Countrywide Financial Q2 2007 Earnings Call Transcript

Question-and-Answer Session

Operator

(Operator Instructions) Your first question comes from the line of Paul Miller from Friedman, Billings, Ramsey. Please go ahead.

Paul Miller - Friedman, Billings, Ramsey

Thank you very much. Angelo, you've been through a lot of these different cycles out there and this doesn't seems to be becoming a lot stronger and a lot harder than a lot of people thought. When do you think this ends? I know you've been quoted out there you think this maybe it is an '09 event. But, what's some of the things we have to see? Does the CDO market have to come back? Or does liquidity have to come back? Or do the inventories in the housing market have to go away? What are some of the things that we need to look for?

Angelo Mozilo

I think the first thing is that the inventory in the house supply has to reverse itself. Because as I view it, and I have been through a lot of these things in 54 years, although the market is a lot bigger now. So, the problems are a lot bigger, but as I try to walk through what happened here, and could a lot of this have been foreseen?

These tend to try to reflect on your own activities, and should we have known, could we have seen it? But, as I do reflect on it and I do a lot, that nobody saw this coming. S&P and Moody's didn't see it coming but they simply just downgrade bonds. They don't take hits. Bear Stearns certainly didn't see it coming, Merrill Lynch didn't see it coming, nobody saw this coming.

And so, it was the deterioration in real estate values that was the base cause of all of this. We had none of these problems as real estate values were going up, so it is an oversimplification admittedly, but clearly the deterioration in real estate values, as a result of the affordability issue and an oversupply.

So I think, one turning point is the supply of housing, because I think, once that turns around the psychology of the country changes. Because now, the borrowers, that potential buyers simply say, look, I will just wait, because I will be able to buy the house cheaper tomorrow than I can today and that psychology has to change and the only thing that is going to change it is supply.

The other, just so I can reflect on this as you people think of your questions. The other is that the Fed knowing that well over 50%, 60%, 70% of the loans made in 2003, '04, '05, and '06 were indexed variable-rate loans, indexed one way or another to the Fed funds rate, increased the Fed funds rate 17 times, 17 consecutive times with most of the product out there being variable-rate product.

You know, and you never knew when they were going to stop increasing, but the fact they did that had a material impact on affordability. As people went to refinance or people went to buy, major, major impact. So, for a Fed Governor to say that the lending industry had this coming is unbelievable when the Fed, to a great extent, was a unknowing contributing factor to this.

Plus they came in with the Fed, with the joint AC guidelines, which restricted the amount of the type of loans we could make in an environment where we had limited liquidity to start with. The other was the rapid increase in real estate values that we have faced over the last few years, caused people to stretch themselves and their financial resources in order to get into a home. There is a high desire for people to own a home.

And the mortgage product then was developed to try to help them get into the home, which was known as exotic products of various kinds, but there was a secondary market for it, there was plenty of liquidity for that. So, the primary market responded to that.

And, I say also the traditional underwriting standards, which John McMurray alluded to, were altered to use more technology and more credit scoring as a judgmental factor in whether a loan could qualify or not, versus the traditional documentation. And you had on top of that, which again John related to, was speculation.

So, I just want to share those thoughts with you. Now, getting back to your base question, as I say 2009 because my experience is that it just takes a long time to change, to turn a battleship around. This is a huge battleship and it is headed in the wrong direction.

So, first, we have to get it to slow down, then stop and then turn. And I think, that this is just a gut feeling, based upon what I have seen in the past and the size of this market is that it's going to take 2007, the balance of this year, to get this thing to look like it is slowing down, 2008 to get it to slow down and stop; and 2009 to head in the other direction.

My feeling is that by that time, you will have reduced competition, very substantial pent-up demand, because of all of the people who have been closed out of housing, probably lower interest rates.

I do think that this ultimately has to have an effect on the economy. I just can't believe that this economy is totally insulated from housing and will be 2009, 2010, 2011 I look to as sort of like 2003, 2004, 2005, great years for the industry.

Paul Miller - Friedman, Billings, Ramsey

Hey, thank you very much, Angelo.

Angelo Mozilo

You are welcome.

Operator

And your next question comes from the line of Ken Posner. Please go ahead.

Ken Posner - Morgan Stanley

Hi. Good morning Angelo and John. I wanted to ask if I could, about the performance in the prime portfolio. I've got a lot of questions from investors wondering, does this mean that all prime mortgages are in trouble?

Or is there something specific about your portfolio that could explain the increase in charge-offs from 4 basis points last year to 19 basis points in the first quarter to around 47 basis points in the second quarter?

What specifically is driving that, because these are prime people, right, they haven't lost their jobs and the housing markets have only just started to soften?

Angelo Mozilo

Ken, but since you've mentioned that, before I turn it over to John on this issue, so far what we have seen in delinquencies to a great extent are not resets at all but people losing their jobs, loss of marriage, loss of health and the problem is they can't either refinance, because the value of their homes have gone down.

So, they are under water, or the program that they used to get into the home is no longer available to them. And so right now, the delinquencies are being driven by more traditional issues than they are by the concern about resets. John?

John McMurray

Sure. Ken so, the way I think about prime is that it covers a very vast spectrum. So, I don't thank you can paint it with a single brush. Part of the reason that we shared the odds ratios charts with you is to show you some of the key things that are driving both prime and subprime performance.

So, in the prime sector, recall how I showed you the line that covered FICO. There is a belief by many that prime FICOs stop at 620 that is not the case. There are affordability programs and Fannie Mae, expanded approval, as an example, that go far below 620, yet those are still considered prime.

Documentation and leverage are also important factors so, if you have the existence of one of these high risk factors or the combination of several of these factors in a prime loan, it is going to exhibit higher delinquencies.

Ken Posner - Morgan Stanley

I understand. John, would it be safe to say then that in Countrywide's prime portfolio, it would not be the FICO scores obviously; they're very high, it would not be the LTVs; they're very moderate.

But, we should assume then that there are, in fact multiple risk factors that are driving the spike to 47 basis points in charge-offs, because that is just not a charge-off ratio one would expect for at least for an old-fashioned prime portfolio.

John McMurray

Well, a couple things. Again to remember even in prime there is a very broad distribution. So, even though on average, the FICOs are very favorable and the CLTVs are very favorable, you're still going to have tails at both ends, both very good loans and loans with a lot of high risk factors.

The charge-offs ratio that you're seeing in the bank also, as I said, be sure to see footnote 3, a substantial portion of what you see this quarter relates to a change in our charge-off practices.

So, some of the charge-offs that would have been taken in future quarters were accelerated into this quarter. So...

Ken Posner - Morgan Stanley

John, I will confess, I missed footnote 3. Could you explain what the magnitude of that effect is and maybe just take a second if that is an important factor?

John McMurray

Sure, so for the HFI portfolio across the firm, we adopted a 180-day charge-off standard. Prior to that for much of the HFI portfolio across the firm, we adopted a 180-day charge-off standard. Prior to that, for much of the HFI portfolio, we used a standard that's similar to what's used in our securities, where we wait for the loan to go into foreclosure and through REO before doing the final charge-off.

The advantage of the approach to that we were using is that it's much more precise. The later we go in the process, the more certainty we're going to have exactly with respect to what's charged off. The advantage of the approach that we moved to is that you charge the loans off earlier, though you do lose some of the precision.

But in any case, by adopting those standards firm wide, as I said, we moved some of the charge-offs that we would have had in future quarters into this quarter.

Ken Posner - Morgan Stanley

And did you quantify the impact from that change? And then I would like to go back in line.

John McMurray

I did, but just as a quick reminder -- and I wanted to make one other comment. So inside of the banking operations segment, the impact is going to be in the neighborhood of $30 million for the quarter. On a consolidated basis, it's going to be in the neighborhood of $50 million.

One final quick comment. As we have talked about in prior calls and during our presentations, Countrywide is a mortgage supermarket. So we generally offer what's offered by the market at large. So it's my belief that the portfolio that we have for the most part is going to be a good reference for what exists on a broader basis.

And then also, keep in mind the comments I had on the delinquencies. Many firms report out using the OTS standard. Eventually, those delinquencies are going to catch up with the MBA standard, but you're not going to get as early of a read.

Ken Posner - Morgan Stanley

Thank you very much.

Angelo Mozilo

Ken, I would also comment that when you made the comment about the traditional prime and don't expect that kind of delinquency, I do think it's -- be important to observe what happens going forward, because we are experiencing home price depreciation almost like never before, with the exception of the Great Depression.

And so I think using standards or frames of reference on prime and the performance of prime in other environments may not be a fair comparison in light of what's happening to real estate values.

Ken Posner - Morgan Stanley

Point taken. Thank you.

David Sambol

Yeah. Ken, this is David Sambol. Let me also weigh in. I think you were attempting to identify what maybe sub segments of the portfolio have contributed to higher charge-offs and delinquency trends. And if we had to identify any particular category of the home equity portfolio, it certainly would be the higher CLTV and the higher CLTV reduced documentation loans that we have in the portfolio, that are disproportionately contributing to charge-offs and delinquencies.

And many of those are stem from the higher concentration of piggyback financing that we did and that we have in the port stemming from what was occurring in the market. I point out that when we originated those loans, we certainly were cognizant of the fact that they would perform differently than traditional home equity loans and we attempted to price for that.

So that one of the data points on John's presentation that you might have noted was the pricing on our average HELOC book, expressed as a margin over prime, and it's close to prime plus 190. You would compare that to, for example, typical stand-alone HELOCs historically done would be priced at prime flat, or even prime minus for many of the banks.

And so that was a risk premium that we added to the pricing for those loans. But certainly, we didn't anticipate what would happen with HPI. And again, as John illustrated, the correlation between significantly up-sloping losses and the kind of environment that we're seeing.

We also enjoyed very robust earnings on that book with negligible charge-offs and losses historically as a result of the very benign environment we have come out of the last two years. And now, we're really seeing some of that risk premium. We charged or embedded in the loan being absorbed. So that's kind of the way, I look at -- it's another way to look at what we're seeing.

Ken Posner - Morgan Stanley

That makes a lot of sense. Thank you, David.

Operator

Your next question comes from the line of Eric Wasserstrom. Please go ahead.

Eric Wasserstrom - UBS
Thanks. Just one point of clarification and then one question. I guess the point of clarification is I kind of summarize these comments that you've made on credit quality. Is it just too simple to say in areas, whether they were in sub prime or prime, where you had excessive risk layering with an excessive dependence on home price appreciation that you're currently seeing the process of that unwinding in terms of the credit performance?
Angelo Mozilo
I think that is an oversimplification. We didn't rely upon home price appreciation. We relied upon an appraisal of current value as a lender. You can't forecast as a lender, which way values are going to be going, up or down. You at least traditionally and historically use appraisals, with certain protocols to establish what the value is.
So you can determine what kind of loan-to-value you want to establish based upon the quality of the credit of the borrower. So we did not make these loans based upon value is going to go up forever, because we know they are not going to go up forever. But you don't know what they are going to do, whether they are going to stabilize, go down; if they do go down, how far? It's just unpredictable.
So in our business, you're limited to what you believe the value to be based upon a professional appraiser valuing a piece of property at that time.
Eric Wasserstrom - UBS
Maybe I'll follow-up with a little bit more about that off-line. The question I have is --just to get away from this topic for a moment -- you know, you guys have engaged in some capital optimization and some other elements of financial engineering.
I think efforts to migrate some of your MSR assets into the Bank. Can you just give us update on where those various efforts are currently and what that suggests about capital optimization from here?
John McMurray
Yeah. Well, two things. In terms of our capital position, I would characterize where we are at as we are in good shape and strong capital position. We've talked in the past about having excess capital. We remain of the view that we have excess capital in the near-term, certainly over the next quarter or so. We intend to put that capital to use by investing in the balance sheet.
As Kevin mentioned, we expect to use our balance sheet to hold additional assets as a result of some of the volatility out there until the secondary market conditions normalize. We also as a result of credit spread widening. We view this as an environment that will throw off opportunities for the Bank to accelerate growth of their loan portfolio, their HFI investment portfolio.
That's evidenced by our decision during the quarter to move some home equity loans that we originated into the Bank. And so this environment will give us an opportunity to deploy capital back into the business as a result of spread widening. And we also expect that other opportunities will present themselves over the quarter as the stressed environment results in issues for some of our competitors.
In fact, we're already beginning to see -- this is a leading indicator I could share with you -- that over the last quarter our growth in the sales force was probably at a one to two year high. I'm trying to determine the last time we grew it at that pace.
But all because things are beginning -- consolidation is beginning to accelerate and that means more opportunities, hopefully more production of volume, which will require balance sheet. And so we don't expect -- we talked about cap optimization in the past. We don't expect and certainly in the near-term, any buyback.

In terms of your question about MSRs and the Bank, I think we previewed that it was our -- that we have a process that is occurring whereby we are seeking to migrate our mortgage banking operation from CHL into the Bank as part of our plan. We anticipated that beginning in 2008, we would start investing in MSRs within the Bank.

And we are still on track for that. Our plans are on track and but that's unlikely to occur before next year. When it does occur, what we'll see happening is the Bank MSR portfolio beginning to grow, and the MSR portfolio in CHL beginning to shrink.

Eric Wasserstrom - UBS

Thanks very much.

Operator

And your next question comes form the line of Chris Brendler. Please go ahead.

Chris Brendler - Stifel Nicolaus

Hi, thanks. Good morning. I guess, one thing I'm struggling with is the undiscounted losses embedded in your home equity and subprime, and I guess also the Bank portfolio. I'm surprised that you haven't seen I guess issues besides life events in terms of rising delinquencies.

So, what I'm trying to get a handle on is, given how it seems like we're still early in the housing price decline that could accelerate as the year progresses and into 2008. How conservative or how appropriate are these marks today? What is the housing outlook embedded in there?

And maybe you could give us any color, I do think we have seen some resets hit in the second quarter. How are the resets performing? Doesn't that add a wave of pressure on these valuations? Also, what is happening from a loan modification standpoint? Thank you.

Kevin Bartlett

All right, let me work backwards from your questions. On the loan modification front it has been our long-standing practice to always pursue a modification or a workout with a borrower as a first line of attack for somebody that falls delinquent or gets into trouble.

Two reasons for that, one is it's the right thing to do for the consumer; and secondly, for Countrywide it usually results in better economics. So, on the modification, in the area of modifications, we are going to continue with the philosophy that we have had, although there obviously, will be more of that activity.

With the respect to your second to the last questions, which had to do with resets. We haven't seen a lot of that activity yet, with the exception of subprime. So, if you look at the 2/28 and 3/27, if you look at the 2/28 and 3/27 subprime loans, most of the loans tend to prepay prior to the reset, but those that are left subsequent to the reset tend to have much higher delinquency rates.

And, so one of the concerns that we have is just the less availability of subprime financing as a result of the guideline cutbacks. So, we are watching that carefully.

Now, let me go back to your first question. So, did you want me to address that with respect to residuals?

Chris Brendler - Stifel Nicolaus

Residuals, I guess, and the bank portfolio. It seems like it is hard to figure out where we are. I thought last quarter...

John McMurray

Let's do a couple things; let's start with a key distinction between the Bank portfolio and residuals. In the Bank HFI portfolio, credit losses are provided for via a traditional reserve. So, that reserve is going to consist of two parts.

The first part is a general reserve and so that's going to cover loans that we expect to become 90 days or more past due in the next 12 months. So, it provides for 12 months of coverage there.

On loans that are now 90 plus or higher delinquent, we provide for a lifetime loss expectation. So, that's the Bank HFI portfolio.

In the residual valuation, there what we're doing is we are estimating losses over the life of those loans; and then that is being incorporated into the cash flow. So, you're going to have a combination of interest-only cash flows or excess servicing in effect, plus the projection of losses.

Those are netted together and then discounted back to the present. So, on residuals, we are able to always contemplate our current view of lifetime loss expectations; that is not going to be the case in the bank portfolio.

Kind of the final comment here is that given the environment that we're in, I still think there is a fair amount of uncertainty with respect to anyone estimating what future losses will be. In fact, most of the increase in loss estimates that we made on the home equity residual portfolio this quarter was basically entirely on loans that are currently not delinquent. In other words, they are current. So they are loans that we expect to become delinquent and default in the future.

Chris Brendler - Stifel Nicolaus

Let me just ask it a different way, I guess the sequential change in subprime loss rate was zero. So, you are still looking at 6.3% losses. If I took the pool factor of 54%, so you're looking at cume losses I think, which are basically half that assuming that most of the early loans didn't have any losses. They prepaid.

So, given Angelo's comments about the housing downturn extending into 2008, maybe 2009, I'm trying and given the fact that housing data over the last three months has been pretty much a train wreck. How do we reconcile? How do I feel comfortable that there is not further residual write-downs coming?

John McMurray

Well, we believe we have a housing price forecast embedded in the valuation that is more severe than anything that we've seen in the past. I hesitate to give any comfort because the future is uncertain, so it's possible that it will have to be revisited. We hope that's not the case.

David Sambol

This is Dave Sambol. Let me see if I could give a little bit of extra color. With respect to the remaining losses we have provided for on an undiscounted basis in the subprime portfolio, it is the case that it is approximately 6.3% as John reflects.

But it's a much higher number on more recent vintages like 2006, and a lower number on older vintages that have more accumulated equity appreciation. And so, I would make that point. I would also make the point that the entire balance sheet exposure in subprime residuals, while not immaterial on an absolute sense is only $382 million, representing $442 million, representing an aggregate kind of cap as to what the exposure could be if we were wrong and additional impairment was necessary.

As it relates to the home equity write-downs that we took and fairly significant increases in projected future losses that drove that write-down and is embedded in our current numbers that John showed. I would point out that we're providing not only significant portion of that is on current loans, and not necessarily on delinquent loans.

We're providing for future losses at a level that is greater than anything that we have ever seen, just the size kind of the scope of it. And again, absent a crystal ball, we don't know. But it is probably, as it relates to the home equity portfolio, our view, more conservative than from our reading of other press releases and so forth that we think others are providing for.

In terms of rate resets, that was mentioned and Angelo commented on that. Just to elaborate on that and I think I discussed this last quarter. As we look at and do an autopsy or post mortem on loans that

go through the foreclosure sale process for the purpose of identifying the driving cause and what the consumer told us.

It really is to date the case that a very, very small percentage of those customers that lost their home through a foreclosure lost the home as a result of payment shock or rate reset. And I think, the numbers are close to 60% are attributable to some form of loss of income or material curtailment of income, something happened and this is slightly under 60%, another 25% is attributable to death or divorce or disability and illness.

Then increasingly we're seeing investors; a significant percent you know, now is explained by investors that are unable to get out of the property. And a very small percent really, so far, is explained by rate resets.

In terms of the last topic you mentioned modifications as John mentioned we do. I think as much if not more than most everybody in ensuring that we keep people in their homes, not only because that is the right thing to do. But because it mitigates our losses as well as I'm sure you know. Just in the month of June we effected approximately 2,000 modifications on loans that were otherwise in the foreclosure process.

That resulted in the loans leaving the foreclosure process that compares to approximately 1,000 it is more than doubled or approximately doubled one year ago. So modifications are being used wherever it makes economic sense, and otherwise makes sense for the borrower.

Angelo Mozilo

Okay. I just wanted to make a clarification; I know the press is on the line and get you out of that statement that, I am not saying that house prices are going to decline in 2009, going back to my battleship analogy. I think it's going to take all of 2007 part of 2008 to get this whole negative process house prices. Increased delinquencies and foreclosures to slow down, and the balance of 2008 to get that battleship stopped and 2009 to get it going in the right direction.

As to when house prices will decline I don't know. What I was referring to was in terms of the performance of the industry performance of countrywide more specifically that at least my view of it and just take it as that; this is a visceral view of it just based upon past experience, it doesn't mean it's going to happen that way.

But that, we at least internally prepare ourselves to make sure that we are doing everything we can during the next year and a half to reverse the trend. And then to take advantage of the opportunities we're going to have in 2009. That it is what I am referring to not that I don't know when house the cessation of house pricing declines are going to take place.

Chris Brendler - Stifel Nicolaus

Thank you, very much.

Operator

And your next question comes from the line of Moshe Orenbuch. Please go ahead.

Moshe Orenbuch - Credit Suisse

Thanks, I was wondering in the slide presentation you mentioned that about three quarters of your option ARMs were covered by mortgage insurance; could you talk about first of all; how that will play out in terms of when you will actually be able to draw on that. And how that is going to impact and your future expectations for the provisioning within the Bank.

John McMurray

Sure, well to start with the provisions that we make contemplate this credit enhancement, as I mentioned roughly 62%, or I think I said which equates to $47 million out of the $77 million or so, is first loss; so what that means. As soon as a loan that's covered by that policy defaults because the

coverage is first loss. We will be able to submit a claim immediately. There's other coverage that's mezzanine coverage.
And so the way that will work is the pool of loans that are covered by those policies are going to have to accumulate a certain level of losses before we are able to start submitting claims. But again on just under two-thirds of the coverage its first loss. So we from the very first loss on loans that are covered we can submit claims.
Moshe Orenbuch - Credit Suisse
And how does that impact your provisioning as you go forward; and what should we look for in terms of that provisioning?
John McMurray
First of all, it affects the, if a loan is covered by a credit enhancement particularly a first loss credit enhancement. That is going to affect the calculation of our reserve because the expected loss is provided for via a credit enhancement, as opposed to charging it off against a reserve that we're holding on the balance sheet.
Moshe Orenbuch - Credit Suisse
Do you have a sense as to how much that benefited the current quarter.
John McMurray
It basically has had very little to no benefit so far. So those benefits are going to come in future quarters, so its not been used heavily yet, but its there standing by in case pay option losses start to ramp up. Next question?
Operator
Your next question comes from the line of Fred Cannon. Please go ahead.
Fred Cannon - Keefe, Bruyette & Woods
Thank you and good morning, a question you guys floated about $4 billion in convertible securities in the second quarter. And they had a pretty low coupon on them because of the convert and I know there were some accounting issues.
I was wondering if you could tell us what the interest charge that went through the income statement for the quarter on those was?
Eric Sieracki
Hi Fred; you're correct, we did issue $4 billion of convertible debt and one of the key advantages that we had, there are were many; we were able to tap investor groups other than MTN investors, we were able to save a significant amount of coupon probably about 325 basis points was the savings on the coupons, so $4 billion 325 basis points for a quarter would have been theoretically the savings. We didn't have those converts outstanding for the entire period.
But it also should be noted that there are some ramifications of future accounting promulgations, we may see inline with fair value reporting the GAAP benefit go away from the difference in the coupon; but at least for now until that new promulgation comes about. We do get the benefit of the lower coupon through P&L. Again it would be 325 basis points times the $4 billion if it was outstanding for the full quarter. You would have to quarterize that.
Fred Cannon - Keefe, Bruyette & Woods
Okay, and then I know they have a fairly short option on them for the owners to put them back to you, if that occurred would you, what's your thinking on this security Eric; did you like it? Would you do it again I guess is the question?
Eric Sieracki
Obviously we like the security; we were able to place almost 40% of our full year financing away from MTN investors away from term debt investors; got the 325 basis points reduction in the coupon, we

are able to fill the Delta short in connection with that trade as well so it was a great trade. There were two tranches, $2 billion each, one was 17 months; one was 24 months.
And so, we would very happily consider issuing additional converts in the future. One of the things we're trying to do was monetize very high VAL (ph) in CFC equity, which is a company asset that is difficult to monetize; and through this trade we were able to do that. The bottom line is that we were at $48 million in interest expense on those $4 billion of converts during the quarter.
Fred Cannon - Keefe, Bruyette & Woods
Great, and one other question I know you're talking about making incremental investments given the market conditions, and I noted at the Bank I think your securities portfolio was most of the growth in the Bank assets was in fact, all of that lives in the securities portfolio, which would appear to be earning a relatively modest spread in this environment; could you kind of expand on the strategy regarding securities investments at the Bank.
Angelo Mozilo
Let me just we will have I guess Carlos cover that but let me. I would just point out maybe modest but it's safe. You know which is particularly in this environment. Secondly it was an alternative course, because we couldn't find the assets.
The appropriate assets that met all our hurdles for the bank, it was a good alternative for us at the time to put assets in the balance sheet. The negative part of that is that it exacerbates delinquencies, because you can't put that in your denominator in your delinquency calculation.
It is not a loan, and so the delinquencies in the bank are exacerbated by that factor, but they're a good safe AAA investments, so Carlos do you want to talk about it?
Carlos Garcia
Yes I would mirror what Angelo just said and just add that in this period where credit risk is a key consideration. These securities offer the bank a transitional investment strategy that provides us with A; low level of credit exposure, very high-quality assets, low risk base capital implications and predictable returns on the security cash flow themselves. But I should remind you that the securities are short-term in terms of their expected life. And they have a significant prepayment.
Those prepayments will be reinvested, and the ultimate return will depend highly on what those cash flows that come back to us get reinvested in, we don't see the housing market staying permanently this way, we don't know what to call the end of it, but certainly at some point in time it should improve.
Fred Cannon - Keefe, Bruyette & Woods
I guess Carlos the question I had also is kind of vis-à-vis Kevin's comment about willing to invest in certain parts of the straight loans, given that growth in the securities portfolio. Should we expect that to stabilize or decline given that short duration, start to see loans go back up; or are you guys being pretty cautious regarding credit risk at the bank at this point in time.
Carlos Garcia
First let me say that we are being very cautious with regards to credit risk; but secondly let me say that in this environment, I think Kevin and others alluded that credit spreads are widening from total investment is a good thing, because that means a better return. So, we will be very opportunistic about what assets we select. But the opportunities, I think, will be greater.
I should also point out that some of the suboptimal returns that you may see in the current quarter represent a snapshot in time of the return of an asset. The lifetime returns of these assets are very good.
But we have just come out of a period that suffered benign credit into a very difficult period. So we're transitioning something that required less reserves to something that requires a lot of reserves and that's all getting concentrated in a few quarters.

But going forward, the returns, assuming our assumptions about the future are correct these reserves will start to improve. Certainly the new assets that we put on the books are all priced at very acceptable in fact attractive, returns.

Fred Cannon - Keefe, Bruyette & Woods

Great, thank you.

David Sambol

Yes, I would also add, this is Dave Sambol, that maybe emphasize that one of the positive byproducts of the current volatility in the market is this widening of credit spreads. It is just providing the Bank an opportunity to grow at HFI portfolio, its residential loan portfolio, more than it has been able to over the last several quarters.

And because credit spreads have been so tight that we do not believe that we were getting sufficiently compensated for credit risk, and that explains why our investment strategy became weighted to more very liquid high-quality securities.

That is changing and in the near term, we do expect, as is the case in the second quarter, to maybe divert more production that otherwise meets the Bank's credit criteria filters to the Bank, as a result of wider credit spreads.

And, kind of the flipside of maybe the negative impact on the production sector margins that we anticipate from these wider spreads and lesser sales and associated gain on sale in the second half of the year.

Fred Cannon - Keefe, Bruyette & Woods

Okay. Thanks.

Eric Sieracki

Fred, I have a correction on that interest expense on the convertible. Based on the amount of time the convert was actually outstanding for the period, the interest expense on the convert was actually $11 million and the approximate savings versus term debt that would have been comparable to that would have been about $14 million. So correction the amount of the expense was $11 million.

Fred Cannon - Keefe, Bruyette & Woods

Thanks.

Operator

Your next question comes from the line of Brad Ball. Please go ahead.

Brad Ball - Citigroup

Thanks. Trying to sort of work through how this all shakes out in the end, it seems like the problems at first were contained within subprime, we attributed it all to irrational behavior some players that were overly aggressive during the decline in industry volumes doing things they shouldn't have done. Now it seems that we have shifted to a discussion that surrounds prime. I am curious if you would characterize some of the behaviors in the marketplace as irrational and I wonder if you could comment, given that we have the benefit of hindsight, if we went back a year or two and you were in the marketplace at that time, what would you have done differently?

Would you have put in place the actions that you have underway today, the operational responses that you discussed? Could you have put those in place a year or two ago?

Angelo Mozilo

Yes, I think your last question is a very good one. Could you have put it in place? The obvious answer is that the deterioration in house values we knew that; that it was going to go back. We would have had to really stop doing that business and the Company would have been a very different Company, because you can't do this absent competition.

And, so our volumes, our whole place in the industry would have changed dramatically because we would have arbitrarily made a decision that was contrary to what everything appeared to be. Values going up and no delinquencies, no foreclosures, and we suddenly stop the music and say that we're not going to participate in home equity loans, in subprime, in high LTVs, no docs, and that sort of thing.

It would have been an insight that only, I think, that a superior spirit could have had at the time. So I don't mean, because I think it is a very good question. I ask myself that all the time as CEO. That is the kind of question I ask. What should I have known and when should I have known it and what should I have done about it?

And as I go through that process, it is obvious that if we had stopped participating in those major areas of the business we just couldn't stop it there. It would have affected us through the entire spectrum of our lending operations.

Because you can't simply say, we are out of subprime, we only want prime. Because the providers of loans provide both subprime and prime both and will not give you the prime if you're not willing to take the subprime, that kind of thing.

So. But I think in the theoretical sense, would we do things a lot differently, knowing what we know now? Absolutely. We would have done a lot of things differently. But we didn't. The fact is we didn't know.

I think as John, pointed out the first part of your question as to prime. A prime is a, does have a lot of definitions attached to it. It is CLTV driven, it is FICO driven, it is credit, it is all downpayment driven, it is credit history driven. So it is hard to say that a prime loan is not a 70% LTV, 780 FICO. It is just not it is a mixture of a lot of things.

So the spillover into prime, I don't think is something that should shock anybody once you understand the definition of prime. Because I think the basic issue you see today particularly with Countrywide, is the spillover into the HELOC portfolio.

At least for this quarter, it's not really a subprime story; it is a HELOC story and the deterioration in that, and the piggybacks that were originated in order to assist the mortgagor to avoid PMI. And all the advantages that, that avoidance provided for the borrower.

And reduced costs and tax deductibility at the time, because PMI insurance was not tax-deductible at the time. So it is a these are difficult things to retrace your steps on, but I think the issue now for us, speaking for Countrywide, is the HELOC portfolio. We will have to see what happens with subprime going forward.

But I think that David pointed out that there is a limit to this in terms of our total. The total residual on our balance sheet is about $400 million. If everything collapsed, that would be the extent of our residual exposure. But I do think, it is a question of what happens in Alt-A. Alt-A is again a very broad definition of Alt-A, even broader than prime.

We will have to see what the spillover effect is. But the bottom line is, as values decrease the options for borrowers, homebuyers and borrowers, people and the combination of limiting their product available to them, is exacerbating the problem.

We will just have to see how long that plays out. In fact the Fed joint agency guidelines seriously restricted liquidity for borrowers to either refinance or for people to buy homes. I am not making a judgment whether it was right, wrong, or indifferent.

It is just that that is what it did. And then combined with a volatile secondary market if you think about the perfect storm, that is the perfect storm.

Brad Ball - Citigroup

So it sounds like you are saying that what we are experiencing right now is not the product of irrational behavior like the subprime debacle that came upon us late last year, but rather the product of an industry with excess capacity and pretty intense competition and a market environment that looked pretty good at the time.

Angelo Mozilo

I think that is fair to say. I mean, even in the HELOC. If you look at the history of HELOCs by banks, I mean they, very often it was 100% LTV. When they came in out of piggyback, when somebody came in for a second mortgage on their home or home equity line. It is very common to provide that type of financing by banks. And in an ordinary market, it worked fine.

It's this sudden and severe and deep deterioration in values, and particularly in certain parts of the country, has really exacerbated. Any even minor judgment area you're going to make has become a major issue. David?

David Sambol

Yes, just some additional perspective on the topic. I agree with Angelo. Certainly hindsight being 2020, there are things that would all maybe do differently, but I think it is important to emphasize some of the things we did do and we are pleased that we did.

First, as it relates to the majority of our production, as you know, we sold all of the credit risk on the majority of the production, and that was the case in the majority of the Alt-A. Virtually all of the Alt-A production maybe with the exception of pay option ARMs, both fixed and adjustable rate, to retain no credit, retain interest.

We also sold last year a good portion of our subprime residuals, approximately 50%. We, as you now know, credit enhanced a significant portion of our held-for-investment portfolio in the bank.

And so we took a lot of actions to mitigate risk, and beyond all that, we of course, as I said at the time, priced, where we in the market and we liberalized guidelines, we sought to price for more risk and more liberalized guidelines. And much of that translated into fairly significant earnings over the last several years, where today only some of that is really now clawing back.

So that maybe gives some additional perspective on the topic.

Brad Ball - Citigroup

Thank you.

Operator

Your next question comes from the line of Bob Napoli. Please go ahead.

Bob Napoli - Piper Jaffray

Thank you. We have a different moderator today. A couple of questions. I guess, first of all, on the growth of the sales force in this environment is it, why do you feel that it is a good thing to be growing the sales force? There is overcapacity in industry.

Overcapacity finally seems to be starting to roll over. There is a lot of risk in the market, home prices are unstable. Yet, I think that Countrywide is one of the few companies that as been aggressively growing its sales force in this environment.

Angelo Mozilo

Yeah, Bob. The reason is, a lot of that is coming to us. The reason is that on the retail side, our investment and the costs associated with that sales force is very variable.

So the volume, the incremental volume, we pay them to the extent that they source incremental volume. And the incremental volume that they source is accretive to our bottom line, and it helps offset. It will help offset some of the pressures on earnings from some of the other dynamics that we talked about.

And so we are not paying big premiums applicable to the sales force expansion. We're not paying significant goodwill or big M&A premiums. It is coming to us organically, and the breakeven economics for new sales force hires is very compelling.
Several months after they're boarded, to the extent that they pass our filter, which they need to before we hire them, their contribution is accretive to us.

Angelo Mozilo

Bob, a couple things I think you should think about. One is that our market share, although rising 18%, 19%, as you saw this last quarter, in the retail sector it is very, very low. It is below 10%. And that is our most profitable, our most stable business.
We get repetitive business from them, cross-selling, refinances and insurance product. So it is very, very important that we take this opportunity, which is a rare opportunity to get high-quality salespeople into the retail sector to pick up our market share and to continue to grow the business.
The most stable part of the business we have is retail. And these people are very difficult to get when things are going well. So, as David pointed out, the economics for these people are very compelling.
The second point you raised, which is with deteriorating values and the danger of making loans today, it would seem to me that this is the time to be making loans when values are lower. Otherwise, you would only make loans when values are higher and always expose yourself to a deteriorating situation.
So that as values are going down and you stay in the business, sort of you're continuously building a better book of business, rather than just laying back, not playing in the game until values go back up and then get caught in that cycle again.
So you have to be in the game every day in a major way. I wouldn't, the capacity in the business is being driven out quite rapidly, as you will see over the next six months, as announcements are made as to people going out of business or just merging. Again, this at least historically has been an opportune time for us to strike.

Bob Napoli - Piper Jaffray

So we shouldn't expect to see any announcements out of Countrywide you're laying off 500 people or I mean, is that...

Angelo Mozilo

No, I think you could yes. You certainly there's two ways, two things you have to look at. You have to bifurcate Countrywide's operations. One is its sales force, the people who make something out of nothing, who create value by bringing in business.
And those who process that business, and that whole processing operation is driven by, the number of people involved in it is driven by the volumes flowing through the operations.
As that volume decreases you, by certain measurements, begin laying off people. So it is certainly, we are deeply involved right now in cost reduction measures. So that and our history is that we will, as you know, you have been involved with the company a long time, we will take the appropriate steps in terms of reducing personnel costs when appropriate.

Bob Napoli - Piper Jaffray

Okay. Just maybe some color on the gain on sale margins that you have in your outlook. If you can give some color on the volatility in the secondary market. I mean, the agency business, where, how are the margins in the agency business?
Is it are those margins stronger today? And the nonconforming business, how much of that would you feel comfortable holding on your balance sheet?

David Sambol

Bob, it's Dave. It is the case that the volatility that we made reference to today, and that which we anticipate, is primarily applicable to the non-agency business. And our forecast with respect to production margin again sale margin in the second half of the year was particularly adversely impacted by what we envision in the near term for the non-agency production.

And really, the reason for the forecast is the convergence of a number of factors that are creating what we see to be a very stressed second half, particularly the third quarter. We have seen recent trends on the application side, both refinance applications and purchase applications trend downward. We have seen, as interest rates have increased the latter part of the second quarter, and volume as new apps have fallen, increased front-end pricing pressures, competitive pressures on our margins, across the Board.

And then, most notably here in the latter part of the second quarter as Kevin mentioned, and the beginning part of the third quarter, this very material disruption in liquidity for non-agency related products and widening of spread will we believe have a material impact on the back end on our gain on sale margins, particularly for inventory that we carried into this environment from the second quarter.

We had a very healthy pipeline in inventory coming into the third quarter that is going to be subject to the spread widening stemming from what is occurring in the non-agency markets today. Really, we don't know when that will normalize and subside.

In terms of our capacity, we of course, in planning for a worst, for a stressed case, one where I think Kevin mentioned if we had to keep for all non-agency originations, all bonds below AAA, the approximate amount, Eric, can you give us some numbers on the approximate monthly volume of additional assets we would be retaining in capital that that would consume?

Eric Sieracki

Sure. Talking about subprime, HELOC, fixed-rate, second, Alt-A, and pay option ARMs, contemplating only selling the AAA, keeping all the securities underneath that credit level, the incremental monthly equity drain would be about $100 million. The amount of debt we have to raise would be about $600 million. That is incremental over our normal course of operations. That is a monthly level.

That is something that our contingent liquidity planning more than amply provides for. So, I wouldn't call it rounding but it is very easy for us to provide that additional financing.

David Sambol

Now, the impact on second quarter or second half, I should say, our production margins stems from the fact that even if we retain it, we have to mark to market. And so, we expect that margins will be impacted by the wider spreads, certainly on the inventory coming in.

We also as I mentioned, expect to sell less particularly, in the third quarter, and that maybe divert more to the Bank given this environment, which will adversely impact production margins. And all of those factors are converging and were considered in our guidance and estimate of second-half production sector performance.

Bob Napoli - Piper Jaffray

Okay, that mark-to-market would go through the gain on sale line for the inventory?

David Sambol

Yes.

Bob Napoli - Piper Jaffray

Just on the credit side, we got -- it seemed to accelerate obviously, in this quarter. As you said it was more of a HELOC issue this quarter, it was subprime last quarter. Fortunately, the job market has

been pretty strong through this. So, I wonder what it would look like if the job market starts to fall apart.

But do you see an acceleration coming out of this quarter into the back half of the year on the negativity of the credit statistics? And I don't know if you can give any color on the rate of trend of change in credit statistics that you see.

John McMurray

Well, I think you make a good point, Bob; the unemployment situation has been favorable. So, I do think if that was more adverse, we would see higher delinquencies and defaults.

Angelo Mozilo

I think that however, again, these numbers are averages. If you look at three states were there's very serious problems in Michigan, in Ohio, and Indiana, where the unemployment rate is very high. We are experiencing high delinquencies today in those three states.

Bob Napoli - Piper Jaffray

That was one of my questions as well the geography. How regional is the problem on the credit side?

Angelo Mozilo

I'm sorry, just generally speaking and I will let John do this, but I mean, where you have had high acceleration in prices, for example, in California where people stretched themselves to get into the home. As John pointed out in Sacramento, Fresno, Modesto, Stockton, you see high delinquencies for that reason.

In the states that I just mentioned, you see high delinquencies as a result of unemployment. In Dade and Broward County, in San Diego, as John pointed out, you see high delinquencies because of oversupply of condos and speculation. So, it is regional, but each of these regions have their specific reason, as to why we see exacerbated delinquencies. John, would you agree with that?

John McMurray

I would not only agree with that and let me just make two quick points. So, geography matters a great deal. The first region -- the first reason, it matters is with respect to home prices. So, we see big differences from MSA to MSA, even MSAs that are close to one another.

The second reason that geography matters is even after we adjust the effect of home prices out of the equation. We still see many geographies underperforming. So, the Midwest as Angelo mentioned, is an example, which doesn't show up on a lot of the charts as having a serious risk of a home price depreciation going forward. Still has very bad performance even after adjusting both for home prices and all loan attributes.

David Sambol

I would also point out that in the scenario, where the economy worsened, and we begin to see what has happened in housing spillover, the broader economy, and if unemployment picks up. The business, as I imagine, you know is subject to somewhat of an intrinsic hedge.

It is an inversely correlated risk, we have would suggest they know that the Fed in that kind of a scenario, would be motivated to maybe ease. And with an easing, we would expect a bond market rally. And with a reduction in long-term interest rates, the nature of our model is such that we believe that the increased origination volumes and profits will likely more than offset the increased credit cost in that kind of an environment. And so that is important to understand as well.

Angelo Mozilo

It just doesn't go one way, Bob. Dave is absolutely right, historically, that if in fact this does have an impact on the economy, unemployment begins to increase. The Fed would have to lower rates and that is the overall cure for all of this, lower rates.

Bob Napoli - Piper Jaffray

Last question, is any easy one. What was the ending fully diluted share count?

Angelo Mozilo

It's obviously not so easy (multiple speakers).

Bob Napoli - Piper Jaffray

Thank you. You can get back to me with that.

Eric Sieracki

We will announce that shortly, Bob.

Bob Napoli - Piper Jaffray

Thank you.

Eric Sieracki

595, 540.

Bob Napoli - Piper Jaffray

Thank you.

Operator

Thank you, sir. Our next question comes from the line of Ken Bruce, please go ahead.

Ken Bruce - Merrill Lynch

Good morning, thank you for the question. There is not a lot of encouraging news that we are hearing today. I was hoping, maybe to go back and get you to answer a question that you danced around with Bob but I think is important.

Could you reflect back to how much of your business is agency eligible, and what the pricing dynamic is within that market, please? And obviously, there is quite a bit of uncertainty, as it relates to the nonprime or the non-agency business.

But, if you could just maybe discuss what the implications are for your margins, with respect to prime. And how that business may reshape or begin to reassert itself in terms of the prime component of your business model going forward, please?

Angelo Mozilo

We understand the question. The question is how much of our business that we're doing is agency eligible?

Ken Bruce - Merrill Lynch

Yes, you said in the past about 75% is GSE eligible. I had hoped to maybe update that number and just give us some sense, as to what the pricing dynamic is there, please.

David Sambol

Okay. I would -- these are just rough estimates, but at the height of the housing and refi boom, the percentage of agency production in total production fell into the 30s, where the non GSE eligible production was in the 60s, maybe even approaching 70.

The agencies have since in the last several quarters, picked up dramatic market share. And our mix of business, the weighting has increased materially towards the agency side where today, between Fannie, Freddie, and Ginny eligible production it exceeds 50%.

In terms of the margins on that business, historically, the margins on the agency business were lesser than the non-agency business. Although, in a stressed environment where spreads have widened, mostly in non-agency. I would say the agency margins are superior to the non-agency margins over the last month or so, as a result, again of widening on the non-agency side.

But the agency business is affected, as is the overall volume that we are originating by competitive pressures that are increasing and impacting that business as well. So, margin trends are on the decline or under pressure, I would say.

Ken Bruce - Merrill Lynch

And do you see that generally speaking having any impact in terms of your prospective business, as it relates to just positioning, in terms of the different products that you're focusing on? I mean, if you look back over the course of the last few years, there has been such a profit-driven increase in the origination of some of these nonprime assets or these alternative assets that in many ways, that is ultimately kind of creating its own demand.

And as that market goes away, because of the dislocation in the capital markets, are you seeing an increasing interest in that GSE product that different maybe, in terms of margins. But just in terms of stability is going to be a very different marketplace going forward?

David Sambol

Yes, very much. One notable area, where we are seeing a material shift in mix emerging is in the government side. We have seen over the last several months, and quarters, the FHA business growing in fact, it has doubled. While it's been very stagnant and really very immaterial, it is still not hugely material to us. It is a 5% of our overall volume, but it was as low as 2%.

And I think the FHA programs, are growing in popularity with the decline in the declining offerings in the Alt-A and subprime market. So, that is a trend that is notable to mention.

In terms of our posture, I think somebody mentioned that the best way to look at countrywide is somewhat of a supermarket. We offer all products that are otherwise appropriately or legitimately offered in the marketplace, and we don't try to direct or divert people necessarily into one product versus the other.

We just provide for a complete menu except in educating our customers, as to the pros and cons of the alternatives available to them. And just market forces right now are such, that business mix is shifting towards the agency products, government and conventional.

Angelo Mozilo

Let me just intercede here. Two things, one, Bob Napoli's question was not answered correctly.

He asked for the ending shares at the end of the period outstanding, and we gave him the average number. We'll get back to him on the ending number of shares.

In terms of the agencies, Fannie and Freddie would love to take this opportunity that they have, which is a unique opportunity and play a much more compelling role in taking in more product. But they do have despite the tremendous improvement in performance in both of those entities, they still are laboring under restrictions from their regulator.

And therefore, even though they are willing and able to participate more in this market, take advantage of the situation, at least at this juncture, unable to do as much as they would like to do.

David Sambol

You know Kevin Bartlett, our Chief Investment Officer just handed me a note to convey that while I mentioned that slightly over 50% of our volume today, or in Q2 was agency eligible. If you include, that does not include agency eligible Alt-A, and if you include agency eligible Alt-A, the number that we're delivering to the agencies is closer to 70%. It's 68%.

Ken Bruce - Merrill Lynch

Okay. Thanks, that's closer to the number you had mentioned earlier this year. Maybe one other piece of color from Kevin. Is there a time frame that you think is going to be required to have the secondary market begin to calm down or otherwise distill what the S&P ratings changes are, and ultimately might suggest what this dislocation or at least in tenure what the duration of this dislocation in the capital markets may be?

Kevin Bartlett

Yes, sure. I think the first thing that we need to have happen is that the rating agencies need to clear up the uncertainty that relates to how they are going to rate different loan programs going forward.

The one area where we have a little bit of certainty is on the subprime area. But the other products, I think, they are still open. And so we need them to clear up their uncertainty.

And then the next thing is, I think, once the new deals are rated by the agencies, and they come into the market, I think the market is going to see that the greater level of protection afforded by their new levels will make the new securities more attractive. And I think the market will come back for those securities, and probably become somewhat bifurcated from kind of post-rating agency changes and pre-rating agency changes.

So I think the market will probably separate and the new stuff will eventually find either the traditional buyers of credit, which I mentioned in my remarks earlier, the banks, insurance companies, money managers etcetera.

And then perhaps, we'll see some reformed CDO machine that rehabilitates itself for the future. But at this point, the press on the CDO machine is not real positive.

Ken Bruce - Merrill Lynch

Thank you for all of your comments.

Operator

Your next question comes from the line of Samuel Crawford (ph). Please go ahead.

Samuel Crawford - Analyst

Thank you for taking the question. I wonder if I could get just a brief idea of how important fraud has been in the course of this quarter, as a cause of loss relative to Q4 or Q1. Is it just as relevant? Is it dropping off precipitously? Is it increasing? What's happening?

Angelo Mozilo

Well again, I think like all of these definitions, they are very broad. I think the primary issue has been issue of speculation, rather than fraud. I'm not saying there hasn't been some fraud in the traditional, where people just crooks got involved in totally fraudulent transactions, straw buyers and that kind of thing. I think that appears to be de minimis.

It's really where people have given us information in terms of a variety of issues that where there really their intention was always to speculate on the properties. And I think it's more of this speculation issue, which the builders try to address, the homebuilders in their contracts, which was deemed to be unconstitutional, and they couldn't do that.

But in these condos, particularly in the condo area, there's a lot of speculation. And I think that's where the, I think history, we will only know a couple years from now, but that seems to us where the problems are, more than the speculative area. Would you agree with that, David?

David Sambol

Yes.

Samuel Crawford - Analyst

Okay, and you...

Angelo Mozilo

Now obviously in terms of your credit question, about has it slowed down, I mean, I think, it's probably nonexistent today, because everything has tightened up so much, that everybody's antenna has been so sensitized to all the possibilities here, that it's pretty hard to get through the system now if you're not telling us the truth.

Samuel Crawford - Analyst

All right. You all have tried to speak, I think very clearly about the situation in regards to resets. But I'm afraid, I'm still a little lost as to where countrywide finds itself in the process of absorption.

If you think back to the portfolio as it stood at the beginning of 2006, and you look forward from that date, the historical portfolio, and you look forward to the resets this summer and the resets again in

2008, the two bunches, of those resets is it possible to give us an idea what portion of that original early 2006 portfolio has by now refinanced itself out of the way of danger?

Angelo Mozilo

Yeah, we can, I think. Do you have that number? And I think...

John McMurray

Are you speaking of subprime or...

Angelo Mozilo

No, no. Total.

Samuel Crawford - Analyst

I think, I was talking about total, but you know the rubber hits the road on subprime.

John McMurray

Typically, typically what, the behavior that we've observed over many years is that most borrowers do refinance prior to the reset. One of the worries that we have going into this environment is there may not be as many programs for the borrowers to refi into as had been the case in the past.

But so far, going up to the point now, we still see a substantial number of the borrowers refi-ing prior to that point.

Angelo Mozilo

Do you have the percentage? We had a percentage at one time that I was using in terms of the 2006 book that had refinance. Do we have that number?

John McMurray

Not handy. You know, when we take a look at the remaining loans, in any given vintage, after the reset and within the six to 12 months after the reset, it's a very small percentage of the original balance.

So that's the vast majority, the overwhelming majority of the original book will have refinanced out or otherwise paid off. The exact number I don't have. Do we have factors, though?

Angelo Mozilo

We're looking.

Angelo Mozilo

Okay, we'll give you that as soon as we find it.

Samuel Crawford - Analyst

All right, I'll come back around for that. One very last question if I may, please. When S&P took its most recent ratings action, some of the press releases that they put out in connection with that action, struck me that while they weren't saying explicitly this, they were substantially saying this that they felt they got so far outside of the realm of normal experience with certain types of assets that their models simply were irrelevant. They had to go back and redo the whole thing.

And I am just wondering if you felt like they did encounter, was that your impression as well? They encountered that degree of model risk, and it shocked them so severely that they basically just started tearing up method and going back to rewrite?

And did you all encounter anything in your scoring or your advanced modeling which surprised you with equal drama in terms of unexpected model risk that appeared?

Angelo Mozilo

I think your S&P question, and not to skirt, I don't really know the answer to that. Because I don't know what emotional trauma they went through or what their conclusions were, and why they came to those conclusions that caused the actions they have taken.

I think it seems to me the obvious conclusion come to is that the models were not working the way they thought they were going to work. And they began the process adjusting those models.

So, that they performed in accordance with what their expectations were. But that seems to me to be the case. But I don't have the insights into that, do you? Into what caused them to do that?

Kevin Bartlett

I mean, this is Kevin, I think, that the rating agencies were looking at recent performance, in the context of the housing decline. They're concerned about, I think you've seen this in the press and also directly in some of their publications. They're concerned about the '06 to early '07 vintages of loans. And I think, when they saw the performance of those loans versus their models; they are make -- they are trying to make appropriate adjustments to those models to reflect their new views.

David Sambol

As we have by the way and I think, it's safe to say, this is Dave Sambol, that with credit having liberalized in the market, in the last several years, with higher LTVs and limited documentation, and the combination of those things.

They really had not been for our models or for the rating agency's models very much in the way of historical empirical. For that kind of product going through such a significant HPI decline, home price decline; with which to accurately develop models.

And as empirical data has now presented itself; I know in our case, and now certainly, based on what the rating agencies are saying in their case. Everybody's models have or are being adjusted accordingly.

Angelo Mozilo

Including corporate debt, I mean, as I think about it, and reflect upon it. It's been common knowledge, at least among observers that it appeared that the market, in all debt categories, whether it'd be corporate debt, or home finance debt. They were not pricing for risk. You can see all those adjustments are taking place now, throughout the entire debt universe.

Samuel Crawford - Analyst

It's all right.

John McMurray

We can dimension the resets for you. So, in the prime sector 24% of the loans to be reset in 2007, and 35% scheduled to reset in 2008; are still currently active. And that would compare to 30% and 38%, at the end of Q1.

In subprime, 36% of subprime loans scheduled to reset in 2007, remain active. 60% scheduled to reset in 2008, remain active. And that compares with 37% and 66% at the end of the first quarter.

Samuel Crawford - Analyst

That is very helpful. Thank you very much, John, thank you all for your time.

Operator

Your next question comes from the line of Gary Gordon. Please go ahead.

Gary Gordon - Portales Partners

Okay. Thank you. In light of your outlook for credit I thought about your captive insurance, reinsurance business. And how you are treating that. Any particular changes in the business? Specifically MGIC, had about 45% of its loans insured in the second quarter, or 100% LTV. Is your reinsurance in Q2, have anything like that kind of 100% LTV proportion?

Angelo Mozilo

I think, first of all, it's important to understand that the level of risk, we're taking. We're taking the mezzanine risks. So we don't have the first loss nor do we have the cat piece. We have the middle piece of it.

Now, in terms of your question about the type of loans that we reinsured, do you know? If you have that.

John McMurray
The type of loans that we reinsure will cover the whole spectrum. So it would include some of the 100% that you are talking about. Although, I don't know whether it's as high as the figures that you quote for MGIC.
This high LTV business along with the high CLTV business that we talked about earlier, is going to be subject to, and in some cases has already been subject to the cutbacks that we described. And I would anticipate, the mortgage insurers tightening up their guidelines as well.
David Sambol
Again, I would also add by the way that we only reinsure in our reinsurance entity, primary mortgage insurance and not pool insurance of the type that MGIC and others write.
While, I am not certain, I would guess that if there was that high percentage of 100% LTV financing that they insured, it must have emanated in material part from pool insurance policies they wrote. Because 100% financing in the primary MI business would represent, I think John, a small percentage, would it not?
John McMurray
I believe that's the case. The other important point, just to piggyback, on Dave's pool insurance comment. Many of the pool insurance policies are written are called modified pools. So they will be subject to a loan level stop loss. So they're still pool-style coverage. But oftentimes, some of the insurers include that, or report that at least, as primary business, or they have in the past.
Gary Gordon - Portales Partners
Okay. Thanks. On subprime, just to check some numbers. The residual, the subprime residual; your residual balance grew by $31 million, so far this year. I believe your write-downs are $256 million. So the math would say $287 million of new retained residuals. Does that number sound about right?
John McMurray
It sounds close. All of the increase between Q2 and Q1 relates to new deals. In fact it is probably more than all of the increase between Q2 and Q1.
Gary Gordon - Portales Partners
Okay. And one last question for Angelo. You assume that the industry should see some consolidation or shrinkage in light of shrinking demand, tough competition. The industry is fairly concentrated at this point.
The top 10 players, I think, are 70% of the business, which would argue that to really get a capacity shrink you would need to see some of these big players pull back in a material way. Is that your assumption?
Angelo Mozilo
No. Let me just break it down this way. I think that about 50% of the originations are from mortgage brokers or small mortgage bankers. I think, clearly, most of those, many of those, are going out of business today.
They are fed into what you just talk about the 10 top players. But, even if you look at the 10 top players, some of those, there's been public announcements about problems among the top 10.
That I believe that, what you're going to see over the next few years, is a concentration down to five. And they are the five major players today. At least, that again, I could be wrong on all of these things. But, I am just seeing continuous consolidation. Several years ago, I said it'd be about 10. It is about 10 now. And I think, we will get to five for two reasons. One, it's increasingly becoming a more complicated business.
It requires a lot of capital scale to make this thing work. And so, I think you can see further consolidation in the mortgage-banking portion of the 10 players.

And you've seen it, in terms of Wachovia and World and Fleet and Bank of America and all big players at one time. I think nothing is out of the realm of possibility, in this environment. So, I think you are going to see further capacity shrink, even among the top 10 players.

Gary Gordon - Portales Partners

Okay. Thanks.

David Sambol

Also, I think you'll be seeing more of this from us in future disclosure, when we talk about market share. But, what we're going to seek to do is increasingly clarify the components of our market share and what's happening, I think also in the market relative to consolidation.

And the way we look at market share internally, is separately when we look at our originated share, which is our wholesale and retail operations, and that share, by the way, today for us, is a number less than 10%. So, a little bit above 9%. Earlier, Angelo was talking about the retail-only share, that number is slightly above 5%.

And so, we look at our share in the market separately, and what we described as originated share, which is wholesale and retail, and then purchased share, which represents our correspondent business and our capital markets conduit purchases, and the bulk purchases that our Bank does. That's what gets our share up to the 18% that we quote in the aggregate.

But if you looked at the market and the share of the top 10, just on the basis of originated share, you would see that that number is still below 50%, and not 70%. Suggesting that there is a lot more consolidation in the origination market than what would be implied with a 70% number for the top 10 players.

And for us, by extension, a lot more opportunity than what might be apparent if you looked at the 20% number. Considering that where we expect share growth for Countrywide is to come from the higher margin originated, or origination channels. Excluding our purchased and lower margin business there.

Gary Gordon - Portales Partners

Okay. Thanks a lot for that, take care.

David Sambol

Thank you.

Operator

Your next question comes from the line of Adam Weinrich. Please go ahead.

Angelo Mozilo

I guess, Adam is out dancing. Can we go to the...

Operator

We will move on from the line of Howard Shapiro. Please go ahead.

Howard Shapiro - Goldman Sachs

Hi. Thank you very much. I just wanted to ask two questions. The first is on the decision to keep all of the residual securities or all the bonds below the AAA. Given your share price today, it just passed below $30 a share.

You've got to think that the IRR on retaining these assets is significantly higher than repurchase. So I'm wondering if you can share with us even approximately what you think the IRR on those investments would be? Then I do have one follow-up.

Kevin Bartlett

This is Kevin. I think first of all, I think, Howard the, what we plan to do is, we are reacting to the secondary market to the extent that there is still uncertainty posed by the rating agencies in their approach to new transactions. We anticipate holding the below AAAs to the extent that they can't be distributed at attractive levels.

And I think if we look at the levels that we think that we would retain them at, we are going to see ROEs in the North, probably North of the high teens to very high returns, depending on which particular bond class we are retaining.
So part of it's just in reaction of the secondary market. And what we will do is we are going to adapt as the market returns in terms of the liquidity of those particular bond classes. We will distribute them when it makes sense to do so.

Howard Shapiro - Goldman Sachs

Okay. And just the other question, just to clarify. When you value your residuals, are you essentially using a mark-to-market methodology or a mark-to-model methodology? Could you just explain?

Kevin Bartlett

Well, it's a bit of a combination of both. I mean the assets are carried at market value. And the way we do that is we approximate it by using models that many in the industry would use as well. We use discount rate, speeds and loss assumptions that we believe the market would employ.

Howard Shapiro - Goldman Sachs

Okay. So then I mean given the lack of liquidity in the market today, how comfortable are you with your model?

Kevin Bartlett

I think, with the most recent loss in prepay estimates and discount rates I think, we are comfortable.

Howard Shapiro - Goldman Sachs

Okay. Thank you very much.

Operator

Thank you. And next we'll go to a line of Jim Fowler. Please go ahead.

Jim Fowler - JMP Securities

Thank you. Two questions, please. Kevin, could you give me the subordination levels of the AAA across the broad mortgage classes that you'll be retaining?

Kevin Bartlett

Yes. Sure. It kind of depends on the product. You know for Alt-A, depending on the like on the hybrid side, you are probably in the 7% area. In the fixed Alt-A, you are probably at, I would say, let's call it for the Alt-A stuff that is hybrids, probably in the mid 7s to low 7s, low to mid 7s.
For the fixed-rate stuff, you are probably around 7%. For the subprime, I believe it's, we are probably in the 17% range. In the HELOCs, it's, we will probably hold that stuff in the HFI portfolio. So it's going to be the capital that's required by the rating agencies. Not so much the subordination requirements. In the pay options it's around 12% that is the support level for AAAs.

Jim Fowler - JMP Securities

Other than the subprime, are there over-finalization accounts required in any of these? Or are these just principal subordination levels?

Kevin Bartlett

Those are principal subordination levels. If you want to look at subprime, you would add around, it's about the same level that you would see on the balance sheet for residuals.

Jim Fowler - JMP Securities

Okay. And then one question more broadly, please. You made mention earlier on in the conference call on modifications. I think you noted 2,000 in the month of June. I'm wondering a couple of things. Specifically, is there a type of modification that you are finding, that you're using more, such as deferment or capitalization of unpaid or rate and term adjustments? Just some thoughts there.
And then secondly, I'm wondering if since these loans haven't cured up until foreclosure, what is it that's being modified, so that the foreclosure doesn't -- isn't just pushed into the future, I guess is a

clumsy way to say it? What is it that you're doing? What tack is generally being taken that you think will change the prospects at the borrower level that your collection and curing attempts from 30-day to 90-day hasn't been as successful? Thanks for the answer.

Kevin Bartlett

Most of the modifications do represent the first two categories I think you mentioned. They represent a deferment of past-due interest or capitalization of the past-due amounts. And to a far lesser extent in fact it's not very material at all the percent that represent interest rate reductions.

And the criteria that we use when we decide to modify is an assessment of the borrower's condition and our conclusion that we believe that, in effecting the modification, the borrower would in fact thereafter have the wherewithal to pay as agreed on the modified loan.

And we make that assessment by getting our hands around. The reasons for the default, what's happening with the borrower's income and we only will effect the modification if we believe we are not just delaying a lot.

Operator

Thank you. Next we'll go to the line of Michael Harkins (ph). Please go ahead.

Michael Harkins - Analyst

Angelo, I'm one of your biggest fans. So I don't mean this to seem impertinent. But you are 68 years old. Aren't you tempted to just sell this asset let somebody else fix it?

Angelo Mozilo

Yes. Absolutely.

Michael Harkins - Analyst

Okay. That was my question. Thank you.

Angelo Mozilo

If I wasn't so emotionally attached to this Company and the people in it. It's a difficult time for all of us here at Countrywide. But I do have moral responsibilities to the shareholders, to the people in the Company, first, I think. And I do have contractual responsibilities.

And it is important that I continue to carryout those responsibilities. And I will. And we have a very good team here. We have been through a lot before come out of it always stronger. And I believe we will come out of this stronger even stronger than we ever have in the past, because we are a much bigger, better Company than we ever, ever have been in the past.

Michael Harkins - Analyst

Thank you.

Operator

Thank you. We have a question from the line of Jim Delice (ph). Please go ahead.

Jim Delice - Analyst

Hello.

Angelo Mozilo

Hi.

Jim Delice - Analyst

Hi. I had a question, looking at the presentation you had a category in there I'm unfamiliar with seeing, which is the reserves for reps and warranties.

Angelo Mozilo

Okay. Do you want us to explain that?

Jim Delice - Analyst

Well. I guess my question is, has it been there before and I just glossed over it? Or is this something kind of after the thing has been sold for a while after the EPD period has ended, there is still some contingent liability that we have to reserve for?

John McMurray

Well. First of all, it has been there before in fact we've talked about it in the last quarter supplement. So the way that works is the, that reserve is accrued at the time the loan is sold. And it's going to fall into two categories. The much smaller category is EPD and that tends to, that liability tends to turn over fairly quickly.

The majority of that, rep and warrant reserve are for the rep, representations and warranties, we make as part of our securitizations and whole loan sales. So again it's accrued at the time that, it's first accrued at the time that the loan is sold or securitized and then each period it's trued up.

Angelo Mozilo

Before we take the next question, we have been in the conference here for two hours and 40 minutes. And we appreciate and respect the desire of the remaining 509 people still on the line to answer their questions, but we do for your sake have a company to run. So we will go another 20 minutes that will put us exactly 3 hours on, to answer questions. Hopefully, most of your questions at that point will be answered, the next question?

Operator

Thank you. We'll go to the line of Larry Rittel (ph). Please go ahead.

Larry Rittel - Analyst

Hi, thanks. You were speaking earlier about the prime and also the subprime loans from, that are still active that still need to be reset. And I'm wondering and maybe you addressed this earlier and if you did I apologize.

But I'm wondering with you all and some of the other lenders taking the 2/28 product off the shelf where will these borrowers go? Because they obviously won't be able to afford the higher reset rate, what are they going to do? Where will they go to...

Angelo Mozilo

It is not good news; I mean it's a very good question you're asking its problematic. The secondary market, first of all the joint agency guidelines attacked that first because they have to be qualified it fully and that's great. We sort of took it out anyway, and then the secondary market backed up on that product and therefore on the 2/28s and the 3/27s.

You can see a couple of companies have announced, major companies announced eliminating that product, but they have, these are people who got the home under one set of rules. And in the middle of the game the rules have been changed on them, that's why we're trying to use modifications, we're trying to use every tool we have available to see if we can refinance them in some other product that is affordable for them, but that's the crux of the issue that we face with these people who have not yet refinanced.

Larry Rittel - Analyst

I mean its no secret Angelo, that this train is coming, and I'm just wondering the extent to, which you all have analyzed the pipeline if you will of resets coming at you. And figured out which, what percentage will be refinanced into another product, I am not sure what product, but any products. What percent will be modified, and so on? If you could help us understand that that would be great.

Angelo Mozilo

Interest rates are at the time we go to reset. But I think, John answered that earlier, But give the corollary of that, what yet of the, let's say, '05 and '06 vintage of the reset loans are going to reset in '07, '08, rather, are yet had already refinanced. What percentage? Is it 60%?

John McMurray
Its on the order of two thirds have refinanced already, And just...
Angelo Mozilo
So, I understand it's about, it's only one third of it is left, so, you can't. The mistake made by everybody including the press here was to take the entire book of business originating in '05, and the entire book of business in '06 made it static.
And said that that is going to reset in '08 and '09, and its not because people have moved very quickly to refinance themselves. Out of that into some other product that made some sense for them, so its one third of that book, that we are looking at.
John McMurray
Yes. And let me share some other rough numbers with you, so on subprime hybrids. As we just pointed out most of them do refinance before the reset, and so if we look at those that refinance approximately 50% of those borrowers refinance into a prime loan, of the remaining 50%.
25% refinance into a subprime fixed-rate loan and then the remaining 25% rolls back into another hybrid. So, it's that third category that would have ordinarily rolled back into a hybrid, that we are particularly concerned about because those programs are going away. We have already eliminated the 2/28; and the 3/27 seems to be vulnerable at this juncture.
David Sambol
But our exposure, this is Dave Sambol, it is important to emphasize because we talked about modifications. That our exposure is mitigated by our view that for those borrowers that have the wherewithal to make the current payment before the reset and the desire to stay in the house
We believe that either through in their case through a refinance, if they have equity and or, if they have credit, or through a payoff; or through a modification that they will be able to stay in the house. And that the losses associated as a result from resets will be dampened.
As a result, of at least in our case. Our own modification strategy and so it's not the case that because 3/27s and 2/28s, are not available that necessarily translates into a loss to us.
Larry Rittel - Analyst
Okay, okay, that's helpful, and then. And if I could just quickly ask you about what you see coming in the Alt-A market. I guess there are some new guidelines coming out, what do you think that might do to volumes?
David Sambol
Yeah. It will further reduce volumes the interbank regulators did recently publish new guidance applicable to subprime lending, in fact the subprime ARMs specifically. And the two notable things, which have an impact on volume in those guidelines, were the requirement that subprime ARMs be underwritten at the fully indexed and fully amortizing rate.
And the second notable change was a guidance that would effectively limit what could be offered in stated income loans to subprime ARM borrowers. The impact of both of those provisions of the guidance will without question reduce subprime volume in the market further.
It is our estimate that the reduction would be in the, will likely be in the neighborhood of say 25% without considering other factors. Such as further tightening and spread widening and associated increases in interest rates, which these wider spreads are translating into that will further put downward pressure on volume.
The other aspects of the guidance are things that, such as clearer disclosures, which in our case. We have, had complied with even before the guidance for the most part, and some restrictions on prepayment penalties. And when they need to expire the impact of which we don't believe will be material.

Larry Rittel - Analyst
Did you see, do you foresee an impact from the guidelines specifically on Alt-A? I may have misspoken.
David Sambol
The guidance did not cover Alt-A. Although another notable environmental factor worth mentioning is that, currently the Federal Reserve is considering, and they are holding, hearings and meetings with industry groups for the stated objective of maybe announcing some changes to their rules and regulations.
Including changes to what they call HOPA, the Home Ownership Protection Act and possibly the Truth in Lending Act. And we understand that the Fed is considering maybe making some rules that might impact us prepayment penalties and disclosures themselves.
And stated income loans, is something that they are considering. And so, its possible that that might have a downward impact on volumes as well. We are very supportive by the way of these actions that the Fed is considering. Particularly because, I think they're motivated to make sure that whatever the rules in the marketplace are applicable to all lenders not just regulated institutions.
Larry Rittel - Analyst
All Right. Okay, terrific. Thank you very much.
David Sambol
Thank you.
Operator
We have a question from the line of Mike Hill. Please go ahead.
Angelo Mozilo
I think we go to the next one.
Operator
We have a question from the line of Mike Hill. Mr. Hill, your line is open.
Angelo Mozilo
He's not there.
Operator
Okay. We'll go to the line of Satesh Pull (ph). Please go ahead.
Satesh Pull - Analyst
Good afternoon. I had a couple of questions; the first was based on the supplemental presentation that you kindly provided. I'm looking at page 6 where you look at, where you sort of give us some detail on your portfolio composition?
Within that I guess what I'm looking for drawing from our experience overall on the subprime sector is whether you could give us any detail on what the rating agencies like to call layered risks, how much of the loans. For example in pay option, Bank HFI that have a FICO less than 660 or less than 699 also have a high loan-to-value and also have a low doc. That kind of thing and would it be possible at some point for Countrywide to provide us with that kind of detail?
John McMurray
Well. It might be possible at some point in the future. We'll have to reflect on that, but two important things to keep in mind. So, the way the guidelines work is there are generally trade-offs, so while you will have some layered risk, the guidelines are going to restrict certain dimensions.
So, as an example, the lower that you go in terms of FICO, the less likely, for example, that you would be able to get a high CLTV and a low-doc loan, so that's point one.
Point two is that our automated underwriting system and in particular our quantitative scorecards are designed to assess this layered risk, so there will be mathematical trade-offs within that scorecard

when that loan is running through automated underwriting. I said only two points but I will go ahead and make a third.
The third has to do with risk-based pricing. So, as additional risk factors are layered onto a loan, it is generally going to have a higher price. The borrower is going to pay a higher rate or higher discount points in order to have that risk layering.
Satesh Pull - Analyst
Fantastic. Thank you. If you don't mind, I have a sort of slightly different question. In the recent fixed income investor presentation, you did mention that you were looking to migrate a lot of your funding from CHL to CFC.
Now, given the fact that you are looking at much higher financing requirements going forward. Do you feel a need to review any of those financing plans at all, even if they are sort of medium-term, long-term financing plans?
Angelo Mozilo
I think you mean to the Bank.
Satesh Pull - Analyst
Yes, that's right.
Eric Sieracki
Well. I am trying to understand your question in the context of us migrating to the Bank. Your thought was we are going from CHL to CFC. I can give you some overview comments on our liquidity. But, we're certainly not going to have any issues funding the Company.
We have a very conservative liquidity management philosophy; we have adequate diversified and reliable sources of liquidity available. The pressure point would be short-term funding. We've got $95 billion of short-term liquidity funding sources. At June 30, $76 billion of that $95 billion was available and unused.
The Bank represents another highly reliable source of liquidity. They had an additional $27 billion of unused liquidity at June 30. In terms of contingency planning for the situation you referred to we contemplate slower turn times, holding securities below AAA, limited market access, etc.; and we still have plenty of liquidity cushion.
We have a policy of pre-funding our term debt. And quite candidly we do not need to issue medium-term notes again in 2007 if we choose not to. Probably, the last comment I would make to comfort you is that our short-term spreads were totally unaffected at our ABCP conduits.
We've funded our normal CP this morning and there was no friction of any kind on price, size, or term of issuance. So, we have abundant excess capital in terms of equity and we have tremendous liquidity sources to fund ourselves through this situation. And we feel very, very comfortable about our liquidity scenario overall.
Satesh Pull - Analyst
Thank You.
Eric Sieracki
Hope that's helpful.
Angelo Mozilo
Next question.
Operator
There are questions from the line of Ronald Redfield (ph). Please go ahead.
Ronald Redfield - Analyst

Thank you for taking the call. You retain greater MSRs than anticipated, and you explained that, did that lead at all to increased gain on sales? Are you seeing requirements to retain greater MSRs from the securitizors? That's my first question.

Angelo Mozilo

I didn't hear the question.

Angelo Mozilo

The question is on the, we have increased MSRs; the cause of the MSRs is a result of a desire on our part to do that with the kind of securizations that we are doing.

Ronald Redfield - Analyst

Or is it a requirement by the securitizors to have you hold more of the risk? Is that increasing your gain on sale, as if you would get a lower price if you didn't carry as much MSRs, would be my first question?

Kevin Bartlett

Yeah. Let me address this. This is Kevin Bartlett. There is no requirement on the part of the securization vehicles to retain more or less excess. Most of what we did in the last year really related to our desire to invest in excess by virtue of retaining it through the securitization process, which was an option on our part.

Our views at the time and I think, we talked about these many times before, was that our access investment was in part due to the desire to basically not invest too much in credit risk over the last six to nine months and more to invest in those assets that would benefit from a slowdown in the housing market. Meaning lower prepayment speeds, so it was purely an option on a perspective, from our perspective.

In the second quarter, we retained slightly less excess as a result of the market really realizing that housing price, the housing market was slowing down, the speeds were slowing down and as a result the spreads required by investors to buy interest-only securities decreased dramatically during the quarter.

And as a result towards the end of June and during June, we sold some of the excess that we would have ordinarily retained in the current market.

Ronald Redfield - Analyst

Maybe, I am ignorant here you have $20 billion of MSRs and you already indicated like $300 million or $400 million were subprime, so the other is non subprime, Alt-A or prime. If they start going, if the vintages start going bad you are the first to suffer, right? You cover that before the pools get hit, the tranches that...

David Sambol

I think you had a little misnomer.

Angelo Mozilo

Residuals in MSR.

David Sambol

There are residual interests on our books which are by and large, there is a caveat to this, but by and large first loss positions, that would be that you would see those as the home equity residual interest in the BC, subprime residual interest.

But, the primary servicing is in the senior position. So, you are paid to service the loans, and so, there is no real credit exposure to those assets other than a slight credit exposure in the sense of increased expenses to support the increased delinquencies that we might have.

Ronald Redfield - Analyst

What is the total amount at risk concluding prime?

Angelo Mozilo
Somebody's got that number, it is probably 1 billion-ish, right?
Ronald Redfield - Analyst
Okay, a billion-ish is great, no problem, can I ask a few others?
Angelo Mozilo
No, we are limited here and there's other people on the line if don't mind. You are welcome to call...
Ronald Redfield - Analyst
I think they are very pertinent for shareholders. It will be very quick.
Angelo Mozilo
Okay.
Ronald Redfield - Analyst
Were there any buybacks during the quarter? And do you find Angelo, with all respect, you selling a material amount of shares into buybacks? You previously mentioned you own 10 million shares. How many shares do you currently own, not including options?
Angelo Mozilo
I don't know the answer to that question. I own, including options I think, it's around 11 million, 12 million, something like that. The sales of the stock had nothing to do with buybacks because that 10b5-1 agreement was made well over a year ago.
Ronald Redfield - Analyst
No, the legality is fine, but one can think that perhaps the price is being held up the buybacks creating a demand.
Angelo Mozilo
Yes, well, if you think like that, I don't think like that. The buybacks were done because we thought it was in the best interest of shareholders. I have, as somebody pointed out, I'm 68 years old, I own a lot of shares and I have 10b5-1 that's in process right now.
That is selling into this market when the buybacks are not holding it up. So, it's an independent issue that's not relevant to buybacks or not buybacks, it is a personal situation that I'm selling into a market no matter where the price of the stock is.
Ronald Redfield - Analyst
Okay, you mention that you guys will come out stronger than ever like you have always in the past. Have you ever had before in excess of 12 times assets to equity? Which is in other words heavy leverage?
Eric Sieracki
Our leverage is a result of the mix of our different businesses. Different businesses grow at different rates. We have very high leverage in our capital markets unit, we relatively high leverage in our Bank. Historically low leverage in our insurance subsidiary.
So, it's going to be a dynamic organism as the organizations grow at different speeds, you're going to see our leverage change. Our leverage within each of our business has remained relatively constant, as the mix of assets owned by those businesses changes, the overall leverage changes.
Ronald Redfield - Analyst
Okay, thanks.
Angelo Mozilo
Next question?
Operator
There is a question from the line of Christina Amon (ph). Please go ahead.
Christina Amon - Analyst

Thank you very much. I wondered if you could comment a little bit? I know that the Countrywide Home Loan entity has been mentioned a few times on the call. I wonder if you could just give us kind of an update on the progress. I know that there had been some talk about focusing more on the Bank as a funding vehicle going forward; and just kind of wondering what that means for the future of CHL?

David Sambol

Sure, our expectation is -- and our desire is -- that at some point for the majority of our mortgage operations to be conducted under the Bank, and the majority of the balance sheet to therefore reside in our Federal Savings Bank.

We still, though, anticipate an entity, CHL, that will survive and certain activities and balance sheet will reside there. But it will be a small percentage when everything evolves as we desire, relative to what is in CHL today.

Christina Amon - Analyst

And then just a quick follow-up, in terms of your plans to issue longer-dated paper out of CHL versus CFC. Any thoughts on that?

Eric Sieracki

There are a number of considerations as to where we will issue out of, as you know, for the first 10 years of issuance, it was CHL as issuer guaranteed by CFC. More recently, CFC has been the issuer. There are many issues attendant to the integration of the Bank and CHL that cause us to rethink that. It is entirely possible that you will see CHL as the issuer in the near-term future.

Christina Amon - Analyst

Okay, great. Thank you very much.

Angelo Mozilo

Okay, we will take one more question.

Operator

Thank you. And next we'll go to the line of Tom Atteberry. Please go ahead.

Thomas Atteberry - First Pacific Advisors

Yeah, I just want to get a clarification so I have a better understanding. Could you go through sort of using your '05 and your '06 vintages and define for me prime, as you have a prime loan defined, as it relates to FICO and loan-to-value and those sorts of issues.

I know you had commented that there is a wide disparity of those numbers. If you could sort of give me the high and low range, so I get to get a picture of what that prime borrower -- or how you define that prime borrower -- looks like from a statistical standpoint.

John McMurray

Certainly. This is John. Let's turn over to page 4 in the supplement, because that will help a little bit. But the way we define prime versus subprime is based on the program that the loan comes in under. And so, there are a couple key areas that would demarcate prime from subprime.

One is the bankruptcy and foreclosure seasoning on the borrower. So if they have had a foreclosure or if they had a bankruptcy in the past, how much time has passed since that has happened. So in some cases, no matter how high the FICO might be, if one of those events was fairly recent that may preclude the borrower from getting prime in many cases.

Another detailed credit requirement is mortgage history. Under most prime programs, a borrower is allowed to have one 30-day late with an explanation in the past 12 months. If they have got more than that that will sometimes take them out of contention for a prime loan.

The third area would be the combination of leverage, documentation, and credit background. So the more aggressive product offerings are going to tend to be in subprime rather than prime.

If we look over on the top left of page 4 in the supplement, I have got odds ratio lines drawn for the different product types. So the copper colored line represents subprime, and you can see that that ranges all the way from FICOs in the mid 400s all the way down to the lower right to FICOs in the high 700s; so a tremendous range there. Those are for first lien subprime, by the way.

The dark blue line represents prime. So for the most part, it overlaps the FICO range of subprime, although it stops a little short. And then you can see the seconds as well.

But anyhow, it's a long-winded response to say it's the program that determines whether it is prime or subprime and the combination of guidelines along with the detailed credit requirements.

Thomas Atteberry - First Pacific Advisors

Okay, then one last thing, real short. You were talking about -- someone was asking you, your securities you were holding in the Bank went up and that was a lot of your asset growth in the last quarter. Could you give us some detail and some granularity to what those securities really are, other than just they're AAA?

Kevin Bartlett

Sure. This is Kevin Bartlett. I mean if the -- most of the securities growth is in, I would say, in securities that are backed by hybrid loans, three- and five-year and seven-year hybrid loans. And then in addition, basically the front-end portions of REMIC securities, which traditionally are more of a two-, three-year average life kind of investment.

Thomas Atteberry - First Pacific Advisors

Okay, thanks.

Angelo Mozilo

Okay, some final comments. One to the individual who asked about my sale of stock. The decision to buyback stock is a collective decision, really emanates from the financial operations of the Company as to what is the best return for the investment of the shareholders, invested capital for the shareholders. So it is totally unrelated to any of my issues relative to the sale of stock.

Secondly, as I said, I don't know the exact amount of shares that I have. But the shares that I have, actual stock I have, I have retained for 39.5 years. Not sold a share of the initial stock that I got when Dave and I started this Company, and I got that I purchased.

And the only thing that is being sold under the 10b5-1 are options with expiration dates. David, do you have a comment?

David Sambol

Yeah, what I would like to do before we terminate the call -- this is Dave Sambol -- is just maybe take a stab at putting those earnings call and our guidance and our commentary into context. And emphasize that it's our view that the market conditions that we described here today, and that will certainly impact the near-term quarters, are extremely stressed conditions and from many of our perspectives quite anomalous in terms of what we see for volumes and margins and secondary market uncertainty, and at the same time a soft housing market.

But in spite of that, our guidance suggests that we will nevertheless -- we expect to generate profitability, albeit at lower levels than what we have generated historically. But if you look at the range that we are projecting and what that implies for the year, this year is still expected to be a year in which the Company generates double-digit returns on our equity.

And I can tell you that the management team believes that this disruption, while certainly not a positive to our near-term, will be very beneficial for the Company in the long-term in terms of rationalizing and providing for what we believe is an overdue correction to the industry. And a correction that will we believe, result in much of the overcapacity that exists in the market today working itself out. And so our view of the future remains very, very bullish for those reasons.

Angelo Mozilo

Okay, we want to thank everybody for participating. Thank you for all the shareholders who continue to support the Company. And we will be talking to you at the end of the next quarter. Thank you very much.

Operator

Thank you. And ladies and gentlemen, this conference will be available for replay starting at 12 PM Pacific Time today until midnight on August 7. You can access the AT&T teleconference replay service by dialing 800-475-6701 and entering the access code 877952. International callers can dial 320-365-3844, access code 877952. Once again those numbers are 800-475-6701 and 320-365-3844, access code 877952.

That does conclude our conference for today. Thank you for your participation and for using AT&T executive teleconference service. You may now disconnect.

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