's transparent and the risks are clear. That's what should happen in a democracy that is as grown-up and, ideally, as adult as ours.

Thank you.

JOHN WEICHER: Thank you, Russell! That was a lively set of comments from the various members of the panel. Before we started, I offered to Debby (Goldberg) the opportunity to offer the first comments on whatever she would like about the presentations, because she was the first to give her presentation and the other speakers were able to address her comments in their remarks. This holds true, obviously to a lesser extent, also for Howard (Husock) and Barry (Zigas).

RUSSELL ROBERTS: And I don't have a right to comment a second time, obviously, because I've already done that. But that's fine!

(Laughter.)

JOHN WEICHER: Well, unless people attack you!

(Laughter.)

JOHN WEICHER: I'm going to get out of the way, and be in a position to call on the audience for comments and questions. Debby?

DEBORAH GOLDBERG: Gosh, there is a lot! It's hard to know what to start with and what to take even into a couple of minutes on. So, let me just look at a couple of things.

One is, I agree that we need more transparency. I would add to that that I think we need better oversight of the various entities that are involved in this whole mortgage finance chain. I was talking to my brother, who lives in Berlin, Germany, yesterday. He was telling me what the German take on this crisis is – which is anger. They have committed \$400 billion to bailing out German banks. And Bavaria, which usually brags about how it's the best of all German states, is teetering on the brink of disaster. And when I said that this crisis in the States is having such a big impact that state and city budgets all around the country are being slashed, he said that the Berlin school system is having its budget slashed as well. It's not just in America that the impact on tax revenues is affecting public services.

What does this have to do with our discussion? It seems to me that the reason the ripple effect of this crisis has moved as far out into the world as it has only has a little bit to do with the loans themselves. It has a lot to do with what happened around those loans: the securitization, the credit-default swaps, these exotic financial instruments that the smartest people I know who work in the banking business tell me they don't really understand themselves. So many of the players, starting with the broker and unregulated mortgage lender all the way up the chain, essentially are unregulated and have very little obligation to make sure that their activities are transparent. So I would certainly argue that greater transparency is needed throughout the system.

There are a lot of things I could comment on. One other thing I want to mention for right now, at least – and I'm sure we'll get into more in the Q&A – is credit scoring and its impact in this crisis as well. Howard (Husock) mentioned that we should use credit scoring more effectively to

separate out those who are credit worthy from those who are not in order to get them the product that they require.

I think first we have to have a little bit of a question about how effectively credit scoring actually works for people across the board. We have some economists here from the Fed, so they'll correct me if I say this wrong: The Federal Reserve and the Federal Trade Commission recently did a study looking at credit scoring and found it, in their view, to be largely effective but did find that there are certain borrowers for whom credit scoring is actually not a very good indicator of risk.

Similarly, I've seen a variety of analyses over the years showing that anywhere from 20 percent to 60 percent of borrowers who ended up in the subprime market actually qualified for prime loans. The biggest factor in determining the kind of loan that you got was the channel that you came through. Did you come through the insured depository institution? Did you come through the mortgage bank? Did you come through the finance company? Did you come through a broker? Brokers increasingly represent the dominant part of the mortgage market; their share of originations has – I don't even know what the current figures are. (Speaking to two audience members), you probably know. Anyway, it's a big part of the market, and a bigger determinant of the type of product you get than what your credit-worthiness actually is. And that is also a problem we need to figure out a way to get at. My view would be that we need better regulation, partly to promote greater transparency.

HOWARD HUSOCK: I was very pleased to hear Barry (Zigas) talk about the need for better data about what really happened with CRA. I'm surprised that over the many years that the act has been in place there has never been such a study, nor was there any pressure from CRA advocates for such a study to be done – until now, when CRA is under some scrutiny – nor does the problem of a small sample vis-à-vis that North Carolina data prevent advocates such as the National Community Reinvestment Coalition from influencing the editorial writers at the *New York Times* to use that one small slice of data to run a lead editorial absolving CRA from any – even supporting – role in under the headline “Misplaced Blame.” And so, let's have in the GAO and all of that. It's worth noting that the CBO has looked at low down payment home mortgage products – analysts Charles Capone and Albert Metz said, “Once a neighborhood foreclosure cycle starts... it becomes progressively harder for other households to sell their homes. Abandoned properties and blight can destroy neighborhoods where low down payment affordable housing programs are prevalent.”<sup>6</sup> That's not refinance. That's low down payment, affordable housing programs. That's what CRA is. CBO already found it to be potentially involved. But I completely agree – let's have a full-blown study. Let's get all of the big banks involved. Let's get Bank of America involved.

A small sample size of a model program just is unconvincing.

JOHN WEICHER: Barry (Zigas), did you want to comment?

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<sup>6</sup> Capone and Metz, “Mortgage Default and Default Resolutions: Their Impact on Communities” (paper presented at the Federal Reserve Bank of Chicago's conference on sustainable community development, Washington, DC, March 27, 2003), online at [http://chicagofed.org/cedric/files/2003\\_conf\\_paper\\_session2\\_capone.pdf](http://chicagofed.org/cedric/files/2003_conf_paper_session2_capone.pdf) (last accessed November 3, 2008).

BARRY ZIGAS: No, except to make a point that while the amount of publicly available data is smaller than I would like it to be – a lot of my time at Fannie Mae was spent going over and managing all of their data on this, and it was frustrating not to see more publicly available data – I do know from conversations with lenders that they have stayed very focused on this. And I think it's important to get the data out there because right now, the only data that has been produced like this tends to support the argument that it's products and channels, not borrowers and not extending service and credit into low- and moderate-income neighborhoods that matters. And I guess my corollary to Howard (Husock)'s plea would be for us to turn down all of the temperature on this and not try to assign blame until we have a little bit more of a fact set. This set of data is very compelling, to me, and really just invites the need for a much more comprehensive look at this.

JOHN WEICHER: Russ (Roberts)?

RUSSELL ROBERTS: I'd like to open it up to the audience and hear what they have to say!

JOHN WEICHER: That's my line, but I'll take it! Questions? Yes?

CHIA CHEN, freelance writer: My first question is, we've only talked about CRA, but what about the institutions that handle CRA? Second, I'm trying to connect what Howard Husock said about highly available capital, and what Russell Roberts said about people spending other people's money in ways that are not responsible. Isn't the basic problem that there is just too much money in the United States? What about those people who give the United States money? Japan has \$600 billion here, and China has \$1.3 trillion here – is that true? Finally, we talked about the bailout bill, and this is the second time I've heard that the end amount of the bill is \$800 billion. Is this true?

HOWARD HUSOCK: The idea that the United States has too much money? Yes – that was part of the problem. One percent interest rates for a really long time created a huge money supply, and it did chase a lot of questionable mortgages. I think the entire panel agrees that there is no one culprit, and that loose monetary policy – which is another way to say what Mr. Chen just said – was involved.

BARRY ZIGAS: There was an interesting piece on *This American Life*, a National Public Radio program, last May. For a whole hour they looked at this issue of what happened. It's called "A Giant Pool of Money."<sup>7</sup> The fact that struck me – to your point, sir – came out when they were interviewing someone from the IMF who made the point that the total pool of savings in the world – capital looking for investment – had doubled in about ten years from \$36 trillion to more than \$70 trillion. All of this money – accumulated capital – being held in central banks and private banks was looking for a return. And then, to take up what Howard (Husock) said, when the Federal Reserve said that they were going to keep interest rates at 1 percent, that meant that they started looking for someplace besides US treasuries in which to place it. And I think a

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<sup>7</sup> Alex Blumberg and Adam Davidson, "A Giant Pool of Money," Program No. 355, *This American Life*, NPR, May 9, 2008. Transcript available online at [http://www.thislife.org/extras/radio/355\\_transcript.pdf](http://www.thislife.org/extras/radio/355_transcript.pdf) (last accessed November 3, 2008).

persuasive argument can be made that there was a tremendous demand push for high-yield securities in a market that traditionally had been very safe, and it drove a tremendous amount of ultimately irresponsible lending. The money was there. People assumed it was safe. And the train just could not be stopped.

I see a big difference between that source of capital and the lending it drove and CRA and what it has done for the last close to forty years. They may be linked, but they're just not the same thing. And there are lots of important questions to ask: Where were the investors, and where was the money coming from? What were their expectations? What role did Wall Street, rating agencies, and others play in satisfying that demand with increasingly risky products simply to soak up the dough?

RUSSELL ROBERTS: This points, to me, to what is the most depressing, nontransparent effect of this problem, which is that partly through the existence of Fannie and Freddie – which acted as if they were an arm of the US government, issuing what were thought to be these implicitly guaranteed loans, which turned out to be guaranteed – we encouraged the Chinese and others, including Americans – to pour hundreds of billions of dollars into a sector of the economy, the housing sector, that was artificially made attractive. Instead of that money going to create new products for health, entertainment, and a higher standard of living, we have more people owning houses that they couldn't keep, unfortunately, and bigger houses – which is nice but not as nice as, say, a new health product. So we artificially subsidized the sector, which has been a tremendous mistake, and the price it is totally hidden. You'll never see the things that we could have had, that we would have made, that we could have enjoyed, because we put so capital into housing.

So I wouldn't say that we had too much money. I would love to have – capital is what creates our future. What we did that was mistaken was to channel that capital into a segment of the economy that was not as productive as others but appeared to be through artificial stimulus.

DEBORAH GOLDBERG: And I would say just a couple of things. One is, in contrast to some of my co-panelists here it seems to me that a lot of this money from other countries, fueled by the very factors that we've been talking about, ended up coming down to individuals not through Fannie Mae and Freddie Mac but ultimately as private-labeled securities.

When John (Weicher) introduced me, he mentioned that my current title is “director of the Hurricane Relief Project” for the National Fair Housing Alliance – which may seem far afield from this topic but actually isn't. One of the things that we do in our project is to help homeowners in the Gulf who have been affected by the hurricanes with their mortgage and insurance problems. And what we've discovered is that virtually every person who has walked through our door – hundreds of people over the last couple of years – who has problems with their mortgage actually in some perverse way was helped by the hurricanes, and in the absence of the hurricane would have been facing foreclosure much sooner than they ended up facing foreclosure – because they are facing foreclosure.

These are all people who I think you could characterize in general as being low- and moderate-income; many are elderly; many are disabled; many are on fixed income. Most owned their home

for some period of time, and at some point before this storm ended up refinancing into a subprime 228 adjustable-rate mortgage, although some have 327s. A lot of them have piggy-back loans with terms that would turn your hair even grayer than mine.

How anybody expected that folks like this would be able to deal with the increased payment that came when their ARM adjusted is beyond belief. I am not an economist, I will admit, but even to me the notion that housing prices would continue to appreciate indefinitely at the levels they had been – which is also what I think drove this market, made such profits for people, and attracted all this capital – seems incredible. So there are clearly other factors at work here in making this bubble and the bursting of the bubble happen.

(Cross talk.)

JOHN WEICHER: There are a lot of hands up! We may have to come back to this after the discussion, or after the remote possibility that we run through all of the questions. Next question, please?

JUDY KENNEDY, National Association of Affordable Housing Lenders: This is the in the category of “if you live long enough” – and clearly most of us have. I was struck by the title of this conference, and so I went back to some files I had from 2000 and came across a Cato Institute report, and I just want to read a few sentences from it to set the stage for my question.

Despite wide acceptance of the claims made by CRA’s advocates [“that it democratized credit” – Kennedy’s words, not in the article], those claims are conceptually and observationally unfounded. Economic theory and empirical evidence indicate that the reason for recent growth in lending to low-income neighborhoods is not CRA, but the effectiveness of market forces in breaking down the types of financial barriers that were prevalent when CRA was enacted. In reality, deregulation and new technologies have promoted competition and precipitated a great broadening of the credit market.<sup>8</sup>

If CRA were the driving force behind the recent increases in home-purchase lending in low-income neighborhoods, we would see evidence of a treatment effect. Lenders subject to the “CRA treatment” would have refocused their activity toward CRA objectives to a greater extent than lenders in the untreated control group. However, there is little evidence of such a treatment effect. To the contrary, it was lenders in the control group that refocused their efforts in line with the mid-1990s boom in lending in low-income neighborhoods. In fact, lending in low-income neighborhoods grew faster than other types of lending at institutions not covered by CRA, whereas low-income lending grew at the same rate as other types of lending activity for CRA-covered lenders.<sup>9</sup>

So while I’m thrilled to hear that everybody agrees that we need more transparency and regulation of everybody in the chain – otherwise people will always play the wedges – I guess I’m struck by the association of CRA with charities. Our members are banks and nonprofit

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<sup>8</sup> Jeffrey Gunther, “Should CRA Stand for ‘Community Redundancy Act?’” *Regulation Magazine*, Volume 23, No. 3 (Fall 2000), p. 56. Online at <http://www.cato.org/pubs/regulation/regv23n3/gunther.pdf> (last accessed November 4, 2008).

<sup>9</sup> Jeffrey Gunther, “Should CRA Stand for ‘Community Redundancy Act?’” 58. Online at <http://www.cato.org/pubs/regulation/regv23n3/gunther.pdf> (last accessed November 4, 2008).

lenders that because of the law were impelled to innovate and find creative ways of lending without losses – maybe less of a return, but without losses.

I'd like to differentiate between taking less of a return and charitable giving, and I'd also like to differentiate between low down payment loans for people who have had counseling versus people who haven't. Barry (Zigas) alluded to it in the CAP (ph) study. NeighborWorks has done an analysis that demonstrates that those who have had counseling are one fifth as likely to have a default as those who haven't had counseling. So we know how to do it right for homes that people are proud to call home. I think the question is, what is the next step to get to the transparency and regulation that we need?

RUSSELL ROBERTS: First, I was one of many people who applauded the innovation on Wall Street that allowed what appeared to be high-risk loans to be bundled with low-risk loans to increase access to home ownership. I thought it seemed like a really good idea. Most everybody did at the time as well, regardless of your ideology, political perspective, party, etc. What we did not see – and I don't think this is answered – is what the risks were in those packages.

Those smart people that Deborah (Goldberg) referred to either misestimated it, or thought they could sell it to someone else, or thought they would get out soon enough, or they misunderstood the systemic risks that were going to pull down the guarantors of these loans. Were housing prices not artificially pumped up, those loans would have been much less destructive to the whole system. It's also important to point out that even at current high default rates, most people are paying their loans back. Right? People are in their homes and they're paying back those high-risk loans. The tragedy of this is that the higher default rate isn't just punishing a handful of lenders; it's punishing the entire system. And that systemic collapse I think we don't fully understand.

The only other comment I would make is that when you ask a business to make less than it otherwise would, you are asking them to act like a charity; you are asking them to give away money, and you put at risk the existence of the institution – as we've seen with Fannie Mae and Freddie Mac. They're gone. It remains to be seen how they'll be reconstituted. But when you say, "Make less because you don't need so much," you are playing with fire. It's a nice idea, but I'd prefer that we played with our own money when we act that way, not with that of the people who'd invested. I think that's a bad strategy.

BARRY ZIGAS: Two comments on this. One is, the part of this equation we haven't really discussed is the degree to which this acceleration of lending, this acceleration of technology, this acceleration of capital was accompanied by a public policy decision to back off of the regulatory framework that would have channeled these energies in what I could call a productive way. It wasn't until 2006 that the bank regulators fought to put in place the kind of regulation called for by advocates in these communities, whom because of their advocacy of CRA are blamed by some for this whole crisis, but who were the first to ring the bell about subprime and the damage it was doing in communities, and who were the first to try to seek more management and control over the flow of these funds into their communities – not to ask for more of the same. It wasn't until 2006 that the federal regulatory agencies promulgated new rules about this lending, and thought they had to tell banks, "Don't make loans to people whom you don't have a

demonstrable belief can repay them!” In my way of thinking, that’s a market failure. It shouldn’t fall to regulators to tell lenders how to do their business, but there we are. And that’s a complete breakdown.

And this question of rising housing costs and this kind of mortgage lending I think are inextricably linked. Many of these loans were sold to people with so-called “affordability products.” You know, just because you call it a pig it will not fly. These products were not affordable except in the sense that it enabled you to get into a home that was too expensive for your ability to repay with a loan that was unrealistic in its terms. If lenders had had to hew – had been regulated to hew – to a higher standard of care and a standard of accountability to their borrowers, I suspect that the boom would have fizzled much quicker, because at some point credit would have been choked off. Then we would have had a different question: If people still can’t afford homes, whether to rent or to buy, what do we do about it?

This excess of capital in a largely – I believe – unregulated channel led to the ability to keep leveraging people in the homes way beyond any notion of reasonable underwriting. And when the book is all written, I think we’re going to find that many of these loans were not made to low- and moderate-income people, they were made in very high-cost areas for high-priced homes; people leveraged into them who were failing quickly – some of them never even made one payment; and we’re going to find that there was a lot of fraud involved, particularly in the Alt-A business, which was really the fastest-growing part of this industry. People didn’t even have to declare their income or their assets, which married the worst parts of asset-based lending with the worst parts of credit-based lending. So I think there are a lot of wrinkles in here.

JOHN WEICHER: I see my job as moderator and not as a participant, but I just want to say that in Barry (Zigas)’ chart showing the increases in delinquencies by type of loan category, you may have noticed prime ARMs showing a sharp increase in delinquencies. Mortgage bankers count Alt-As as prime, and my understanding is that that’s what you’re picking up in that chart, to a substantial extent.

SPEAKER: You’re probably right.

HOWARD HUSOCK: I think referring to the Cato study of 2000 is quite interesting; that was the point I was trying to make before: CRA continued even though the world had changed. The world had changed dramatically. All of a sudden, Ditech.com existed! Poor neighborhoods were being flooded with offers.

To me, the advocates who were concerned about what they called predatory lending I think were maybe a little expansive about that; people have a right to make bad decisions up to a point. More disclosure would have been a good thing. But how much stronger a position would they have been in if they were not also trying to direct lending on non-market terms to select neighborhoods, amplifying that demand on government through Fannie Mae and Freddie Mac? If there was supporting role in the crisis, connecting the dots between CRA and the crisis, government failure through Fannie Mae and Freddie Mac has to be part of the story. If a lot more money was coming into poor neighborhoods, as Cato said – and it was true, it was because the market had changed. Advocates would have been much better advised to say, “Let’s regulate this

market, but we understand that money will flow there, and we don't need to force government to make the money flow; we need to force government to regulate the money." They didn't do that.

DEBORAH GOLDBERG: I have a couple of comments. One is to Judy (Kennedy)'s question about profitability or lack of profitability. What I remember lenders telling me over the years about CRA is that yes, it might be less profitable than some other parts of their business, but that when you looked at the books of business of any financial institution, they have a host of different products, a host of different profit centers, some of which make more money and some of which make less money; some of which are more risky and some of which are less risky. This is one pot that got factored into that overall mix. And I think that there is at least a significant amount of credible evidence to suggest that the CRA pot was not the riskiest. It may not have been the most profitable, but it was not the riskiest pot in the book of business for the financial institutions that were covered by it.

I'd also like to get to this question of how money flows. I would certainly acknowledge that there has not been the kind of oversight on the part of regulators that could have helped, in part, to prevent this problem. I want to underscore Barry Zigas' point about advocates raising the alarm about this problem. In 2002, when I was at the Center for Community Change, we released a report called *Risk or Race?* in which we analyzed subprime lending in all of the metropolitan areas in the country. And what we found was that subprime lending was very highly concentrated in communities of color.

There were some cities around the country where the level of subprime lending was, to me, inexplicable. It was just hard for me to understand how there could be so many people with bad credit in certain parts of the country. Maybe it was true – I don't know. But one of the things that we did was to raise the alarm about the potential for foreclosure and the impact of foreclosure when you have concentrated loans in certain communities that we knew at that point had a much higher risk of foreclosure than other types of loans. And we were not alone in that effort; there were lots of folks who did lots of studies and had lots of conversations with regulators about the potential problems of this market.

But I think you have to go back to who was actually making these loans. As a part of my project in the Gulf, when I look at who our borrowers got loans from, it was not insured depository institutions. It was you-name-'em; there is a long list of institutions, many of which don't exist anymore, that were heavy into the subprime market. And the regulations we had at that point – and still today have, for the most part – do not get to those lenders. So that's a part of what we need to do as a fix.

And one last thing: We need to get to the question of how we stop these foreclosures. How do we stop more foreclosures from happening? I have read some of the bailout bill. I haven't read all four-hundred-and-however-many pages there are. But to me, the biggest problem with it is not the Volt and whatever pork may have made its way in there. The biggest problem is that the government did not use its leverage, based on \$700 billion, to make sure that loans that are facing foreclosure that were made on terms that were unsustainable get modified *so that people can pay on those loans*. If we could not accomplish that when we were putting \$700 billion on the line, when the hell are we going to be able to do that?

BARRY ZIGAS: Just a point of fact, just for the audience: For those of you who are not, as we are, deeply into this discipline, I think it's important to point out that while we talk about subprime loans as if they're easy to find and there is lots of data about them, I think one of the other data weaknesses in this entire area that John (Weicher) and I grappled with when I was at Fannie and he was at HUD is understanding from whatever data we have available what is subprime? How do you define it? How do you describe it? And how do you understand the impact it's having? It's a very, very murky area that complicates this whole thing.

ERNEST ISTOOK, Heritage Foundation: Before I pose my question, I want to thank Professor Roberts for making public more about the issues with the quota system that HUD created for Fannie and Freddie to require a certain percentage of their repurchases to be in the lowest level of income, the so-called very low income category. The Clinton administration created the quota, and the Bush administration perpetuated it, and guaranteed that there was a way that people who had made bad loans could pass them on to somebody else. So I appreciate your work, and I've tried to expand upon it on some things.

The question I wanted to pose: I have not heard anybody discuss in all of this circumstance what happened to the mortgage protection insurance that was required in so many of these packages. People are required to pay PMI. Is that somehow caught up in all of the credit default swaps? What happened to this insurance protection for mortgage premiums? It seems to have evaporated in the public discussion. That was a safeguard. What happened to it?

BARRY ZIGAS: I'll quickly try to address that. First of all, most of the lending that took place in the Alt-A and subprime areas was not securitized through Fannie Mae or Freddie Mac, and it did not have mortgage insurance on it. That's number one.

Number two, for the lending that does have mortgage insurance and is in trouble, the mortgage insurers are getting hammered by claims, and they're going to have to pay up a lot of money in order to meet those claims. We're in a falling market, and the insurance may not be enough to cover the ultimate losses because expectations of the severity of the loss – how big of a loss you can take on a sale, which is how insurance is priced – turned out to be too optimistic. So the ultimate investor, the one who is protected by private mortgage insurance – either the holder of the loan from the bank or, in most cases, Fannie Mae or Freddie Mac – basically takes the mortgage, makes a claim, and sells the house, and if there is not enough left, takes the loss. If there is enough left, the investor breaks even. But in the present falling market, I suspect that we're going to see that with PMI the losses are less than they would have been, but there are still losses because the mortgage insurance is not big enough to cover it. You probably have read that at least one mortgage insurer is going out of business or being acquired because they're running out of capital, and can't meet the claims.

HOWARD HUSOCK: I think that's another way of saying that Fannie and Freddie were self-insured. They absorbed that risk. As I'm sure John (Weicher) and Barry (Zigas) know, for many years there was a group called FM Watch, which was a thorn in the side of Fannie Mae and Freddie Mac, and understood them to be government-subsidized competition for private mortgage insurance.

BARRY ZIGAS: No, no, no, Howard, that's just not right. The private mortgage insurance industry exists only because Congress required Fannie Mae and Freddie Mac to have it on their loans. They did not compete with private mortgage insurance companies; they could not make loans – over 80 percent – without coverage from PMI. And to the extent that PMI isn't going to be enough to cover the losses, then their shareholders are going to bear that expense. But that's not a self-insurance model. That's a miscalculation of the extent of the insurance you need, perhaps. There's a very big difference.

HOWARD HUSOCK: That's fair.

PAUL MANCHESTER, US Department of Housing and Urban Development: The question I was going to ask I've actually changed in response to the previous questioner's comment about so-called hard quotas for Fannie Mae and Freddie Mac. I've been working on these since the early 1990s, and they are not quotas, they are goals. They can be suspended depending on the financial condition of Fannie and Freddie and on market factors, and in fact HUD has done so with regard to 2007, and that responsibility has now been shifted to the Federal Housing Finance Agency, and it will be up to them to decide what to do about 2008. So I think it is misleading to refer to these as rigid quotas.

My original question was, I am very surprised that no one has mentioned what was featured in the *Washington Post* today, based on Congressman Waxman's hearing yesterday, on the role of the rating agencies.<sup>10</sup> It seems to me that people of all political persuasions probably agree that the rating agencies totally blew it. I wonder if anybody has any comments defending them, if there is anybody, or –

RUSSELL ROBERTS: I'll briefly comment on the quota issue. I think the relationship between Fannie and the regulators is quite murky, for those of us on the outside. It's another example of nontransparency. Somebody told me – off the record – that Fannie wrote the original level, at 12, because they were already meeting it so they didn't have any trouble with that; they said, "Fine, make us do 12 and we'll do 12." I don't think they planned on it going to 28 by 2008, but maybe they did. Maybe they thought they could meet that, too. They did meet those targets every year until recently.

So it's a complicated situation. Another example of nontransparency is what was allowed to be counted as meeting those goals. Some have reported that that includes the purchases of subprime securities as opposed to the purchases of mortgages. So it's a murky, again, issue that I think would have been better brought to light.

I read that *Washington Post* story today, and I was disappointed with the lack of information in it. The big finding of it was that it's a conflict of interest that rating agencies were paid by the people who issued the securities. Everybody knew that. The puzzle is, why did they trust them? Was it just reputation? Did they not care? Did they just want deniability? There's a great mystery

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<sup>10</sup> Amit R. Paley, "Credit-Rating Firms Grilled Over Conflicts," *Washington Post*, October 23, 2008, p. A01. See also US Congress. House of Representatives. Committee on Oversight and Government Reform. *Credit Rating Agencies and the Financial Crisis*. 110<sup>th</sup> Congress. 2<sup>nd</sup> sess., October 22, 2008.

there. People have claimed – I don't know if it's true – that there was a political role in that. I have no evidence for that. But it is a mystery as to why those rating agencies went along. People say, well, it's because they wanted to make money, but they wanted to make money in 1983, too; that's never a good explanation. People say they were greedy, but people were greedy when they came out of the Garden of Eden. What changed?

The simplest thing that changed was the amount of money to be made when housing prices were soaring. That's why I continually point to the things that the government did that artificially pushed up the demand for housing and pushed up the role of the prices of housing – which we homeowners thought was just grand, but has now come to exact a price.

BARRY ZIGAS: I have to take issue with Russ (Roberts)' comment about the opacity of the Fannie Mae/Freddie Mac regulatory environment. First of all, Congress mandated these goals in 1992 and charged HUD with writing regulations to implement it, which HUD did through four rounds of regulatory rule making. In each case, the changes – the initial ones and the later changes – were put out for public comment. Dozens if not hundreds of comments were received. And hundreds of pages of comments were submitted by both Fannie Mae and Freddie Mac throughout the process.

You can quarrel with the results. You can quarrel with where they wound up. But there's a huge docket to be looked at in terms of the research and analysis HUD used to reach its conclusions about the level of the goals, and the commentary they received from many, many, many members of the public on that. Again, you can argue that they missed the mark, perhaps, but there was a lot of transparency in the setting of those goals.

RUSSELL ROBERTS: I cannot find in the public record – it's not on the internet, so maybe I have to go down to an actual library – the details of those transactions, those decisions. And I think the deeper point is that none of us were paying attention. That's our fault.

DEBORAH GOLDBERG: Some of us weren't paying attention.

RUSSELL ROBERTS: Excuse me – almost none of us were paying attention. (Laughter.) The people who were involved day-to-day were paying a lot of attention – which is always the way it is.

BARRY ZIGAS: The rules docket clerk will be happy to make available to you all of the comments that were made.

(Laughter. Cross talk.)

DEBORAH GOLDBERG: And when you dig through them, you will find that there were some groups that argued that subprime lending in whatever form should not be counted against the goals. It did not prevail, but the argument was made.

HOWARD HUSOCK: Did not prevail – and that's really important.

JOHN EVANS, retired (inaudible) professor: Conceding that forced lending is a bad idea and may have been the root of this thing, would we have had a crisis even though Wall Street securitized mortgages – and not only that, it bundled them, meaning good with the bad? I don't think we would have had a crisis. I don't think anybody would have bought these bonds because they didn't know what these things were worth – which is why nobody can buy them now; they don't know what they're worth. Would this have happened if Standard & Poor's and Moody's had said, "Look, we don't know." They admitted yesterday that they knew there were difficulties, and yet they went ahead and rated these things – favorably. Couldn't the free market have stopped this?

RUSSELL ROBERTS: Well, just as a quick comment, again, the *Washington Post* coverage I found very disappointing. To dig up two or three e-mails from people inside an organization that said, "Uh, I don't know what's going on – it's a whole house of cards" – that's just not very informative. I do think it was unlikely that it would have happened, again, had the housing price run-up not happened, which I think made the risks very much smaller for a while.

But I think the real question is, what really happened inside those rating agencies? I talked to an insider a few weeks ago, and he claimed – again, I don't know if it's true; it was one interview and I need to talk to more people, and the *Post* needs to dig a little deeper – they used the default rates from the Great Depression in trying to decide the level of default that was going to occur. That's a pretty good starting place! It could get worse than that. But I think we've exaggerated their cowboy mentality and just going along. That story needs to be written. We'll find out, I hope.

JOHN WEICHER: If you go to Hudson Institute's web site, you will find that we had an event like this earlier this year on the issue of the role of the rating agencies in the problem, and what a number of panelists referred to as the conflict of interest between doing a rating and making the money off the rating, which only applied if the deal went through.<sup>11</sup>

DARREN BEATTIE, Hudson Institute: I have two questions not exactly pertaining to the financial crisis but to the CRA in particular, maybe more directed at Ms. Goldberg. We hear this narrative that before the CRA came out in the 1970s, there was a kind of subprime crisis, and the CRA came out of the needs of the community to have access to more responsible lending and whatnot. And when the CRA began to show signs of success, subprime mortgages came in and overtook things, and I recall your quote, "If only so many loans had been made under the Community Reinvestment Act over the years that anything that happened with them could have the impact that the subprime meltdown and unfolding economic crisis has had!"

So, I have two questions. If I'm correct in gathering from these graphs that under the CRA the loans were safe and profitable, then why was the CRA necessary, particularly in the 1990s? If there is this large, untapped part of the market that you are able to issue safe and profitable loans to, why would you need to be coerced?

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<sup>11</sup> "The Ongoing Credit Crunch: What's Next for Structured Finance, Credit Rating Agencies, and Bond Insurers?" Hudson Institute conference, February 12, 2008. Prepared remarks and audio and video recordings can be found online at [http://www.hudson.org/index.cfm?fuseaction=HUDSON\\_upcoming\\_events&id=503](http://www.hudson.org/index.cfm?fuseaction=HUDSON_upcoming_events&id=503).

And from the other side, from the point of the view of the people taking these loans, it seems like when the CRA loans and subprime loans were available concurrently, the subprime loans seemed more attractive, or at least more people were washed into them. Is that because they were not informed, or was it because the people who took the subprime loans would not have been eligible under the CRA requirements? Now, the CRA requirements were loosened but not ridiculous, as you mentioned. But you expressed hoped that more people had gotten loans under the CRA. So should they have been loosened even more?

DEBORAH GOLDBERG: You asked a couple of questions there. First, I would take issue with your characterization of CRA as coercion, although that has certainly been put out there over the years. But I would say that from my perspective, what prevented insured depository institutions from doing a better job of reaching into low- and moderate-income neighborhoods and neighborhoods of color prior to CRA's enactment was discrimination – people operating on stereotypes based on lack of understanding and exposure.

The banking world at that time was dominated by very nice and well-meaning white men who had nothing to do with people of color, for the most part; didn't go into low-income neighborhood, for the most part; and had a stereotype in mind that those communities were bad credit risks. That was a difficult barrier to overcome. If you want, we can have a conversation on the side about how the banking agencies had to be sued in order to uphold their responsibilities under the Fair Housing Act, and the evidence that exists that discrimination was reasonably widespread in the lending market in the late 1960s and early 1970s and into the period in which CRA was enacted. But it's not because there weren't good business opportunities there. It was because of the stereotypes that constrained the operations of those institutions, which it took a little nudge for them to overcome. So that's my answer to the first question. Other panelists might have other things to say.

In terms of the second, I think that a couple of people have made comments here that are important to keep in mind. When we talk about the subprime market and the credit crisis right now, it's a multi-faceted issue and it's important not to be overly broad in the statements that we make, or at least to allow that there are a lot of variations on the theme, here. So some of the loans that are going to be running into problems soon are probably less concentrated in low-income communities, although maybe to some extent concentrated among people of color – you know, option ARMs. There was an article in the paper today about Wachovia taking a huge write-down before Wells acquires it because of their pick-a-payment loans. Many of those are not to the people who would necessarily be viewed as who CRA is trying to get at.

But I think, when you look at those folks and the loans that up until now, at least, have largely been made in those neighborhoods through the subprime market, what you see is what is characterized as “push marketing.” It's very aggressive marketing on terms that lenders have told me over the years they're just not willing or able – I'm not sure – to put the money and the effort into trying to market as aggressively as subprime mortgage brokers who go out and knock on people's doors, put flyers in their mailboxes, and advertise on the radio and late-night television. The advertising is all about the monthly payment, and how your payment is going to be affordable. And if you even get into the question of whether or not it's an adjustable-rate loan, people are assured that this is a good thing because when rates go down your payment will adjust

downward – something we haven't seen too much of in recent times, and something that is often constrained by the terms of the note, if you read the ARM rider that is attached to the end. They're told that even if they can't afford it, it's no problem to be able to refinance – which for a while was in fact the case, but at this point is no longer the case. So I would not say it's that people were ignorant, or that people thought that this was a better option than a CRA loan might have been. The level of marketing was very intense, and it was very persuasive. In many cases people weren't even looking for a loan, but someone came and convinced them that they should refinance their mortgage so that they could take out a little bit of money. In some cases people needed to repair their roof, or needed money for a medical emergency or something, and they were convinced that this was the best way to do it. Very persuasive. But if you've every looked at the cases that were filed against, for example, the Associates, they had a whole script that they loan originators would follow, and for any question that might come up they were given an answer; they were taught how to tweak and obfuscate what the real deal was in order to get their point across and get people to take those loans. It was a very aggressive machine, there. That's really difficult for people to understand the details of, and understand what it's really going to mean for them.

JOHN WEICHER: Other people may want to comment and there is at least one more question out there, but we've promised our panel and the audience that we would finish at 2:00 p.m. I would like, therefore, to call this session to a close. I would like to thank our panel for coming, and thank the audience. I think this has been stimulating and interesting – thank you very much.

(Applause.)