Statement of
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Federal Deposit Insurance Corporation
On
Oversight of Implementation of the Emergency Economic Stabilization Act of 2008
and Of
Government Lending and Insurance Facilities
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Chairman Frank, Ranking Member Bachus, and Members of the Committee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding recent efforts to stabilize the nation's financial markets and reduce foreclosures.

The events of the past several months are unprecedented. Conditions in the financial markets have shaken the confidence of people around the world in their financial systems. Losses in the stock markets have reduced the valuations of publicly-traded companies and have imposed losses on individual investors. Credit markets have not been functioning normally, contributing to a rising level of distress in the economy. In addition, high levels of foreclosures are contributing to downward pressure on home prices.

The impact on confidence resulting from the cumulative impact of these events has required the government to take extraordinary steps to bolster public confidence in our financial institutions and the American economy.

Achieving this goal requires a sustained and coordinated effort by government authorities. Congress passed the Emergency Economic Stabilization Act of 2008 (EESA), which provides authority for the purchase of troubled assets and direct investments in financial institutions, a mechanism for reducing home foreclosures, and a temporary increase in deposit insurance coverage. Working with our colleagues at the Treasury Department and our fellow bank regulators, the FDIC is prepared to undertake all necessary measures to preserve confidence in insured financial institutions.

Despite what we hear about the credit crisis and the problems facing banks, the bulk of the U.S. banking industry is healthy and remains well-capitalized. What we do have, however, is a liquidity problem. This problem originally arose from uncertainty about the value of mortgage-related assets, but credit concerns have broadened over time, making banks reluctant to lend to each other or lend to consumers and businesses.

In my testimony, I will detail recent actions by the FDIC to restore confidence in insured financial institutions. I also will discuss the FDIC's continuing efforts to address the root cause of the current economic crisis – the failure to deal effectively with unaffordable loans and unnecessary foreclosures.

Recent Actions to Restore Confidence

The FDIC has taken several actions in coordination with Congress, the Treasury Department, the Federal Reserve Board, and other federal regulators, designed to restore confidence in insured financial institutions. These have included temporarily increasing deposit insurance coverage and providing guarantees to new, senior unsecured debt issued by banks, thrifts or holding companies. These measures will help banks fund their operations.

Increased Deposit Insurance

With the enactment of the EESA, deposit insurance coverage for all deposit accounts was temporarily increased to $250,000, the same amount of coverage previously provided for self-directed retirement accounts. Temporarily raising the deposit insurance limits has bolstered public confidence and successfully provided additional liquidity to FDIC-insured institutions.

The FDIC implemented the coverage increase immediately upon enactment of EESA. The FDIC website and deposit insurance calculators were updated promptly to reflect the increase in coverage and ensure that depositors understand the change. It is important to note that the increase in coverage to $250,000 is temporary and only extends through December 31, 2009. The FDIC will work closely with Congress in the coming year to ensure that consumers are fully informed of changes to the deposit insurance coverage level, as well as the temporary nature of the increase, and understand the impact on their accounts.

Temporary Liquidity Guarantee Program

On October 14, the FDIC Board of Directors approved a new Temporary Liquidity Guarantee Program (TLGP) to unlock inter-bank credit markets and restore rationality to credit spreads. This voluntary program is designed to free up funding for banks to make loans to creditworthy businesses and consumers. The Board issued an interim rule1 and requested comments on a number of issues. Comments were due by November 13 and the Board will be reviewing those comments and considering any changes before publishing a final rule. The Board expects to adopt a final rule at its meeting scheduled for Friday this week.

The program as outlined in the interim rule has two key features. The first feature is a guarantee for new, senior unsecured debt issued by banks, thrifts, bank holding companies, and most thrift holding companies, which will help institutions fund their operations. Eligible entities include: 1) FDIC-insured depository institutions; 2) U.S.

bank holding companies; 3) U.S. financial holding companies; and 4) U.S. savings and loan holding companies that either engage only in activities that are permissible for financial holding companies under section 4(k) of the Bank Holding Company Act (BHCA) or have an insured depository institution subsidiary that is the subject of an application under section 4(c)(8) of the BHCA regarding activities closely related to banking.

The guarantee applies to all senior unsecured debt issued by participating entities on or after October 14, 2008, through and including June 30, 2009. In general, issuers will be limited in the amount of guaranteed debt they raise, which may not exceed 125 percent of senior unsecured debt that was outstanding as of September 30, 2008, and scheduled to mature before June 30, 2009. For eligible debt issued on or before June 30, 2009, coverage is only provided until the earlier of the date of maturity of the debt or June 30, 2012.

We originally announced that eligible entities would automatically participate in the FDIC's TLGP unless they opted out by November 12. The Board subsequently extended this date to December 5 in order to give banks additional time to determine how to proceed once the FDIC adopts a final rule. Participating institutions will be subject to supervisory oversight to prevent rapid growth or excessive risk-taking. The FDIC, in consultation with the entity's primary Federal regulator, will determine continued eligibility and parameters for use.

Unsecured bank funding was under extreme pressure in recent weeks, with the interest rate for short-term funding ballooning to several hundred basis points over the rate for comparable U.S. Treasury bills. Since the introduction of this program, we have seen bank funding rates moderate significantly. The new temporary FDIC guarantee has allowed banks and their holding companies to roll maturing senior debt into new issues fully backed by the FDIC.

The second feature of the new program provides insurance coverage for all deposits in non-interest-bearing transaction accounts at insured depository institutions unless they choose to opt out. These accounts are mainly payment processing accounts such as payroll accounts used by businesses. Frequently, such accounts exceed the current maximum insurance limit of $250,000. Many smaller, healthy banks had expressed concerns about deposit outflows based on market conditions.

The temporary guarantee will expire December 31, 2009, consistent with the temporary statutory increase in deposit insurance. This aspect of the program allows bank customers to conduct normal business knowing that their cash accounts are safe and sound. The guarantee has helped stabilize these accounts, and helped the FDIC avoid having to close otherwise viable banks because of large deposit withdrawals.

It is important to note that the TLGP does not rely on taxpayer funding or the Deposit Insurance Fund. Instead, both aspects of the program will be paid for by direct user fees. Coverage for both parts of the program is initially automatic. By December 5, eligible entities must inform the FDIC whether they will opt out of the guarantee program. If an entity does not opt out of the program within a timely manner, it must participate in the program. For an entity that opts out of the program by the opt-out deadline, coverage extends at no cost until the entity opts out. For an entity that remains in the program, premiums or user fees for the coverage will begin accruing as of November 13.

Under the interim rule, premiums are proposed as follows. All newly issued senior unsecured debt will be assessed an annualized fee equal to 75 basis points multiplied by the amount of debt issued under the program. This assessment will generally be at the time of issuance or shortly thereafter. For noninterest-bearing transaction deposit accounts, a 10 basis point surcharge will be applied to deposits in noninterest-bearing transaction deposit accounts not otherwise covered by the existing deposit insurance limit of $250,000. This surcharge will be added to the participating bank's existing risk-based deposit insurance premium paid on those deposits.

As noted above, the comment period on the interim rule closed on November 13 and we expect a final rule to be considered by the FDIC Board at the end of this week. We received numerous comments on several aspects of the interim rule, including the type of debt guaranteed, the types of transaction accounts guaranteed, the disclosures to be required, and the user fees. We are evaluating carefully all the comments received and may make some changes to the program when we adopt a final rule. For example, we are considering suggestions with regard to whether the debt guarantee program should cover very short term funding or whether we should have a tiered fee structure based upon the maturity of the debt guaranteed.

The TLGP is similar to actions by the international community. If the FDIC had not acted, guarantees for bank debt and increases in deposit insurance by foreign governments would have created a competitive disadvantage for U.S. banks. Along with Treasury's actions to inject more capital into the banking system, the combined coordinated measures to free up credit markets have had a stabilizing effect on bank funding.

Since these measures were implemented on October14, we have seen steady progress in reducing risk premiums in money and credit markets. Yields on short-term Treasury instruments, which had approached zero in mid-September, have now risen back in line with longer-maturity instruments. Quotes for Libor, the London Interbank Offer Rate, also have declined in relation to Treasury yields -- indicating a slow thaw in the interbank lending market. Interest rates on short-term commercial paper have fallen back to their lowest levels since mid-September, indicating that liquidity is also starting to return to that market. While it is clearly too early to declare the end of the crisis in our financial markets, as a result of the coordinated response of the Fed, the Treasury, the FDIC and our counterparts overseas, we are making steady progress in returning money and credit markets to a more normal state.

The FDIC's action in establishing the TLGP is unprecedented and necessitated by the crisis in our credit markets, which has been fed by rising risk aversion and serious concerns about the effects this will have on the real economy. The FDIC's action is authorized under the systemic risk exception of the FDIC Improvement Act of 1991. In accordance with the statute, the Secretary of the Treasury invoked the systemic risk exception after consultation with the President and upon the recommendation of the Boards of the FDIC and the Federal Reserve. The systemic risk exception gives the FDIC flexibility to provide such guarantees which are designed to avoid serious adverse effects on economic conditions or financial stability.

TARP Capital Purchase Program

As a part of EESA, the Treasury also has developed a Capital Purchase Program (CPP) which allows certain financial companies to make application for capital augmentation of up to three percent of risk weighted assets. As mentioned earlier, the federal government intervened to inject capital in banks and to guarantee a larger portion of their liabilities so they can better meet the credit needs of the economy. The ongoing financial crisis has already disrupted a number of the channels through which market-based financing is normally provided to U.S. businesses and households. Private asset-backed securitization remains virtually shut down, and the commercial paper market is now heavily dependent on credit facilities created by the Federal Reserve. In this environment, banks will need to provide a greater share of credit intermediation than in the past to support normal levels of economic activity. By contrast, a significant reduction in bank lending would be expected to have strong, negative procyclical effects on the U.S. economy that would worsen the problems of the financial sector.

Before the recent capital infusions, banks appeared to be on course to significantly reduce their supply of new credit as a response to an unusually severe combination of credit distress and financial market turmoil. Standard banking practice during previous periods of severe credit distress has been to conserve capital by curtailing lending. In the present episode, lending standards were likely to be tightened further due to higher funding costs resulting from overall financial market uncertainty. There was ample evidence in the Federal Reserve's Senior Loan Officer Survey in October that bank lending standards were being tightened to a degree that is unprecedented in recent history.2

Government intervention was essential to interrupt this self-reinforcing cycle of credit losses and reduced lending. We fully support the CPP as a means of countering the procyclical economic effects of financial sector de-leveraging. We see the TLGP as a necessary complement to this effort, and are looking at additional ways that we might structure our liquidity guarantees to enhance the incentive and capacity to lend on the part of FDIC-insured institutions.

The combined federal policy response will make capital and debt finance more readily available to banks on favorable terms. The expectation is that banks will actively seek ways to use this assistance by making sound loans to household and business borrowers. Doing so will require a balanced perspective that takes into account the long-term viability of these borrowers and the fact that they may have unusual short-term liquidity needs.

We recognize that banks will need to make adjustments to their operations, even cutting back in certain areas, to cope with recent adverse credit trends. However, the goal of providing government support is to ensure that such adjustments are made mostly in areas such as dividend policy and the management compensation, rather than in the volume of bank lending. These considerations are consistent with the precept that the highest and best use of bank capital in the present crisis is to support lending activity. Ongoing supervisory assessments of bank earnings and capital will take into account how available capital is deployed to generate income through expanded lending.

In addition, we maintain that compensation programs must discourage excessive risk-taking and the pursuit of near-term rewards with long-term risks. Only compensation structures that create appropriate incentives for bank managers and reward long-term performance are consistent with the basic principles of safe-and-sound banking. The federal banking regulators expect that all banks will compensate their managers in ways that will encourage the type of sustainable lending that leads to long-term profitability. Bank supervisors will consider the incentives built into compensation policies when assessing the quality of bank management.

Thus far, a number of the largest banking companies in the U.S. have taken advantage of the CPP, significantly bolstering their capital base during a period of economic and financial stress. In addition, over 1,000 community financial institutions have applied to this program. We understand that Treasury will soon finalize terms of the CPP program for the great majority of banks which are not actively traded public companies, including those organized as Subchapter S corporations and mutuals.

It is critically important that community banks (commonly defined as those under $1 billion in total assets) participate in this program. Although, as a group, community banks have performed somewhat better than their larger competitors, they have not fully escaped recent economic problems.

Community banks control eleven percent of industry total assets; however, their importance is especially evident in small towns and rural communities. Of the 9,800 banking offices located in communities with populations of under 10,000, 67 percent are community banks. In these markets, the local bank is often the essential provider of banking services and credit. Their contribution to small business and agriculture lending is especially important and disproportionate to their size. As of June 30, bank lending by community banks accounted for 29 percent of small commercial and industrial loans, 40 percent of small commercial real estate loans, 77 percent of small agricultural production loans, and 75 percent of small farm land loans.[3]

Although the viability of community banks as a sector continues to be strong, the CPP offers an opportunity for individual institutions to strengthen their balance sheets and continue providing banking services and credit to their communities.

Also, last week the FDIC issued an Interagency Statement on Meeting the Needs of Creditworthy Borrowers to all FDIC supervised institutions. The statement encourages financial institutions to support the lending needs of creditworthy borrowers, strengthen capital, engage in loss-mitigation strategies and foreclosure-prevention strategies with mortgage borrowers, and assess the incentive implications of compensation policies.

Efforts to Reduce Unnecessary Foreclosures

Minimizing foreclosures is essential to the broader effort to stabilize global financial markets and the U.S. economy. There were an estimated 1.5 million U.S. foreclosures last year, and another 1.2 million in the first half alone of 2008. Foreclosure is often a very lengthy, costly and destructive process that puts downward pressure on the price of nearby homes. While some level of home price decline is necessary to restore U.S. housing markets to equilibrium, unnecessary foreclosures perpetuate the cycle of financial distress and risk aversion, thus raising the very real possibility that home prices could overcorrect on the downside.

The continuing trend of unnecessary foreclosures imposes costs not only on borrowers and lenders, but also on entire communities and the economy as a whole. Foreclosures may result in vacant homes that may invite crime and create an appearance of market distress, diminishing the market value of other nearby properties. Foreclosures add inventory and create distressed sale prices which place downward pressure on surrounding home values. In addition, the direct costs of foreclosure include legal fees, brokers' fees, property management fees, and other holding costs that are avoided in workout scenarios. These costs can total between 20 and 40 percent of the market value of the property.4 The FDIC has strongly encouraged loan holders and servicers to adopt systematic approaches to loan modifications that result in affordable loans that are sustainable over the long term.

Over the past year and a half, the FDIC has worked with mortgage lenders, the securitization industry, servicers, consumer groups, other regulators and Congress to identify and correct barriers to solving current market problems while establishing controls to guard against their reappearance in the future.

As we all know from events over recent months, no single solution or "silver bullet" can address the adverse effects of the deficiencies that have contributed to the current market turmoil. However, as foreclosures escalate, we are clearly falling behind the curve. Much more aggressive intervention is needed if we are to curb the damage to our neighborhoods and broader economic health.

HOPE for Homeowners Act

The FDIC has been playing a role in the implementation of the HOPE for Homeowners Act. As a member of the Board of Directors of the HOPE for Homeowners Program (Oversight Board), which oversees implementation of the Act, the FDIC has joined the Departments of Housing and Urban Development (HUD) and Treasury and the Federal Reserve in establishing requirements and standards for the Program that are not otherwise specified in the legislation, and prescribing necessary regulations and guidance to implement those requirements and standards.

By working cooperatively to address the many issues necessary to achieve implementation, the Oversight Board was able to meet the October 1, 2008 statutory deadline for implementation. The final rules, as well as other guidance documents and disclosures, were posted on the Program's website on October 1, and the final rules were published in the Federal Register on October 6. Interagency staff is working on revisions to the rules to reflect amendments to the HOPE for Homeowners Act made by EESA and plans to take them to the Oversight Board in the near future. Outreach efforts to servicers, investors, housing counselors and borrowers are underway.

The statutory approach for the Program makes use of existing governmental and market structures. By modeling the proposal on existing FHA programs, the time and expense of implementing the Act were significantly reduced. The Program design incorporates certain principles that the FDIC considers necessary to be effective. In particular, it converts troubled mortgages into loans that should be sustainable over the long-term and subsequently convertible into securities. It also requires that lenders and investors accept significant discounts, protects the Federal Housing Administration (FHA) against redefault risk, and prevents borrowers from being unjustly enriched if home prices appreciate. The Program is still in the early stages of implementation. As a member of the Oversight Board, the FDIC will work to make the Program as effective as possible within the parameters of the statute. The Program has the potential to provide relief to several hundred thousand homeowners. However, given the inherent limitations in a loan-by-loan refinancing process, we believe additional measures must be undertaken to provide stronger incentives for wide-scale loan restructuring.

Emergency Economic Stabilization Act

The EESA, recently passed by Congress, provides broad authority to the Secretary of the Treasury to take action to ameliorate the growing distress in our credit and financial markets, as well as the broader economy. The EESA specifically provides the Secretary with the authority to use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures. We believe that it is essential to utilize this authority to accelerate the pace of loan modifications in order to halt and reverse the rising tide of foreclosures that is imperiling the economy.

The FDIC has proposed to Treasury the creation of a guarantee program based on the FDIC's practical experience in modifying mortgages at IndyMac Federal Bank in California. We believe this program could prevent as many as 1.5 million avoidable foreclosures by the end of 2009. As outlined in more detail below, we have proposed that the government establish standards for loan modifications and provide for a defined sharing of losses on any default by modified mortgages meeting those standards. By doing so, unaffordable loans could be converted into loans that are sustainable over the long term. This proposal is authorized by the EESA and may be implemented under the authority provided to the Secretary under that statute. We have strongly advocated this type of approach to Treasury and continue to believe that it offers the best mechanism for providing appropriate protection for homeowners.

In recent months, the FDIC has demonstrated through our actions with the troubled loans owned or serviced by IndyMac Federal Bank that it is possible to implement a streamlined process to modify troubled mortgages into loans that are affordable and sustainable over the long-term. Not only can the approach used successfully at IndyMac serve as a model for the servicing and banking industry, but we believe it can provide the foundation for a loss sharing guarantee program under the EESA.

IndyMac Federal Bank Loan Modifications

As the Committee knows, the former IndyMac Bank, F.S.B., Pasadena, California, was closed July 11. The FDIC is conservator for a new institution, IndyMac Federal Bank, F.S.B. (IndyMac Federal), which continues the depository, mortgage servicing, and certain other operations of the former IndyMac Bank, F.S.B. As a result, the FDIC has inherited responsibility for servicing a pool of approximately 653,000 first lien mortgage loans, including more than 60,000 mortgage loans that are more than 60 days past due, in bankruptcy, in foreclosure, and otherwise not currently paying. As conservator, the FDIC has the responsibility to maximize the value of the loans owned or serviced by IndyMac Federal. Like any other servicer, IndyMac Federal must comply with its contractual duties in servicing loans owned by investors. Consistent with these duties, we have implemented a loan modification program to convert as many of these distressed loans as possible into performing loans that are affordable and sustainable over the long term. In addition, we are seeking to refinance distressed mortgages through FHA programs, including FHA Secure and HOPE for Homeowners, and have sent letters proposing refinancing through FHA to more than 2,000 borrowers.

On August 20, the FDIC announced a loan modification program to systematically modify troubled residential loans for borrowers with mortgages owned or serviced by IndyMac Federal. This program modifies eligible, delinquent mortgages to achieve affordable and sustainable payments using interest rate reductions, extended amortization and, where necessary, deferring a portion of the principal. By modifying the loans to an affordable debt-to-income ratio and using this menu of options to lower borrowers' payments for the life of their loan, the program improves the value of these troubled mortgages while achieving economies of scale for servicers and stability for borrowers. Of the more than 60,000 mortgages serviced by IndyMac Federal that are more than 60 days past due, in bankruptcy, in foreclosure, and otherwise not currently paying, approximately 40,000 are potentially eligible for our loan modification program.[5] Initially, the program was applied only to mortgages either owned by IndyMac Federal or serviced under IndyMac Federal's pre-existing securitization agreements.

Subsequently, we have obtained agreements to apply the program to many delinquent loans owned by Freddie Mac, Fannie Mae, and other investors.

It is important to recognize that securitization agreements typically provide servicers with sufficient flexibility to apply the IndyMac Federal loan modification approach. While some have argued that servicing agreements preclude or routinely require investor approval for loan modifications, this is not true for the vast majority of servicing agreements. In fact, the American Securitization Forum has repeatedly confirmed that most servicing agreements do allow for loan modifications for troubled mortgages that are delinquent or where default is "reasonably foreseeable" if the modification is in the best interest of securityholders as a whole.6 If, as under the model applied at IndyMac Federal, the modification provides an improved net present value for securityholders as a whole in the securitization compared to foreclosure, the modification is permitted under the agreements as well as applicable tax and accounting standards. In fact, the agreements at IndyMac Federal were more restrictive than those that apply to many other securitizations as they limited modifications to mortgages that were "seriously delinquent" rather than permitting modification when default was "reasonably foreseeable." As a result, the model applied at IndyMac Federal can be applied broadly for securitized as well as for portfolio loans.

Using the model at IndyMac Federal to achieve mortgage payments for borrowers that are both affordable and sustainable, the distressed mortgages will be rehabilitated into performing loans and avoid unnecessary and costly foreclosures. By taking this approach, future defaults will be reduced, the value of the mortgages will improve, and servicing costs will be cut. The streamlined modification program will achieve improved recoveries on loans in default or in danger of default, and improve the return to uninsured depositors, the deposit insurance fund, and other creditors of the failed institution. At the same time, many troubled borrowers can remain in their homes. Under the program, modifications are only being offered where doing so will result in an improved value for IndyMac Federal or for investors in securitized or whole loans, and where consistent with relevant servicing agreements.

Applying workout procedures for troubled loans in a failed bank scenario is something the FDIC has been doing since the 1980s. Our experience has been that performing loans yield greater returns than non-performing loans. In recent years, we have seen troubled loan portfolios yield about 32 percent of book value compared to our sales of performing loans, which have yielded over 87 percent.

Through this week, IndyMac Federal has mailed more than 23,000 loan modification proposals to borrowers, and will mail over 7,000 more in the next several days. We have contacted many thousands more in continuing efforts to help avoid unnecessary foreclosures. Already, over 5,000 borrowers have accepted the offers, verified their incomes, and are now making payments on their modified mortgages. Thousands more are making lower payments as we complete verification of incomes. I am pleased to report that these efforts have prevented many foreclosures that would have been costly to the FDIC and to investors. This has been done while providing long-term sustainable mortgage payments to borrowers who were seriously delinquent. On average, the modifications have cut each borrower's monthly payment by more than $380 or 23 percent of their monthly payment on principal and interest. Our hope is that the program we announced at IndyMac Federal will serve as a catalyst to promote more loan modifications for troubled borrowers across the country.

Loss Sharing Proposal to Promote Affordable Loan Modifications

Although foreclosures are costly to lenders, borrowers and communities, efforts to avoid unnecessary foreclosures are not keeping pace with delinquencies. By the end of 2009, more than 4.4 million non-GSE mortgages are estimated to become delinquent. While the HOPE for Homeowners refinancing program is part of the solution, the limitations inherent in refinancing mortgages out of securitization transactions indicate that other, more streamlined approaches are necessary.

A major acceleration in loan modifications is essential if we are to stem the growing flood of foreclosures. Yet today, only around 4 percent of seriously delinquent loans are being modified each month. While the FDIC's experience at IndyMac demonstrates that modifications provide a better return than foreclosure in the vast majority of mortgages today, many servicers continue to rely on slower custom modifications that are not focused on long-term affordability. Many servicers continue to argue that they are concerned about proving to investors that modifications provide a better return than foreclosure. As a result, far too many of the responses to troubled mortgages have focused on repayment plans, temporary forbearance, or short-term modifications often based on verbal financial information.

Today, the stakes are too high to rely exclusively on industry commitments to apply more streamlined loan modification protocols. The damage to borrowers, our communities, our public finances, and our financial institutions is already too severe. An effective remedy requires targeted, prudent incentives to servicers that will achieve sustainable modifications by controlling the key risk from the prior, less sustainable modifications – the losses on redefault. The FDIC's loss sharing proposal addresses this risk directly by providing that the government will share up to 50 percent of the losses with lenders or investors if a mortgage -- modified under the sustainable guidelines used at IndyMac Federal -- later redefaults. With the government sharing the risk of future redefaults, we propose to reduce this risk even further by modifying the mortgages to an even more affordable 31 percent ratio of first mortgage debt to gross income. By controlling this risk, the greater net present value of many more modifications compared to foreclosure will be clear.

Over the next two years, an estimated 4 to 5 million mortgage loans will enter foreclosure if nothing is done. We believe that this program has the potential to reduce the number of foreclosures by up to 1.5 million, thereby helping to reduce the overhang of excess vacant homes that is driving down U.S. home prices. In addition, this approach keeps modified mortgages within existing securitization transactions, does not require approval by second lienholders, ensures that lenders and investors retain some risk of loss, and protects servicers from the putative risks of litigation by providing a clear benefit from the modifications.

The program, limited to loans secured by owner-occupied homes, would have a government loss-sharing component available only after the borrower has made six payments on the modified mortgage. Some of the other features of the proposal include:

Standard Net Present Value (NPV) Test – In order to promote consistency and simplicity in implementation and audit, a standard test comparing the expected NPV of modifying past due loans compared to foreclosure will be applied. Under this NPV test, standard assumptions will be used to ensure that a consistent standard of affordability is provided based on a 31 percent borrower mortgage debt-to-income ratio.

Systematic Loan Review by Participating Servicers – Participating servicers would be required to undertake a systematic review of all of the loans under their management, to subject each loan to a standard NPV test to determine whether it is a suitable candidate for modification, and to modify all loans that pass this test.

Reduced Loss Share Percentage for "Underwater Loans" – For loan-to-value ratios (LTVs) above 100 percent, the government loss share will be progressively reduced from 50 percent to 20 percent as the current LTV rises. If the LTV for the first lien exceeds 150 percent, no loss sharing would be provided.

Simplified Loss Share Calculation – In general terms, the calculation would be based on the difference between the net present value of the modified loan and the amount of recoveries obtained in a disposition by refinancing, short sale or REO sale, net of disposal costs as estimated according to industry standards. Interim modifications would be allowed.

De minimis Test – To lower administrative costs, a de minimis test excludes from loss sharing any modification that did not lower the monthly payment at least 10 percent.

Eight-year Limit on Loss Sharing Payments – The loss sharing guarantee ends eight years after the modification.

Assuming a re-default rate of 33 percent, our plan could reduce the number of foreclosures initiated between now and year-end 2009 by some 1.5 million at a projected program cost of $24.4 billion.

This proposal efficiently uses federal money to achieve an objective that is critical to our economic recovery – stability in our mortgage and housing markets. Mortgage loan modifications have been an area of intense interest and discussion for more than a year now. Meanwhile, despite the many programs introduced to address the problem, the problem continues to get worse. During the second quarter of this year, we saw new mortgage loans becoming 60 days or more past due at a rate of more that 700,000 per quarter – net of past due loans that returned to current status. No one can dispute that this remains the fundamental source of uncertainty for our financial markets and the key sector of weakness for our economy. We must decisively address the mortgage problem as part of our wider strategy to restore confidence and stability to our economy.

While the proposed FDIC program would require a cash outlay in the event of default, we must consider the returns this guarantee would deliver in terms of our housing markets and, by extension, the economic well-being of our communities. While we support the various initiatives taken to date, if we are to achieve stability in our credit and financial markets we cannot simply provide funds to market participants. We must address the root cause of the financial crisis – too many unaffordable mortgages creating too many delinquencies and foreclosures. The time is overdue for us to invest in our homes and communities by adopting a program that will prudently achieve large-scale loan modifications to minimize the impact of foreclosures on households, lenders and local housing markets.

Conclusion

The FDIC has engaged in unprecedented actions to maintain confidence and stability in the banking system. Although some of these steps have been quite broad, we believe that they were necessary to avoid consequences that could have resulted in sustained and significant harm to the economy. The FDIC remains committed to achieving what has been our core mission for the past 75 years – protecting depositors and maintaining public confidence in the financial system.

I will be pleased to answer any questions the Committee might have.

1 73 F.R. 64179 (October 29, 2008) and 73 F.R. 66160 (November 7, 2008).

2 Federal Reserve Board, Senior Loan Officer Opinion Survey on Bank Lending Practices, October 2008,
http://www.federalreserve.gov/boarddocs/snloansurvey/200811/

3 Small commercial and industrial loans and small commercial real estate loans are in amounts under $1 million. Small agricultural production loans and small farm land loans are in amounts under $500,000.

4 Capone, Jr., C. A., Providing Alternatives to Mortgage Foreclosure: A Report to Congress, Washington, D.C.: United States Department of Housing and Urban Development, 1996.

5 Loans not eligible for a modification proposal under the IndyMac Federal modification program include non-owner-occupied loans, loans subject to bankruptcy proceedings, completed foreclosures, and loans secured by properties held after a prior foreclosure.

6 ASF Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans, Dec. 6, 2007; ASF Statement of Principles, Recommendations and Guidelines for the Modification of Securitized Subprime Residential Mortgage Loans, June 2007.

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