Remarks by
FDIC Chairman Sheila C. Bair
at the
2010 Multicultural Real Estate
And
Policy Conference,
Washington, DC
March 4, 2010

Good afternoon. Thank you for inviting me to speak. Like all of you here today, I very much want to see housing markets and mortgage finance get back on track.

Restoring stability to our real estate markets will be essential to our economic recovery. And homeownership remains vital to building strong communities, especially in multicultural neighborhoods. So all of us have a big stake in reforms that prevent the excesses and abuses of the past, and that open the way for new lending and new housing opportunities.

Housing and mortgage markets

After three long and difficult years for housing and mortgage finance, I think we're seeing some progress in stabilizing our housing markets.

The Case-Shiller home price index actually rose – slightly – for seven consecutive months to close out 2009. This came on the heels of a three-year period in which U.S. home prices declined by some 32 percent. The inventory of unsold new homes dipped last year from over 12 months of sales to 8 months of sales, before ticking up in January.

And affordability – the product of lower home prices and historic low interest rates – has improved to a surprising degree. The National Association of Realtors housing affordability index has risen to a historically high level.

We know that it will take time to work off excess inventories in the hardest hit markets. But in other areas, we now see investors buying with cash, and families taking advantage of low mortgage rates and the first-time homebuyer tax credit.

Still, problems remain

While I think we're making progress, we're not yet out of the woods when it comes to problem mortgages and long-term stability of our housing markets.

The Homebuyer Tax Credit is scheduled to expire on April 30. That's about the time that the Federal Reserve expects to end its MBS purchases, which have helped hold down

mortgage rates. These policy adjustments – while inevitable – could slow or even reverse some of the housing market gains we have seen over the past year.

In addition, problem mortgages continued to grow through year-end, while new sources of credit distress have emerged. The Mortgage Bankers Association reports that total past due mortgages amounted to just under 9.5 percent of outstanding loans at year end, which is actually down a little bit from the third quarter. They have seen early-stage delinquencies trend downward for two consecutive quarters.

This could be seen as good news, as it looks like fewer loans are becoming newly delinquent, but it probably also means that more early-stage delinquencies are moving on to foreclosure. Based on the data, we estimate that some 2.8 million loans entered foreclosure last year, an increase of 24 percent from 2008, and about three times the level of just three years ago.

For some time, we have been pointing to the looming challenges posed by nontraditional mortgages – the interest-only and negative amortization loans that were so popular in high-cost areas at the peak of the market. We expect the "recasting" of these loans to higher, fully-amortizing monthly payments to peak between now and 2012.

To be sure, these loans are not as numerous as the subprime mortgages that triggered the crisis. But the payment increases they impose on borrowers are, in many cases, crushing. And these loans tend to be concentrated in the same coastal markets where home prices boomed and then fell sharply.

Moody's economy.com estimates that almost 16 million U.S. homes in all are currently "underwater." This is a major source of concern going forward, and they require us to adjust our policies.

Loss mitigation efforts remain critical

As we've urged throughout this crisis, we need sensible policies that minimize foreclosures and help bring stability to our neighborhoods and housing markets. Sustainable and affordable loan modifications are one such policy. The FDIC pioneered that approach as conservator at IndyMac Federal Bank in 2008.

Since then, we have required the banks that manage mortgages under our loss share agreements to implement the Treasury HAMP modification program. HAMP is the most ambitious mortgage modification effort ever undertaken. It's still too soon to know how successful it will ultimately be. It is true that the numbers of trial and permanent modifications have lagged behind program projections. But at the same time, we saw a slowdown in the pace of new foreclosures in the second half of last year. This suggests that servicers were at least looking for alternatives that could minimize their losses and keep people in their homes.

As loss mitigation efforts continue, we need to recognize the evolving nature of the mortgage problem. The initial phases of the crisis involved poorly structured mortgages that posed an affordability problem. Now we're dealing with underwater mortgages. That's why we're actively looking at principal write-downs within our loss share agreements and other failed bank programs.

We see this as one possible way to encourage borrowers to stick with their mortgages. This could help reduce defaults, keep people in their homes, avoid costly foreclosures, and enhance the value of these loans. We understand that this will not be the solution for every distressed borrower.

And we are approaching this issue strictly by the numbers, in keeping with our fiduciary duty to every bank receivership that we manage. But the fact is that deeply underwater mortgages – those with loan-to-value ratios of 150 percent or more – are very likely to default.

Models also show that the odds of default can be greatly reduced if the LTV ratio can be brought down a level closer to 100 percent. This approach can help mortgage owners cut their losses by avoiding foreclosure costs. Our analysis is ongoing. But I'm committed to doing everything possible along these lines to reduce our resolution costs, minimize foreclosures and help to stabilize our housing markets.

Regulatory reform: What needs to be done

As we continue to address the policy challenges of today, we must also look to the future. We need to lay the groundwork for a fairer, more stable, and more inclusive financial system in the years ahead.

Much has been written and said already about the factors that led to this crisis. One theory holds that the onerous demands of the Community Reinvestment Act drove lenders to make bad loans that ended up wrecking the system. This story has absolutely no basis in fact. CRA in no way mandates the origination of risky or unsuitable loans. Most of the riskiest subprime and nontraditional loans were made by entities that were not subject to CRA. In short, CRA didn't cause the housing crisis.

What's needed now is regulatory reform in three key areas: protecting the consumer, ending Too Big Too Fail, and plugging gaps in the regulatory structure.

Consumer protection is central to our regulatory mission. We cannot have a safe and sound banking system without protecting the consumer from unsafe and unsuitable products and practices. And it's time we had a level playing field for all market players. We need strong rules that apply -- and that are enforced -- across the board for banks and nonbanks. The ideal would be through an independent agency, with consumer protection as its primary mission.

We also need to level the playing field and protect the taxpayer by ending Too Big To Fail. As we saw in 2008, large non-bank firms can also experience liquidity runs in a crisis. And when they run into trouble, it's essential to have the ability to act quickly and decisively without bailing out the owners.

As it stands now, when large non-bank financial firms and bank holding companies get into trouble, they are subject to the commercial bankruptcy process. However, this process does not provide the type of continuity and certainty embodied in the rules that govern the FDIC's receivership authority. Forcing large, non-bank financial institutions through bankruptcy can create significant risks for the real economy by disrupting key financial relationships and transactions. That's why there is an overwhelming tendency to bail them out when they get into trouble. But this only creates moral hazard, contributing to their growth and their incentives to take risks.

We need an effective, pre-funded resolution mechanism, similar to the FDIC's receivership authority for failed banks, so we can close large financial intermediaries when they get into trouble. We also need to require that large, highly interconnected institutions bear the full cost of the systemic risks they create. This can be done with higher capital requirements, insurance assessments, or various types of regulatory limits.

Ending Too Big To Fail is not an impossible goal. It's a mountain we can scale. What it requires is the will to meet the problem head on and set up the appropriate rules, authorities, and funding in advance so that we are prepared to resolve these institutions if they run into trouble.

Regulatory gaps

In terms of plugging the gaps in our regulatory structure, I think the consensus clearly points to a systemic risk council.

Under this approach, the agencies that currently have authority and expertise in specific areas of financial regulation would come together to share data and knowledge. This would ensure that risks do not go undetected because of regulatory gaps among these jurisdictions.

It is essential that we do a better job of assessing macro-level changes in our financial markets that can ultimately disrupt individual institutions, and as we have seen, our economy as a whole. But it is also essential to do this without taking a "one size fits all" approach to our diverse and innovative financial sector.

The future of mortgage finance

As the reform process advances ... at a more deliberate pace I would hope here are things we can do now to improve the system.

For starters, we need to restart securitization and put it on a sounder footing. As deposit insurer and receiver for failed banks and thrifts, the FDIC has a responsibility to control the risks to the Deposit Insurance Fund. This gives us a unique opportunity to help lead the way in reforming securitization practices.

Last November, the FDIC Board approved a "safe harbor" rule intended to clarify the circumstances when the FDIC, as conservator or receiver, will treat a transfer of assets for a securitization or participation as a sale. Under this safe harbor, all securitizations or participations in process through March 31, 2010 would be permanently grandfathered.

In December, the FDIC Board approved a measure seeking public comment on what standards should be applied for safe harbor treatment for transactions created after March 31st. We requested input from the industry as to what standards we should set to help ensure that securitization will strengthen, not weaken, insured banks. The final rule will be developed based on the responses that we receive.

Working with the industry, we are trying to better define the requirements for a well-structured securitization process in which risks can be properly evaluated and managed.

These requirements include:

- Simpler and more transparent structures.
- Loan level disclosures, with an adequate due diligence period and updates throughout the term of the deal.
- Compensation tied to performance.
- And origination standards and some retention of an interest in the deal by the sponsor.

Our proposed rulemaking is very consistent with the legislative direction in the House and Senate. And we are working with the other regulators to achieve consistency across different types of lenders and securitizers. These reforms would prevent the conflicts we've seen in the past and give investors confidence that they can understand and manage the risks associated with asset-backed securities.

Closing

Clearly we need to rebuild mortgage finance and to put it on a stronger footing for the long term. And there are many moving parts to this process. It will require banks to repair their balance sheets, which they are in the process of doing. It will require regulatory reform by Congress and by federal regulators. And to be frank, it will take longer to get the job done than any of us would like.

Today I have laid out my ideas for what needs to be done. But regulators don't have all the answers. As real estate professionals, you have vital role to play in the process.

You're the ones who define industry best practices. Some of these should be formalized through regulation. But you can also enforce these best practices by insisting on them in the transactions that you undertake.

By working together, in Washington and in the marketplace, I know we can restore our mortgage markets, and to make them stronger than ever and to avoid another crisis. Thank you very much.

Last Updated 3/5/2010