Exhibit 3

to

Affidavit of Daniel M. Reilly
in Support of Joint Memorandum of
Law in Opposition to Proposed Settlement

THE

FINANCIAL CRISIS INQUIRY REPORT

Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States

OFFICIAL GOVERNMENT EDITION

mortgage payments on ever more expensive homes affordable—at least initially. Popular Alt-A products included interest-only mortgages and payment-option ARMs. Option ARMs let borrowers pick their payment each month, including payments that actually increased the principal—any shortfall on the interest payment was added to the principal, something called negative amortization. If the balance got large enough, the loan would convert to a fixed-rate mortgage, increasing the monthly payment—perhaps dramatically. Option ARMs rose from 2% of mortgages in 2003 to 9% in 2006. [16]

Simultaneously, underwriting standards for nonprime and prime mortgages weakened. Combined loan-to-value ratios—reflecting first, second, and even third mortgages—rose. Debt-to-income ratios climbed, as did loans made for non-owner-occupied properties. Fannie Mae and Freddie Mac's market share shrank from 57% of all mortgages purchased in 2003 to 42% in 2004, and down to 37% by 2006.[17] Taking their place were private-label securitizations—meaning those not issued and guaranteed by the GSEs.

In this new market, originators competed fiercely; Countrywide Financial Corporation took the crown.[18] It was the biggest mortgage originator from 2004 until the market collapsed in 2007. Even after Countrywide nearly failed, buckling under a mortgage portfolio with loans that its co-founder and CEO Angelo Mozilo once called "toxic," Mozilo would describe his 40-year-old company to the Commission as having helped 25 million people buy homes and prevented social unrest by extending loans to minorities, historically the victims of discrimination: "Countrywide was one of the greatest companies in the history of this country and probably made more difference to society, to the integrity of our society, than any company in the history of America."[19] Lending to home buyers was only part of the business. Countrywide's President and COO David Sambol told the Commission, as long as a loan did not harm the company from a financial or reputation standpoint, Countrywide was "a seller of securities to Wall Street." Countrywide's essential business strategy was "originating what was salable in the secondary market."[20] The company sold or securitized 87% of the $1.5 trillion in mortgages it originated between 2002 and 2005.

In 2004, Mozilo announced a very aggressive goal of gaining "market dominance" by capturing 30% of the origination market.[21] His share at the time was 12%. But Countrywide was not unique: Ameriquest, New Century, Washington Mutual, and others all pursued loans as aggressively. They competed by originating types of mortgages created years before as niche products, but now transformed into riskier, mass-market versions. "The definition of a good loan changed from 'one that pays' to 'one that could be sold,'" Patricia Lindsay, formerly a fraud specialist at New Century, told the FCIC.[22]

2/28s and 3/27s: "Adjust for the affordability"

Historically, 2/28s or 3/27s, also known as *hybrid ARMs,* let credit-impaired borrowers repair their credit. During the first two or three years, a lower interest rate meant a manageable payment schedule and enabled borrowers to demonstrate they could make timely payments. Eventually the interest rates would rise sharply, and payments