Unfair and Unsafe:
How Countrywide's irresponsible practices have harmed borrowers and shareholders

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The Center for Responsible Lending finds that the nation's largest mortgage lender, Countrywide Financial Corporation, targeted borrowers for "unfair and unsafe" loans and squandered shareholders' wealth on a "risky and unsustainable business model " that emphasized short-term gains and increasing top executives' compensation.

Countrywide Watch

Countrywide Financial Corporation and its CEO, Angelo Mozilo, have become synonymous with home loans in America. After a decade of stunning growth, the company ranks as the nation's largest originator and servicer of consumer mortgages.

Countrywide and Mozilo have also become synonymous with the mortgage meltdown, as a growing number of Countrywide's borrowers have defaulted on their loans.

An investigation by the Center for Responsible Lending (CRL) has found that Countrywide has targeted borrowers for unfair and unsafe loans that have left many struggling to hang onto their homes. In the process, Countrywide has harmed its shareholders, squandering its own corporate net worth on a risky and unsustainable business model.

Bank of America's planned acquisition of the company offers hope that Countrywide's practices can be cleaned up and that borrowers who've been harmed by the company will receive a measure of justice. Making that happen will be a large task -- and will require a thorough understanding of the wide-ranging nature of Countrywide's abuses and the elaborate systems it put in place to take advantage of its customers.

CRL's analysis of customer complaints, lawsuits, regulatory actions, news accounts, government reports and company documents has identified seven areas of concern:

Predatory lending. Borrowers and regulators have accused the company of bait-and-switch sales tactics, fraud, racial discrimination, fee-gouging and elder abuse.

Dangerous products. Countrywide has been a leader in pushing unsound products, such as "exploding" subprime adjustable rate mortgages and "stated income" loans, as well as poorly underwritten "payment option" adjustable rate mortgages.

Conflicts of interest. Countrywide has created a corporate structure designed to allow its subsidiaries to work hand-in-hand in squeezing borrowers with excessive fees and penalties.

Broken promises on loan modifications. The company has a history of failing to fully live up to its promises to help borrowers keep their homes by modifying onerous loans, prompting questions about whether it can perform better going forward.

Abusive loan servicing. Borrowers claim that Countrywide has engaged in sloppy and fraudulent loan servicing that has produced unwarranted fees and foreclosures.

Weak corporate governance. Countrywide's high-wire growth strategy has backfired, divesting shareholders of billions of dollars in market value and leaving the company teetering on the brink of failure. Meanwhile, even as the company has stumbled, its board members have allowed Mozillo to reap unreasonable personal gains and have claimed excessive compensation for themselves.

Questionable FHLB borrowings. Countrywide's growing reliance on capital from the Federal Home Loan Bank system puts the system in the position of bankrolling abusive loans and at risk of significant losses as more loans go bad.

Predatory Lending

Lawsuits filed around the country (see http://www.responsiblelending.org/pdfs/countrywide-litigation-database-01072007.pdf**)** have accused Countrywide of preying on borrowers through a variety of unfair and fraudulent tactics that have siphoned equity out of their homes and pushed many into foreclosure. Borrowers and regulators have accused the company of:

- Steering borrowers with good credit into higher-cost "subprime" loans;
- Gouging minority borrowers with discriminatory rates and fees;
- Working in cahoots with mortgage brokers who use bait-and-switch tactics to land borrowers into loans they can't afford;
- Targeting elderly and non-English-speaking borrowers for abusive loans; and
- Packing loans with inflated and unauthorized fees.

In one example, a lawsuit filed in federal court in Southern California (http://www.responsiblelending.org/pdfs/cwd-zacholl.pdf) alleges that Countrywide and a pair of mortgage brokers preyed on an elderly, financially unsophisticated homeowner, charging him illegal and excessive fees and lying to him throughout the loan-application process.

The lawsuit claims a mortgage broker "cold-called and aggressively baited" 74-year-old Albert Zacholl, promising him $30,000 cash out and payments of no more than $1,700 a month. In fact, the deal didn't include the promised cash out and consisted of two loans from Countrywide with payments totaling nearly $3,100 a month – a figure well in excess of Mr. Zacholl's modest income.

In court papers, Countrywide responded that Mr. Zacholl "consented to the terms of the transaction" and that any problems were the result of his own "negligence and carelessness."

In another case, filed in federal court in Houston (http://www.responsiblelending.org/pdfs/cwd-zachary.pdf), a former vice president with Countrywide KB Home Loans claims he was fired for complaining about fraudulent lending practices and refusing to approve loans that borrowers couldn't afford. Countrywide KB Home Loans is a joint venture between Countrywide and KB Home, one of the nation's largest builders.

Mark Zachary says in the lawsuit that he warned his superiors as early as September 2006 about the prevalence of "grave illegal" practices, questioning why the lending unit's appraiser was being "strongly encouraged" to inflate property values on homes built by KB Home. He alleges he also complained that employees were coaching borrowers to falsify their incomes on their applications.

In addition, the suit claims, Zachary ran afoul of higher ups because he refused to abide by a requirement that the lending unit approve 10% of backlogged loan applications each day "so that the green light could be given to KB Home to start building the homes under contract." After he said he couldn't meet that goal because many borrowers wouldn't be able to afford these loans, his suit claims, he was "taken out of the loop and . . . treated like a pariah by his supervisor."

Instead, Countrywide KB Home Loans began approving applications through a backdoor process in which loans were "in essence . . . being approved without any review by any underwriter," the suit claims. These authorizations, the suit says, were known as "Shadow Approvals."

Countrywide said it looked into Zachary's claims, but found them to be meritless.

Dangerous Products

Many of the Countrywide's worst loans have been hybrid adjustable rate "subprime" mortgages that start at an affordable interest rate, but then rise precipitously after the second year. This jump in interest increases payments by 30% to 50% even when rates in the economy remain constant. Countrywide continued pushing these "exploding" subprime ARM loans even as other lenders pulled back in 2007, ranking No. 1 in subprime loan volume for the year.[1]

Not all subprime loans are bad for borrowers, but CRL's industry-wide research has shown that a large percentage of recent subprime loans have involved abusive features that put borrowers at risk. These include rapidly increasing interest rates, lack of escrows for taxes and insurance, large prepayment penalties, "yield-spread premium" kickbacks to mortgage brokers, and a lack of income documentation. Evidence of the irresponsible nature of Countrywide's subprime lending can be seen in the rising tide of borrower defaults. As of September 30, 2007, 23.9% of the loans in Countrywide's $118 billion subprime servicing portfolio were in default, with almost 5% already in foreclosure proceedings.[2]

Recent data indicates that its subprime portfolio's performance is getting worse: As of December 31, 2007, 33.6% of Countrywide's subprime loans are delinquent, and 17.3% are more than 90 days delinquent – the point at which a lender generally files a foreclosure notice.[3]

In addition to subprime loans, Countrywide has increasingly pushed unconventional "prime" or "Alt A" mortgage products that emphasize weak underwriting and low payments that rise substantially later. These products make it easy for borrowers to get loans – but don't ensure they'll be able to pay their house debts in the long run.

The change in the kinds of loans Countrywide pushes has been striking. From 1999 to 2003, the company issued between 82% and 95% of its loans with fixed rates. But poorly structured ARMs jumped from 18% of its business in 2003 to 49% in 2005, and until recently remained a major component of the company's lending.[4]

In 2005 and 2006, approximately 17% of the company's lending business consisted of "Pay Option ARM" loans.[5] These products give borrowers the option to make minimal payments that don't cover outstanding interest due -- meaning that, if this option is used, the borrower owes more and more on the loan as each month ticks by.

As with subprime loans, option ARMs are not inherently abusive; these loans can benefit consumers when the lender thoroughly documents their income and ability to repay and structures the deal such that the borrower has 10 years before the monthly payments are "recast" and start climbing dramatically.

However, poorly underwritten and structured option ARMs *are* dangerous for borrowers. During the first three to five years of the loan, poorly structured option ARMs can suddenly recast and push borrowers' monthly payments up to a painfully high level. This recast typically occurs by the fifth year on Countrywide option ARMs. Most borrowers can't afford the new payment, which can be double the previous one. And many are unable to refinance and escape these suspect loans, because the mortgage market has tightened and because the option ARMs' "negative amortization" feature has raised the amount of their debt higher than the actual value of their homes.

Though considered "prime" in nature, Countrywide's option ARMs have shown themselves to be less stable than conventional prime loans. Countrywide has acknowledged that more than 80% of the option ARM loans it originated in 2005 and 2006[6] could not meet the federal regulators' September 2006 Joint Agency Guidelines that set standards for soundly underwritten loans.[7] In total, the company originated $138 billion in option ARMs that could not meet current federal standards.[8]

An October 2007 study prepared by UBS for the *Wall Street Journal* indicated just how much risk there is for the company (and its customers) in its pay option ARMs:

1. Option ARMs packaged into mortgage-backed securities pools in 2006 were already running a 60-day delinquency record of 3.6% -- a full point above the industry as a whole.

2. A full 91% of these loans were "low-doc" mortgages that didn't fully verify customer income. "Low-doc" loans are much more likely to fail than loans that fully assess borrowers' ability to repay.[9]

3. Roughly 29% of the company's option ARMs were coupled with "piggyback" second mortgages, driving these customers' aggregate mortgage debt well above 90% of their homes' value. [10]

Countrywide has not directly reported on the performance of loans originated in 2007, but it appears the company used the same underwriting criteria through at least August of last year. According to industry sources, it originated more than $160 billion in option ARMs in 2007.[11]

Countrywide was one of the last major lenders to back away from the lax underwriting practices that were criticized in banking regulators' guidance and were already promising to produce large numbers of unnecessary foreclosures. And as the industry leader, Countrywide likely motivated other lenders to continue making poorly underwritten loans, too. "Countrywide has revised its guidelines several times in 2007, but the most extensive revisions occurred on Aug. 15," Michael Youngblood, an analyst at FBR Investment Management noted in October 2007. "Since many mortgage banking companies will follow CFC's lead, the slow pace of revision likely slowed the adoption of tightened underwriting standards generally."[12]

Conflicts of Interest

Countrywide has transformed itself into a "full-service" mortgage company by creating a web of subsidiaries that allow it to wring fees from nearly every stage of the mortgage process. Many of the services performed by Countrywide's subunits have traditionally been performed by third-party firms that provide a check to overreaching lenders. By providing appraisals and other services in-house, Countrywide has built conflicts of interest into its corporate structure that allow it to overcharge borrowers.

For example:

❖ Countrywide's ***Landsafe*** unit handles appraisals, credit reports, flood certifications and other documentation for new loans and for loans that have gone into default. In 2002, Countrywide settled a class-action lawsuit in Los Angeles County Superior Court, <u>Gonzales v. Countrywide</u>, accusing it of overcharging borrowers for credit reports obtained through Landsafe. (Countrywide admitted no wrongdoing.)

  A case seeking class action status in federal court in Los Angeles accuses Countrywide and Landsafe of charging fees for appraisals, credit checks and flood certification that "far exceed what other lenders charge" (http://www.responsiblelending.org/pdfs/cwd-white.pdf). These include a $26 charge for flood certifications, roughly twice what other lenders charge, the lawsuit claims**.**

Lawsuits in federal court in Florida http://www.responsiblelending.org/pdfs/cwd-masse.pdf and New Jersey http://www.responsiblelending.org/pdfs/cwd-marple.pdf, meanwhile, charge that Countrywide has schemed to "cheat residential and commercial mortgage customers out of hundreds of millions of dollars" in unearned fees by "marking up" the costs for flood certification and tax services performed by LandSafe. Because Countrywide performs no additional services beyond the work done by LandSafe, the suits contend, the mark-ups violate the federal law. (Countrywide says the fees are legitimate and reasonable.)

- Countrywide reaps significant revenue through its ***Balboa Insurance*** subsidiary by "force-placing" insurance on borrowers whose homeowners insurance has lapsed.

  Balboa ranks as the second largest provider for force-placed insurance, controlling approximately 20% of the market, and is growing steadily.[13] Because Balboa is a subsidiary, Countrywide– the nation's largest home loan servicer – has access to the nation's largest captive market of consumers, who might get stuck with Balboa force-placed insurance when their home loans get into trouble.

  Force-placed insurance policies often carry extremely high premiums and can be highly lucrative for insurers.

  A lawsuit in federal court in Mississippi **http://www.responsiblelending.org/pdfs/cwd-blades.pdf** claims Countrywide and Balboa engaged in a scheme to fleece Gulf Coast homeowners by forcing them to pay for "phantom" homeowners insurance for structures that Hurricanes Katrina and Rita left destroyed or simply uninsurable. The named plaintiff in the case claims that Katrina left only a slab where her home had once been, but Countrywide nonetheless "invaded" her escrow account and bought homeowners insurance in her name through Balboa. (Countrywide says it followed the law and obeyed its contracts with borrowers in good faith.)

- ***Recon Trust*** serves as Countrywide's foreclosure trustee in many states. This allows Countrywide to recoup the trustee fees that normally would go to an independent company.

  Consumer advocates are concerned that such arrangements represent a conflict of interest. They are concerned that the revenues earned by in-house units such as Recon Trust give lenders and servicers a greater incentive to foreclose rather than try to modify unaffordable loans. Ira Rheingold, general counsel for the National Association of Consumer Advocates in Washington, says http://www.msnbc.msn.com/id/18158811/ that companies with ties to the lender shouldn't handle foreclosures. "They should be completely objective and not have any financial interest in how the case is resolved," Rheingold said.[14]

  In an October 26, 2007 conference call, Countrywide President David Sambol highlighted the revenues that can be reaped via foreclosures. He told investors that increased delinquencies and loss mitigation efforts wouldn't have a significant impact on Countrywide's earnings because those expenses "tend to be fully offset" by "greater fee

> income from items like late charges and importantly from 'insourced' vendor functions . . . such as our businesses involved in foreclosure trustee and default title services and property inspection services."[15]

Broken Promises on Loan Modifications

As the subprime crisis escalated in 2007, Countrywide vowed to help struggling borrowers by modifying their loans. But consumer advocates, journalists and industry analysts say Countrywide has failed to live up to its rhetoric.[16] A recent *New York Times* article, "Can These Mortgages Be Saved?," explained:

> *Even as Countrywide maintains that helping its borrowers modify their loans is its top priority, its investors have heard a slightly different story. In a conference call with analysts and investors in late July, Kevin Bartlett, Countrywide's chief investment officer, counted about 2,000 loan modifications done in June. Most of those, he said, involved deferring overdue interest or adding the past due amount to a loan. The company rarely provides workouts that reduce interest rates on loans, Mr. Bartlett told investors.*
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> *Yet reducing rocketing interest rates is exactly the relief that many borrowers are seeking because, consumer advocates say, that is the only way they can afford to stay in their homes. Loan experts say that when workouts involve deferring overdue interest or tacking amounts owed onto the back of a loan, borrowers often wind up in trouble again in just a few years.*[17]

In the same article, the *Times* reported the company had claimed some modifications as success stories even though the borrowers ended up losing their homes. The *Times* said these modifications "include two types of deals that wind up forcing borrowers from their homes. Almost 14 percent of its homeownership preservation efforts involved borrowers who agreed to sell their homes for less than their loan amounts, called a short sale, or involved homeowners turning over their deeds to Countrywide to prevent a foreclosure. Countrywide did not disclose in its news release that such arrangements were included in its workout figures."

A fall 2007 analysis by Credit Suisse ranked Countrywide as having one of the worst records for addressing the growing problem of borrowers whose subprime or option ARMs are resetting to interest rates and payments they can't afford. Credit Suisse estimated Countrywide's real modification rate on its option ARM loans might be as few as 50 per month – at a time the company claimed a much higher rate. It ranked Countrywide as 26th among the 31 top servicers in terms of its speed at modifying ARM reset loans.[18]

As its efforts to modify loans have moved slowly, the pain inflicted on its borrowers has escalated swiftly: the company's foreclosed real estate in portfolio grew by 600% in the first nine months of 2007.

Amid growing criticism, the company announced a $16 billion program to modify existing loans, and has also issued a series of press releases touting its efforts to reach out to borrowers.

However, the Credit Suisse analysis found that the company's rhetoric exceeded the scope of its efforts to help borrowers.

- First, at least $10 billion of the $16 billion plan consists purely of refinancing subprime loans into new prime and subprime loans – and this is a level of refinancing that the company probably would have done anyway, according to Credit Suisse, so it is not really new financing that will address the problem.

- Second, Credit Suisse was skeptical that the company has the capacity to fully deliver on the modification program for the remainder of borrowers. After reviewing the statistics, it concluded: "It's questionable whether the combination of phone calls and using a community group will collectively increase the mod rate from 50 to 1,400" per month – the level targeted by Countrywide."[19]

Like other servicers, Countrywide is participating in a U.S. Treasury Department plan that can provide reduced payments for borrowers struggling with subprime loans. On Jan. 16, Countrywide announced it had "helped more than 80,000 borrowers retain their homes in 2007," adding that its "foreclosure prevention efforts grew substantially in the fourth quarter 2007 as a direct result of increased staffing, outreach and investor support." Steve Bailey, senior managing director of loan administration at the company, said, "Countrywide is proud of the progress made toward helping our customers sustain homeownership."[20]
However, a CRL analysis of Countrywide's numbers -- and data that the company has previously released – suggests that the progress may not measure up.

1. The level of loan modifications actually went down from November to December. The figures went from 12,565 to 10,066 - a drop of 19.9%. This drop occurred in the same month that the Treasury plan was going into effect.[21]

2. The overall level of workouts also decreased, from 15,472 to 13,273 - a drop of 14.2%.[22]

3. In December, the level of loans in foreclosure increased from an estimated 84,798 to 93,961 -- an increase of 9,163.[23]

4. Also in December, the level of delinquent loans in the portfolio rose from an estimated 571,940 to 628,820 - an increase of 56,879.[24]

5. For the year 2007, approximately 225,000 additional loans went into delinquency – and the level of loans at 90-days-plus delinquency increased by almost that exact same amount. Loans at 90-days delinquent are in most cases facing prompt foreclosure action – so that the aggregate level of potential foreclosures in the Countrywide portfolio has grown far more significantly than just the loans that are reported as being in the foreclosure process.[25]

Countrywide has not released detailed data on the nature of the modifications it has performed to date -- so it is impossible to tell if these modifications will stabilize individual homeowners' mortgages in the long term. In addition, workouts, otherwise known as repayment plans, require adding extra payments to cure delinquency on top of regularly scheduled payments. These do little to help borrowers who have loans where the existing interest rate or payment is unaffordable.

Given the sheer size of its loan portfolio, and the number of borrowers who are delinquent, it will be a significant challenge for the company to make the fixes needed to address the crisis.

Abusive Loan Servicing

Legal filings by borrowers accuse Countrywide of incompetence and fraud in the way it collects and records their payments.

- A lawsuit in federal court in Tennessee http://www.responsiblelending.org/pdfs/cwd-chrisman.pdf alleges the company booked higher income on its financial statements by allocating too much of borrowers' payments to interest and not enough to paying down their principal. The suit claims Countrywide posted payments "after unexplained, unreasonable, and significant delays," charged unfair late fees and used foreclosure threats to force borrowers to pay more than they owed.

- A lawsuit in federal court in Washington state http://www.responsiblelending.org/pdfs/cwd-beyer.pdf charges that Countrywide "systematically charged and obtained money from consumers" by assessing them unauthorized "service fees" when they pay off the balance of their loans.

- Countrywide is also the target of a multi-state federal investigation into whether the lender has charged unwarranted fees to consumers who are going through bankruptcy. The U.S. Trustee, an agency that oversees bankruptcy courts, is probing Countrywide's conduct in hundreds of cases in Florida, Texas and Pennsylvania.[26]

In one Florida case, the *Los Angeles Times* reported, the trustee's office said it had opened an inquiry to determine whether Countrywide's claims that a couple owed more than $16,000 in escrow payments and fees contained "factual misrepresentations" and "threatened an abuse of the bankruptcy system."[27] In another Florida case, the *Wall Street Journal* reported, a bankruptcy judge said Countrywide had been caught "with its hand in the cookie jar" after admitting it had been mistaken when it had claimed a borrower should pay $4,800 a month during bankruptcy; the company cut that figure in half after the borrower objected.[28]

In a case in Pittsburgh, Countrywide fabricated documents claiming a borrower owed $4,700 in escrow monies. After Countrywide's attorney acknowledged the letters had been "recreated," the judge overseeing the case remarked, "These letters are a smoking gun that something is not right in Denmark." The *New York Times* reported that the case is one of 300 bankruptcy proceedings involving Countrywide customers that have been red-flagged by a bankruptcy court trustee in Pittsburgh, who contends the company lost or destroyed more than $500,000 in checks it received from homeowners. (Countrywide disputes the allegations.)[29]

Weak Corporate Governance

Countrywide's leadership has been widely criticized for lining its own pockets while the company's customers and financial performance have suffered.

Countrywide's financial instability has been illustrated by the rapid drop in its share price. From a high value of $45.26 per share on January 26, 2007, the company's stock dropped to $6.96 as of January 31, 2008. As a result, its market value has fallen from $26.2 billion tojust over $4 billion – an 85% drop.
For the third quarter of 2007, Countrywide took roughly $2.9 billion in write-offs on its loan assets. These write-offs resulted in an overall loss of $1.2 billion for the quarter – the first quarterly loss the company had suffered in 25 years. Countrywide's CEO, Mozilo, predicted that the company would return to profitability in the fourth quarter.[30] Instead, Countrywide posted its second quarterly loss in a row, reporting a loss of $422 million.[31]

Even as they directed the company on an unsustainable path that produced the lender's current financial meltdown, Mozilo and Countrywide board members have received pay and benefits that are the envy of corporate America.

Mozilo is one of the highest-paid CEOs in the world. In 2005, he earned more than $100 million, collecting the biggest cash bonus of any executive at any company in the S&P 500, according to the Corporate Library, a respected business watchdog. In 2006, his compensation soared past $120 million.[32]

When Mozilo postponed his retirement in 2006, he persuaded the board to give him an extra $10 million to compensate him for retirement benefits he had postponed. Patrick McGurn of Institutional Shareholder Services called the arrangement "the ultimate in CEO moxie – a CEO demanding that in addition to being paid for his service, he gets reimbursed for the retirement income that he would have received if he had retired."[33]

Mozilo also benefited by cashing out more than $140 million in stock options from late 2006 to late 2007, reducing his holdings in the company even as he was urging shareholders to increase their own. The "automatic" stock option trading plans that he set up in late 2006 are now the subject of a Securities and Exchange Commission investigation. Corporate watchdogs have questioned whether he tampered with the "arms-length" nature of the plans in order to accelerate the timing of his stock sales in anticipation that the company's market value would drop as problems in the housing and mortgage markets worsened. The *Los Angeles Times* reported that "Mozilo launched one trading plan October 27, 2006; launched a second December 12; then revised his December plan six weeks later, boosting the number of shares sold from 350,000 to 580,000 per month in the process."[34] According to the newspaper, an economist testified in a civil suit that there was just a 1 in 978 chance that 11 stock grants he examined would be as lucrative as they turned out to be merely by chance – a result "akin to flipping a coin and always seeing heads."[35]

In early January the *Los Angeles Times* reported that even if Mozilo was forced out of the company, he could garner as much as $115 million severance and continue to enjoy free rides on the company jet and have his country club bills paid by the company.[36] As complaints about his severance package grew, Mozilo announced Jan. 28 that he would forego some $37.5 million of his severance pay.[37]

Countrywide's board of directors, meanwhile, has also profited handsomely:

- Outside directors earned between $344,988 and $538,824 in 2006. That compares to the average director compensation of just over $200,000 for S&P 500 blue-chip companies, according to the Corporate Library.
- Harley Snyder has netted $6.6 million in stock option sales.
- Robert Donato has netted $1.7 million.
- Oscar Robertson has netted $9.2 million.[38]

Particularly troublesome is the fact that, at the same time Mozilo and several directors and executives were selling company shares, the company was actually buying back $2.4 billion of its own stock; it even borrowed money to perform the buyback plan, at the same time its access to capital was starting to worsen.[39] Such plans can make sense when a company concludes its stock is undervalued, but they make little sense when the company's stock value is steadily decreasing.

In a study published on BusinessWeek online on Nov. 7, 2007, http://www.businessweek.com/investor/content/nov2007/pi2007116_794258.htm financial analysts Todd Rosenbluth and Stewart Glickman ranked Countrywide's plan as one of the three worst-performing stock buyback plans among S&P 500 companies.[40]

The reviews from the corporate watchdogs have been scathing. The Corporate Library gives Countrywide an "F" rating for corporate governance. "We would give them a lower grade if we had one," said the Library's editor, Nell Minow.[41] Two of her colleagues at the Library have added: "Any board which can make such poor decisions about a CEO's compensation package is almost certain to be making poor decisions elsewhere." [42]

Questionable FHLB Borrowings

As Countrywide saw its sources of capital dry up last year, it increasingly turned to the Federal Home Loan Bank of Atlanta for cash to bankroll its mortgages. Through the first three quarters of 2007, Countrywide's borrowings from FHLB Atlanta grew 81%, to $51 billion. That represented nearly 40% of FHLB Atlanta's total advances. U.S. Senator Charles Schumer of New York called that http://www.senate.gov/~schumer/SchumerWebsite/pressroom/record.cfm?id=287914 "a potentially dangerous level of exposure considering Countrywide's track record in poor underwriting and predatory lending practices in recent years."

"Countrywide is treating the Federal Home Loan Bank system like a personal ATM," Senator Schumer wrote. "When Congress created these banks, it never intended for them to be used to prop up mortgage lenders that specialized in deceiving borrowers." Senator Schumer noted that the $62 billion in home loans that Countrywide put up as collateral for its FHLB transactions included a large proportion of pay option ARMs that do not meet the FHLB's current guidelines for sound lending. At a time when Countrywide's mortgage portfolio is deteriorating, he wrote, "FHLB's exposure to Countrywide poses an unreasonable risk."[43]

In its most recent financial reports, Countrywide has indicated that its level of FHLB borrowing has now decreased slightly, to $47 billion.[44] A recent *Wall Street Journal* article cites regulatory threats to its liquidity – possible reduction in its access to FHLB borrowing based on fears of losses to the system, inquiries into its high-rate federally-insured deposits by the FDIC, and reduction in its ability to use its savings bank to hold custodial deposits if it suffers credit rating downgrades.[45]

A Fresh Start with Bank of America?

On Jan. 11, 2008, Bank of America announced its intent to acquire Countrywide Financial Corporation.[46] The company stated that it intended to complete the transaction and take over Countrywide operations in the third quarter of 2008.

Bank of America CEO Ken Lewis strongly reiterated his intent to complete the purchase recently. He indicated that he was expecting Countrywide's announced $422 million loss for the fourth quarter of 2007, and that he believed the company still had the value he was seeking.[47]

The Center for Responsible Lending believes the merger is a positive development A number of the factors have led CRL to this conclusion:

1. As the nation's largest bank, Bank of America has the liquidity and the resources to keep funding new loans – and to provide ongoing resources to rescue troubled borrowers.

2. In an investor call after the merger announcement, Ken Lewis reiterated his position that Bank of America would avoid subprime lending, limit its use of mortgage brokers in originating new loans, avoid subprime brokers altogether, and avoid large bulk purchases of loan portfolios, in which loans with predatory features might be harder to detect.[48]

3. Bank of America has expressed its commitment to working to help borrowers whose loans are in trouble.

4. Based on its history of shaky lending, poor servicing and weakened financial status, it does not appear that Countrywide, working on a stand-alone basis, can take the needed steps to clean up its current mess and preserve homeownership for its borrowers.

The Center for Responsible Lending's CEO Martin Eakes states:

> *Bank of America has the resources and the will to begin cleaning up the subprime mess that Countrywide has played such a large role in creating. We have nine months between now and the official merger date. This will be the most important period since the Great Depression for dealing with the millions of bad Countrywide loans that have pushed families to the brink of foreclosure. The number one priority during this critical period is fixing these bad loans and keeping people in their homes.*
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> *Over the past few years, by steering millions of people into bad loans, Countrywide has been the largest rogue mortgage lender in the country. Hopefully, Bank of America will not be surprised by the extent of the problems with Countrywide's home loans. Bank of America should be commended for taking the challenge of addressing these problems at a time when ordinary families most desperately need a fair shot at sustainable homeownership.*

CRL will be monitoring the situation on a continuing basis, and making recommendations as needed.

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