TESTIMONY OF

SANDY SAMUELS

Senior Managing Director and Chief Legal Officer

on behalf of

COUNTRYWIDE FINANCIAL CORPORATION

and the

HOUSING POLICY COUNCIL

of THE FINANCIAL SERVICES ROUNDTABLE

Before the

SUBCOMMITTEES ON FINANCIAL INSTITUTIONS AND HOUSING

UNITED STATES HOUSE OF REPRESENTATIVES

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Good morning, Chairman Bachus, Chairman Ney, Congresswoman Waters, Congressman Sanders and members of the Subcommittees. I am Sandy Samuels, Senior Managing Director and Chief Legal Officer of Countrywide Financial Corporation. Countrywide is based in Calabasas, California and is a national leader in home mortgage finance through its main subsidiary, Countrywide Home Loans, Inc. We appreciate the opportunity to testify before the committees today on behalf of The Financial Services Roundtable and the Roundtable's Housing Policy Council.

In today's testimony, we want to give the committees a better picture of the nonprime borrowing market Countrywide and the member companies of the Housing Policy Council serve. While nonprime borrowers vary as much as prime borrowers do, some basic demographic information should help illustrate how and why we serve this market.

The member companies of the Housing Policy Council fund more than 60% of the prime mortgages in the United States every year, through origination or purchase. Council members also service more than 54% percent of all prime mortgages nationwide. Although nonprime figures are harder to quantify, we believe that HPC members fund and service about the same percentages of nonprime loans annually. HPC members, therefore, have experience making and servicing the nonprime sector of the housing market, and have contributed to the historic growth in credit availability that has made first-time homeownership available to so many families and individuals over the past decade.

Countrywide Home Loans is one of the nation's largest mortgage banking companies. In the fourth quarter of 2003, Countrywide became the largest home mortgage lender in the United States. Countrywide funded more than $435 billion in home loans last year. Since our founding in 1969, our mission has been to make the dream of homeownership possible for as many Americans as possible. Our business began with FHA and VA lending, and the vast majority of the loans we fund and purchase today still go to FHA, VA and Fannie Mae/Freddie Mac-eligible borrowers. As a mortgage banking company, Countrywide does not generally hold loans in its portfolio. Rather, we sell or securitize our loans in the secondary market – to Fannie, Freddie and other investors, as well as issue our own mortgage securities.

The existence of this secondary market makes liquidity available to the entire mortgage industry, and has significantly expanded access to and lowered the cost of home mortgage credit. We work closely with these secondary market investors to establish the predictive credit, documentation and collateral criteria that determine whether a borrower qualifies for a prime or a nonprime loan. Other members of the Housing Policy Council hold some or all of their loans in portfolio, and have created their own standards and automated underwriting procedures for their borrowers. Whether a lender sells loans into the secondary market or holds them in portfolio, lenders and investors all share a common goal of ensuring that borrowers have both the capacity and the willingness to repay. As holders, servicers and issuers, HPC member companies all have a financial and reputational stake in seeing borrowers succeed.

Lending to traditionally underserved markets is a priority for Countrywide, and we are proud of our accomplishments in this arena. Countrywide was the nation's largest mortgage lender to African Americans and Hispanics in 2002[1]. We are driven to maintain that distinction, and we believe we retained that position in 2003. Last year at this time, our CEO Angelo Mozilo set a goal to fund $600 billion in home loans to minorities, low-income families and low-income communities by 2010. We are well on our way to achieving this goal.

While the market knows us primarily as a "prime" lender, Countrywide entered the nonprime lending market in 1996 as part of our effort to make homeownership possible for the largest number of American families and individuals. We believed then, and believe now, that nonprime lending is a natural extension of our commitment to bring Americans who have traditionally been outside mainstream mortgage markets into their first homes. Our nonprime lending programs also have helped these families and individuals build equity and use this equity to send their children to colleges, start their own businesses, and gain control over their financial destiny.

We entered the nonprime market with great deliberation and care, and continually assess how best to participate in this market in a responsible manner. Nonprime loan originations still comprise less than 5 percent of our total loan production volume. Although nonprime lending represents only a small fraction of our business, Countrywide is now one of the top ten nonprime lenders in the United States. We originate these

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[1] Based on a peer comparison of loans originated and purchased as reported by individual reporting entities under the Home Mortgage Disclosure Act for 2002.

nonprime loans through our retail subsidiary, Full Spectrum, and through our Specialty Lending Group and its network of mortgage brokers.

Despite the industry's effort to expand access to prime loans through the FHA, VA and the housing GSEs, a large segment of the borrowing public still does not meet the eligibility criteria for prime loans. The GSEs and the FHA work constantly with their lender partners to find new ways to stretch these criteria to qualify as many borrowers as possible, and HPC members that set their own underwriting standards are constantly reevaluating these standards. We have made tremendous progress in this area, as the current record levels of homeownership demonstrate. But the fact remains that not all borrowers qualify for prime mortgages.

The reasons a borrower does not qualify for a prime-rate mortgage are as diverse as the borrowers themselves. They relate to creditworthiness, of course, but also to issues regarding the type of collateral securing the loan, the amount borrowed, other financial assets, and the borrower's ability or willingness to provide the kind of financial documentation our secondary market investors require. The only element that these nonprime borrowers have in common with each other, in fact, is that they possess some attribute that does not conform to the standards that have been set by the FHA, VA, the housing GSEs or the rating agencies for prime quality mortgages. Some recent examples of actual Countrywide borrowers will illustrate this.

Mr. G. from Stockton, California, is a 48-year-old self-employed printer. He had a credit score of 565, because of a Chapter 7 bankruptcy within the previous 24 months. Although he had enough money for a 22% down payment on the home he wanted to buy, his low credit score and his inability to provide standard, full income documentation disqualified him from obtaining a prime loan. We were, however, able to make him a loan for $205,000 at a low 6.25% interest rate, with all loan fees and discount points totaling less than $3,000, or one and one-half points. Mr. G. chose an adjustable-rate loan with fixed payments for the first three years, which allowed him to purchase his home and reestablish himself after the bankruptcy. Without access to a nonprime loan, Mr. G. would have had to wait at least three years to boost his credit score and for the bankruptcy to age.

Had Mr. G. lived in New Jersey, instead of California, state law would have considered his mortgage a “high cost” loan. Because our Full Spectrum affiliate, like most major nonprime lenders, does not originate loans defined as “high cost” by state law, we would not have been able to provide him a loan with such a low rate and payment.

Countrywide made another nonprime loan to Mr. and Mrs. S. from Nicholasville, Kentucky, who were struggling to make ends meet. They had a high-rate second mortgage, at more than 14%. This and other consumer debts pushed their monthly debt service to over 50% of their $3,000 monthly income from Mr. S’s job as a machinist. Although the S’s had an excellent credit score of over 770, the loan-to-value ratio necessary for them to consolidate their first and second mortgages exceeded the guidelines for a prime refinance loan. Full Spectrum was able to make Mr. and Mrs. S. a $94,000 loan at a loan-to-value ratio of 99%. The new loan had a 30-year fixed-rate of 7%, with points and lender fees totaling $2,500. It consolidated the high-rate second mortgage and lowered the couple's monthly payments by more than $200. Their monthly debt-to-income ratio is now a much more manageable 43%.

Had Mr. and Mrs. S. lived in North Carolina or New Jersey, this would have been a "high cost" loan and unavailable from Countrywide at these terms.

Mr. C. from Clovis, California, had a 510 credit score and monthly mortgage and other debt payments that exceeded 60% of the income from the tanning salon he owned. We helped Mr. C. consolidate his fixed-rate first mortgage at 7.75% and his adjustable-rate second mortgage into one 30-year, fixed-rate first mortgage at 6.875%, with total discount points and lender fees equal to 4 percent of the $264,000 loan amount. Mr. C. also opted to take a prepayment penalty in order to reduce his rate. This loan lowered Mr. C.'s monthly payments by more than $1,550, and reduced his monthly debt ratio to a much more manageable 43% of income. Mr. C.'s low credit score precluded any rate reduction refinance or debt consolidation with a prime loan.

Both New Jersey and North Carolina would consider this a "high cost" loan, so it would not have been available to Mr. C. if he had lived in either of these states.

Full Spectrum made a loan to another Mr. C. in San Dimas, California. This Mr. C. is a Senior Administrator in the medical sales business. He had a 509 credit score as a result of numerous recent collection actions on his credit report. He faced more than $75,000 in accumulated debts and expenses that were in various stages of delinquency or collection. We were able to make Mr. C. a $225,000 fixed-rate loan at 6% -- more than 2.5 percentage points lower than his existing mortgage rate – with lender fees and points of $5,200. Mr. C. used this money to refinance his existing high-rate loan and to borrow an additional $77,000 to pay off his mounting debts and other expenses. With our loan, he now has a clean slate on all his debts and expenses, and he still lowered his monthly payments by $50 per month.

Again, had Mr. C. lived in New Jersey, this loan would have been a “high cost” loan, and therefore unavailable to him.

There is no question that certain vulnerable segments of our communities are being targeted by unscrupulous scam artists, particularly the elderly, inner city residents, or families having exceptionally low income or credit scores. I will speak to this very important issue later. This does not, however, represent the Countrywide experience. Let me share with you some of the broad demographics of our prime and nonprime first mortgage borrowers, based on our most recent three months of production, through February 2004.

- The average age of our nonprime borrowers was 43, identical to the average age for our prime customers. Sixty-two percent of our nonprime borrowers were between the ages of 30 and 50. Only 6 percent of our nonprime borrowers were above the age of 60, compared to 10 percent of our prime borrowers.

- Not surprisingly, the average FICO score of our nonprime borrowers was 608, compared to 715 for prime borrowers. However, nearly 20 percent of our nonprime borrowers had FICO scores in excess of 660 – the banking regulators' cutoff point for their definition of nonprime. These borrowers have other factors – collateral, loan-to-value, documentation – that classify them as nonprime.

- The average amount borrowed was virtually identical between prime and nonprime customers -- $179,000 for nonprime, $182,000 for prime. More than one-quarter of our nonprime customers borrowed in excess of $300,000.

- Loan-to-value ratios (LTVs) were also remarkably similar between our prime and nonprime customers. The average LTV for nonprime loans was 82%, compared to 80% for our prime book. The slightly higher LTV ratio for nonprime loans reflects the fact that 17% of our nonprime loans have

LTVs higher than 95%, compared to only 10% of our prime loans. These loans often fall outside prime guidelines because of the elevated risk.

- Even the incomes between our prime and nonprime customers are remarkably similar. The average income of our nonprime customers was $69,000; the average for our prime borrowers was $74,000. Fewer than 3% percent of our nonprime borrowers earned less than $25,000, the same proportion as among prime borrowers.

- Although nonprime customers are more likely to borrow in order to tap their home equity for other financial purposes, a significant percentage of our nonprime borrowers are able to acquire a home. Over the three months ended in February 2004, nearly 30 percent of our nonprime loans went to purchase homes, compared to 49 percent of our prime loan originations.

- The average APR (which includes rate and the lender's points and fees, and other fees considered "finance charges") on our nonprime products for the 3 months ended February 2004 was 7.83%, while the average APR on our prime products was 5.44%. The average nonprime note rate was just over 7%.

This profile, which may seem counterintuitive, corresponds to the profiles of nonprime customers served by other Housing Policy Council member companies.

Countrywide's experiences are consistent with the results of a major study commissioned by The Financial Services Roundtable, "Servicing the Credit Impaired: How Subprime Lending Fills the Gap." This study found that nonprime borrowers span all demographic groups:

> They are often individuals who have experienced a temporary life-disrupting event, such as job loss or medical emergency. Subprime borrowers may also have a history of credit problems. A majority of these borrowers are married, have annual household incomes between $25,000 and $65,000, and are between the ages of 30 to 54. Their racial and ethnic demographics resemble that of the U.S. population as a whole.

The Roundtable study showed that origination costs of nonprime loans can be 30 percent higher than those of prime loans. Servicing costs for nonprime loans are more than double, and delinquency rates can be six times as high for nonprime loans. Nonprime loans, in the aggregate, tend to prepay more quickly than prime loans, which means that lenders must recoup their fixed loan production costs more quickly. Foreclosures, too, cost lenders money; lenders almost never realize a profit for either the borrower or themselves.

While prepayment penalties have been the target of vocal criticism in the predatory lending debate, we believe they have been unfairly maligned. Used properly, prepayment penalties offer significant benefits to borrowers. In today's market conditions, a three-year prepayment penalty on Countrywide's most popular product (a 3/27 adjustable rate loan) provides the borrower with an interest rate reduction of 1 percent. This would reduce the monthly payment on a $150,000 loan by $125, a significant amount for any family trying to make ends meet. It is important to note that Countrywide, like many of our colleagues and competitors, offers borrowers a choice of products with and without a prepayment penalty, and we provide a very clear disclosure of both the benefits and drawbacks of a prepayment penalty. A copy of this disclosure is attached to our written statement.

As noted previously, several elements in addition to credit scores can move a borrower from “prime” to “nonprime” status: the borrower’s ability or willingness to document income; the stability of the borrower’s income; the loan-to-value or loan-to-equity ratio on the mortgaged property; and characteristics of the property that affect its collateral value, including whether it is owner-occupied, a vacation or investor property, or whether it is a condo or a single-family home. Nonprime products give borrowers more choices and make credit more readily available, because we and other lenders can price according to the level of risk. Before the advent of risk based pricing, the mortgage banker’s only other choice was to reject those borrowers that did not fit the prime lending standards.

Credit problems that lead to delinquency and default do occur more frequently in the nonprime market. Interestingly enough, our experience indicates they occur for predominantly the same reasons they occur in the prime market: life disruptions that interfere with the borrower’s ability to repay. A 2000 working paper from Freddie Mac indicates that almost 30 percent of nonprime borrowers reported major medical expenses in the past few years, compared to less than 20 percent of prime borrowers. Approximately 23 percent of nonprime borrowers said they had had a major spell of unemployment; 31.5 percent reported a major decrease in income; and more than 12 percent said they had been separated, divorced or widowed in the past few years. All of these figures are more than twice the rate of these occurrences among prime borrowers.

It frustrates us at Countrywide that we most often see the entire nonprime lending market characterized by the activities of the scam artists who trap borrowers with fraudulently marketed loans. In fact, responsible nonprime lending can be a second chance for individuals to get their economic houses in order and reestablish good credit. Countrywide's internal data show that nonprime status is a temporary condition for many of our borrowers, just as many of these life disruptions represent temporary, not permanent, setbacks.

Of our nonprime customers that refinance with Countrywide, approximately 45 percent graduate into prime products. This is compelling evidence that nonprime loans do indeed provide a "second chance" for families who have experienced adverse life events.

The members of the Housing Policy Council represent the leading lenders in the nonprime mortgage market. The HPC members represent companies that serve both the prime and nonprime segments of the market, and have implemented practices designed to ensure that borrowers get the best loan terms for which they qualify. We at Countrywide are particularly proud of our branch-within-a-branch program, which puts a "prime" desk in our Full Spectrum branches. This program ensures that all loan applicants are run through our automated underwriting engine and those applicants that appear to qualify for prime credit are flagged for further processing as a prime borrower. The system is designed to create the proper work flow processes and incentives to put prime borrowers who enter through the nonprime branch into the best loan product for which they qualify.

Countrywide and the HPC member companies recognize the black eye that some lenders, brokers and home improvement contractors have given the nonprime lending industry. Of even greater concern is the severe financial and emotional pain they have caused to those they ripped off. The HPC supports Congressional efforts to accomplish four major objectives:

1. Enactment of strong, uniform national standards to directly address these predatory practices;
2. Effective enforcement of those standards by federal and state regulators;
3. Stronger financial literacy programs that begin in our schools and reach to those who never got the chance to gain literacy skills in their formative years; and
4. Expanded access to high quality homeownership and credit counseling for those who seek it.

We look forward to working with the Financial Institutions and Housing Subcommittees' and hope that we can begin this dialogue in earnest with the kind of hearings you are having today. The industry wants to support a strong new federal standard, but we must do so in a way that makes sure that we do not unduly increase costs, eliminate choices, or reduce the availability of credit to the types of borrowers I described in my testimony.

As we noted, the laws some states have enacted do not strike this balance. Unfortunately, this means that good loans to borrowers such as those described in our testimony are unintentionally tagged as “high cost” loans – loans that few, if any, legitimate nonprime lenders will make because of the heightened regulatory, legal and reputational risk.

Some will suggest that lenders can eliminate prepayment penalties, reduce other fees and increase the rate in order to stay within state “high cost loan” triggers. These actions, however, will result in significantly higher interest rates and monthly payments for borrowers who can least afford them, and could preclude some borrowers from obtaining credit altogether. As the debate on national standards moves forward, we hope to be able to provide the Subcommittees with additional analysis of the affordability impact of increasing interest rates in this manner.

Countrywide’s nonprime lending programs and those of all the members of the Housing Policy Council expand access to credit for those who do not fit the “standard” credit or collateral profiles established by banks, mortgage insurers, Fannie Mae and Freddie Mac, or the FHA/VA. These standards include detailed income documentation and stability requirements, low loan-to-value and debt-to-income ratio standards, and restrictions on unusual or high risk collateral, as well as limits on borrowers with low credit scores. Countrywide's nonprime loans play a crucial role in our mission of promoting homeownership and financial options to our customers, a mission the members of these two Subcommittees share. We look forward to working with the Congress to advance these mutual goals.

Thank you for your attention. I would be pleased to answer any questions the Committee may have.