Statement of
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For
Policy, Office of the Chairman,
Federal Deposit Insurance Corporation
On
Foreclosure Prevention and Intervention:
The Importance of Loss Mitigation Strategies
for
Keeping Families in Their Homes;before the
Subcommittee on Housing
and
Community Opportunity of the
Financial Services Committee;
U.S. House Of Representatives;
Los Angeles, California
November 30, 2007

Chairman Waters and members of the Committee, thank you for the opportunity to testify on behalf of the Federal Deposit Insurance Corporation regarding foreclosure prevention. This is a subject of tremendous concern to FDIC Chairman Sheila Bair. My testimony will discuss the impact of recent problems in the subprime mortgage market on homeowners and the economy, as well as steps that can be taken to prevent unnecessary foreclosures.

The U.S. housing boom of the first half of this decade ended abruptly in 2006. Housing starts, which peaked at over 2 million units in 2005, have plummeted to just over half of that level, with no recovery yet in sight. Home prices, which were growing at double-digit rates nationally in 2004 and 2005, are now falling in many metropolitan areas and for the nation as a whole. With declining home prices, there are large increases in problem mortgages, particularly in subprime and Alt-A portfolios.1 The deterioration in credit performance began in the industrial Midwest, where economic conditions have been the weakest, but has now spread to the former boom markets of Florida, California and other western states.

The current problem in subprime mortgage lending arose with the rapid growth of 2- and 3-year adjustable rate subprime hybrid loans after 2003. Between year-end 2003 and mid-2007, some 5 million of these loans were originated. Of these, slightly over 2.5 million loans with outstanding balances of $526 billion remain outstanding.

The typical structure of these loans is to provide for a starter rate (typically between 7 and 9 percent), followed in 24 or 36 months by a series of steep increases in the interest rate (often totaling 5 percent or more) and a commensurate rise in the monthly payment. Almost three quarters of subprime mortgages securitized in 2004 and 2005 were structured in this manner, as were over half the subprime loans made in 2006.

Most of these loans also imposed a prepayment penalty if the loan was repaid while the starter rate was still in effect.

These resets of these subprime loans will have a tangible impact on the overall economy. Subprime resets in the U.S. between September 2007 and December 2008 are predicted to total more than $330 billion. California's share is slightly over $102 billion, or 31 percent -- with more than 288,000 first-lien, nonprime loans expected to reset during this period.2

The Effect on California

Exposure to subprime mortgages is particularly significant in California, Combined with large numbers of so-called Alt-A mortgages, the significant numbers of subprime hybrid ARM loans with approaching resets in California have introduced additional uncertainty for California homeowners, lenders, and the public. If the industry fails to take action to respond to the potential defaults and foreclosures that are likely to occur when borrowers cannot make the reset payments, the economic consequences for California will be significant.

California's subprime mortgage problems already have spread to the broader housing sector and related industries, as is evidenced in declining employment levels. Construction employment throughout the state as of the third-quarter of 2007 was down 16 percent from a year-earlier -- and the non-depository finance and services sector also experienced a decline of 3 percent from a year ago.

The slumping housing market led to thousands of job losses throughout California. In October alone, the state lost over 15,800 jobs. Of the 11 major industries, construction job losses were the greatest at 4,200. The job losses are accelerating, leading the Anderson Center for Economic Research at Chapman University in Orange, California, to expect that the worst of the fallout lies ahead. Job losses have intensified and will probably continue well into 2008. The weakness in construction and real estate has spread to retail businesses as well, with losses of 1,700 workers in October and 900 of those layoffs occurring at building-material and garden-equipment stores.3

Problems in subprime lending affect California's fiscal condition as well. State sources predict that curtailed tax revenues associated with the housing market decline will contribute to an expected budget shortfall of nearly $10 billion over the next two years. Tax revenue shortfalls are largely attributable to the laid-off construction workers and mortgage lenders who are no longer paying income taxes. Additionally, slumping home sales are associated with declines in tax-generating purchases of items such as dryers and refrigerators. Similarly, declines in home equity loans are associated with dropoffs in big ticket purchases such as cars.4

Finally, foreclosure rates in California have been rising as many borrowers are unable to afford their higher mortgage payments following the reset of their interest rate. Over 72,000 Notices of Default were filed on California residences during the third quarter of

2007, exceeding the prior peak of 61,000 reached in 1996. This represents an increase of over 166 percent from levels seen during the third-quarter of 2006. Most of the defaulting loans were originated between July 2005 and September 2006.5 By volume, notices of default were the highest in Los Angeles with over 13,000 filings during the third-quarter of 2007, followed by Riverside with over 9,000 filings during the same period. The increasing numbers of defaults and foreclosures demonstrate the need for creative approaches to keep people in their homes by restructuring their loans on a long-term and sustainable basis.

A Proposal for Loan Modification

It appears that subprime loan portfolios can be split into three basic groups: the small subset of loans that can be expected to perform after reset without modification, loans that became past due under the starter rate and probably cannot repay even if they are modified, and loans that have remained current prior to reset, but will likely not remain so after reset without modification.

Based on the limited data, it is difficult to estimate exactly how large each group might be. It is important to emphasize, however, that underwriting standards on these products were extremely low and their structure inherently necessitated frequent refinancing, an option no longer readily available to borrowers. The FDIC's calculations, based on nonprime mortgages included in private mortgage-backed securitizations (MBS), indicate that more than 1.5 million hybrid loans worth $330 billion are scheduled to undergo their first reset between September 2007 and December 2008.6 Today, the vast majority of these loans remain current. Fewer than 350,000 loans are 60 days or more past due or in some stage of foreclosure prior to reset. For loans that remain current or less than 60 days delinquent, only 3.3 percent show both a loan-to-value ratio below 80 percent at origination and a debt service-to-income ratio below 30 percent -- attributes that might indicate a high probability of remaining current even after reset. Based on these criteria, our numbers suggest that the group of loans scheduled to reset that are current but may not remain so after reset are on the order of at least 1.1 million loans.

With regard to that small subset of borrowers who have the ability to repay without modification, these loans should continue according to their contractual terms. As for loans that are already past due and cannot reasonably be expected to repay, even with restructuring, there may be no alternative except for foreclosure. The same is true for loans that were made under fraudulent circumstances or to speculators.

A key issue is how to address the mortgage loans for owner occupied properties where the borrowers are current on their payments but will not be able to maintain the payments following reset. If servicers do nothing and allow all of these loans to reset to the full contract rate, the result will be the eventual default and foreclosure on hundreds of thousands of additional loans.

For this group of borrowers, Chairman Bair has recommended that servicers take a systematic and streamlined approach to restructuring these loans into fixed rate loans at the starter rate -- which is already above market rates for prime loans. These loans should be evaluated to determine the borrowers' ability to make the payment following reset and the net present value (NPV) of the loan modification should exceed the NPV of allowing the loan to go into foreclosure. Loans that are current after two years have clearly demonstrated a record by the borrower of a consistent willingness and ability to repay at the starter rate, which bodes well for their ability to repay at that rate over the long run.

There are several advantages to this approach. A streamlined approach can be undertaken much more rapidly than a loan-by-loan restructuring process. Also, this approach does not involve a bailout involving the federal government. Finally, this policy does not involve government action that would affect the contractual rights of mortgage investors, because it is based on voluntary action by servicers and existing legal rights and responsibilities. This approach makes economic sense and is an appropriate, proactive response to rapidly changing market conditions. Modifying loans before reset will avoid negative credit consequences for borrowers, permit borrowers to keep their homes while making payments they can afford, and at the same time provide investors with a return that exceeds any return they would receive from foreclosures. Under today's conditions, we believe that the NPV analysis itself can be streamlined for many markets because declining housing prices and experience have demonstrated substantial losses through foreclosure compared to the income stream that can be achieved by sustainable, long-term loan modifications.

Correcting Misconceptions about Mortgage Restructuring

Let me turn now to a number of misconceptions about the impact of Chairman Bair's this loan modification proposal and explain how the proposal would work.

Misconception: Restructuring Will Create a Windfall for Subprime Borrowers

Some have expressed concern that restructuring subprime loans to a fixed rate of interest at the starter rate will result in a windfall for subprime borrowers. This misconception is based on the belief that the starter rates for these loans are similar to the low 1 to 2 percent "teaser" rates that were aggressively advertised for prime borrowers. In fact, of subprime hybrid mortgages originated in the first quarter of 2006, the average starter rate was 8.28 percent, which exceeded the average rate on subprime fixed rate loans made in that same quarter (7.93 percent), and was well above rates paid on prime fixed rate loans. These subprime borrowers will continue to pay higher subprime rates even after restructuring.

Misconception: Restructuring Will Deny Investors Their Expected Return

Another popular misconception is that restructuring will deny investors a large stream of interest payments that would rightfully accrue to them after the loans reset to the full contract rate. The reality is that very few hybrid borrowers actually remain in the pools after reset and pay the full contract rate. Among such loans made and securitized in 2003, only one in 30 continues to pay at the full contract rate after four years.

Clearly, these loans generally were never designed or underwritten to perform at the full contract rate after reset. Among subprime hybrid loans made in 2006, nearly half had loan-to-value ratios above 90 percent, and more than half had monthly debt service-to-income ratios above 40 percent. Given that, on average, the full contract rate on these loans is five full percentage points above the starter rate, it is clear that they are not designed for long-term repayment.

Misconception: Restructuring is Unnecessary Based on Past Levels of Credit Losses

Some have argued that standardized and widespread restructuring is unnecessary based on past levels of credit losses. However, previous experience with losses of subprime hybrid ARMs provides very poor guidance regarding how these loans will perform going forward. For example, through August 2007 the cumulative default rate (CDR) for subprime hybrid loans originated in 2004 has been 10 percent; that is, of 1.6 million such loans originated that year, 162,000 have defaulted according to the latest data. However, with the benefit of rapidly rising home prices in many areas of the country, the vast majority of 2004 borrowers were able to repay their loans through refinancing or even the sale of the property.

By contrast, loans resetting today are doing so at a time when home prices are declining in many areas of the country and lenders are making very few subprime loans. Of hybrid loans originated in 2006, the CDR is already 10.5 percent -- before any of these loans have reset. Under today's market conditions, interest rate resets are likely to drive the CDR much higher than levels experienced on previous vintages. This means that the benefits of restructuring cannot be measured against what credit losses were in previous years, but rather must be viewed in the context of how many borrowers can actually afford to pay at the full contract rate where refinancing options are extremely limited and the value of the property has decreased or not increased as anticipated.

Misconception: Standardized Loan Restructuring Cannot Be Accomplished on a Broad Basis

Critics of the proposal to restructure loans to the starter rate as described above argue that such an approach is untested and cannot be implemented on a broad basis. However, the FDIC is aware of servicers that have already begun to use a similar approach with borrowers. Those servicers are reporting that the approach is feasible and significantly reduces the cost of restructuring and its complexity.

Some loan servicers and investors have said that the approach cannot be applied consistent with pooling and servicing agreements (PSAs) because the duty to maximize

NPV requires servicers to review loan by loan to set a new payment between the starter and reset rate. As explained below, this argument fails to consider that a loan-by-loan approach, given the current and anticipated rate of resets, will prevent maximization of NPV for the pool as a whole due to inherently limited servicer resources.

First, the volume of resetting loans means that, in practical terms, the choice is between foreclosures on the one hand and systematic loan modifications for eligible borrowers on the other. A loan-by-loan calibration of what each borrower can pay will take too much time and too many resources. This increases the likelihood that a loan-by-loan approach will mean more foreclosures and loss of value to borrowers and investors. In contrast, following a streamlined modifications approach for eligible borrowers, as we have suggested, will free up resources to address the historic levels of resets that will occur in the coming 18 months and the more difficult loans and borrowers, such as those already delinquent and those with loans, such as Alt-A, that have risk layering characteristics.

Also, applying a modification that increases the rate by 100 or 200 basis points more than the starter rate, though not completely to the reset rate, will increase the potential delinquency rate without significantly increasing the actual cash flow into the trust. "Squeezing" the maximum increase out of a current borrower clearly increases the likelihood of delinquency compared to proven payments at the starter rate.

Finally, brief extensions of the starter rate will not provide stability to the borrower, investors, or the market. Brief extensions simply increase the resource stress on servicers and decrease the ability of the market to determine market prices for mortgage assets.

Current Loan Modification Efforts

Last week, Governor Schwarzenegger announced a particularly encouraging agreement with four major subprime lenders. Countrywide, GMAC, Litton and HomeEq -- which collectively service more than one quarter of subprime loans -- agreed to work with homeowners unable to afford escalating mortgage payments. The servicers agreed to maintain the initial, lower interest rate for some subprime borrowers whose loans are scheduled to reset to a significantly higher interest rate. To qualify, borrowers must occupy their homes, have made their payments on time and prove they cannot afford payments with the higher interest rate. We believe that this is a very positive step because it is a public commitment to support stream-lined loan modifications by the governor of our most populous state and to implement that commitment by loan servicers who service loans throughout the country. We hope that this action will encourage other servicers to adopt this approach to speed up the pace of loan modifications.

Also, earlier this year, the FDIC, along with the other federal banking agencies, issued a statement to banks encouraging them to find more affordable, sustainable products for borrowers who are currently struggling with hybrid adjustable rate mortgages. In the statement, we emphasized that lenders do not face regulatory penalties if they pursue reasonable workout arrangements, and we noted that institutions may receive favorable Community Reinvestment Act consideration for programs that transition borrowers from higher to lower cost loans. The statement also reminded institutions that existing regulatory guidance and accounting standards do not require immediate foreclosure on homes when borrowers fall behind on payments and that institutions should consider working with reputable consumer-based organizations to help financially stressed borrowers avoid predatory foreclosure rescue scams.

In recent months, that some financial institutions are proactively contacting borrowers facing rate resets and seeking to modify the problem loan terms. Borrowers who anticipate having difficulty making payments should take the initiative and seek assistance even if they have not been contacted. They should contact their servicer, the entity that receives their monthly payment, as soon as possible. The contact information for the servicer can be found on the monthly billing statement.

A number of lenders and servicers have initiated programs to help ameliorate the impact on borrowers. Some lenders say they are taking steps to contact troubled borrowers and work with them. Also, the U.S. Treasury-led alliance of mortgage servicers, lenders, investors and counselors called Hope Now began sending out 300,000 letters in mid-November to offer assistance to struggling homeowners who may be in a position to move into a more affordable mortgage.

Another initiative that should be mentioned is the FDIC's Alliance for Economic Inclusion. The Alliance is the FDIC's national initiative to form a network of local coalitions around the country charged with helping underserved populations in nine particular markets across the United States. As part of this effort, the Alliance for Economic Inclusion has partnered with NeighborWorks® America's Center for Foreclosure Solutions to promote foreclosure-prevention strategies for consumers at risk of foreclosure. Within each of the nine markets, the partnership will conduct outreach to identify and help homeowners at risk of foreclosure; work to increase lenders' support for foreclosure intervention; and promote best intervention practices in mortgage servicing programs for consumers at risk of foreclosure who could qualify for alternate financing.

Efforts to Address Questionable Lending Practices

In addition to addressing the problems of current borrowers, the FDIC and other federal banking agencies have issued guidance to address many of the practices that contributed to the current situation. On June 29th, the federal banking agencies issued supervisory guidance to address the underwriting and marketing of subprime adjustable mortgages. The guidance focuses on two fundamental consumer protection principles. First, a loan should be approved based on a borrower's ability to repay according to its terms (not just at the initial rate, for example). Second, borrowers should be provided the information necessary to understand a transaction at a time that will help them decide if the loan is appropriate for their needs. The FDIC and the federal and state banking agencies feel strongly that clear, common sense standards regarding the underwriting and marketing of subprime adjustable mortgages are necessary to protect consumers and reinforce market discipline, while preserving a flow of capital to fund responsible lending.

As outlined in the guidance, we expect institutions to follow standards that: qualify borrowers at the fully indexed rate, assuming a fully amortized repayment schedule; limit risk-layering features; and permit stated income and reduced documentation only in specific, limited circumstances. The guidance also emphasizes that loan product disclosures must be clear and balanced, and that any prepayment penalties must allow for reasonable time for the borrower to refinance without penalty prior to the expiration of the initial interest rate.

Conclusion

In conclusion, as Chairman Bair has testified before Congress, we recognize the importance of subprime lending when properly underwritten and when borrowers are provided with complete and understandable disclosures. However, recent practices have resulted in many borrowers being placed in products that create financial hardship rather than building wealth. The FDIC is committed to help find solutions for borrowers already trapped in mortgages they cannot afford. That concludes my statement and I will be happy to answer any questions.

1 Alt-A loans are those made under expanded underwriting guidelines to borrowers with marginal to very good credit. Alt-A loans are riskier than prime loans due to the underwriting standards of the loans, not necessarily the credit quality of the borrowers.

2 Loan Performance Securities Database.

3 Calbreath, Dean, "Economists Employ 'R' Word on Jobs Data," The San Diego Union-Tribune, November 17, 2007.

4 Aaron C. Davis, "California's Deficit Balloons to $10 Billion Amid Slowing Economy," The Mercury News, November 14, 2007, http://mercurynews.com/breakingnews/ci_7460596 (accessed November 20, 2007).

5 DataQuick Real Estate News & Custom Data, "Record California Foreclosure Activity," October 26, 2007, DQnews.com, http://www.dqnews.com/RRFor1007.shtm, (accessed November 19, 2007).

6 FDIC estimates are based on the Loan Performance Securities database, reflecting loans included in private MBS issues. While this source is thought to include a high proportion of all outstanding subprime hybrid mortgages, totals based on this source must be regarded as lower-bound estimates.

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These resets of these subprime loans will have a tangible impact on the overall economy. Subprime resets in the U.S. between September 2007 and December 2008 are predicted to total more than $330 billion. California's share is slightly over $102 billion, or 31 percent -- with more than 288,000 first-lien, nonprime loans expected to reset during this period.2

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ARM loans with approaching resets in California have introduced additional uncertainty for California homeowners, lenders, and the public. If the industry fails to take action to respond to the potential defaults and foreclosures that are likely to occur when borrowers cannot make the reset payments, the economic consequences for California will be significant.

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Based on the limited data, it is difficult to estimate exactly how large each group might be. It is important to emphasize, however, that underwriting standards on these products were extremely low and their structure inherently necessitated frequent refinancing, an option no longer readily available to borrowers. The FDIC's calculations, based on nonprime mortgages included in private mortgage-backed securitizations (MBS), indicate that more than 1.5 million hybrid loans worth $330 billion are scheduled to undergo their first reset between September 2007 and December 2008.[6] Today, the vast majority of these loans remain current. Fewer than 350,000 loans are 60 days or more past due or in some stage of foreclosure prior to reset. For loans that remain current or less than 60 days delinquent, only 3.3 percent show both a loan-to-value ratio below 80 percent at origination and a debt service-to-income ratio below 30 percent -- attributes that might indicate a high probability of remaining current even after reset. Based on these criteria, our numbers suggest that the group of loans scheduled to reset that are current but may not remain so after reset are on the order of at least 1.1 million loans.

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A key issue is how to address the mortgage loans for owner occupied properties where the borrowers are current on their payments but will not be able to maintain the payments following reset. If servicers do nothing and allow all of these loans to reset to the full contract rate, the result will be the eventual default and foreclosure on hundreds of thousands of additional loans.

For this group of borrowers, Chairman Bair has recommended that servicers take a systematic and streamlined approach to restructuring these loans into fixed rate loans at the starter rate -- which is already above market rates for prime loans. These loans should be evaluated to determine the borrowers' ability to make the payment following reset and the net present value (NPV) of the loan modification should exceed the NPV of allowing the loan to go into foreclosure. Loans that are current after two years have clearly demonstrated a record by the borrower of a consistent willingness and ability to repay at the starter rate, which bodes well for their ability to repay at that rate over the long run.

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Some have expressed concern that restructuring subprime loans to a fixed rate of interest at the starter rate will result in a windfall for subprime borrowers. This misconception is based on the belief that the starter rates for these loans are similar to the low 1 to 2 percent "teaser" rates that were aggressively advertised for prime borrowers. In fact, of subprime hybrid mortgages originated in the first quarter of 2006, the average starter rate was 8.28 percent, which exceeded the average rate on subprime fixed rate loans made in that same quarter (7.93 percent), and was well above rates paid on prime fixed rate loans. These subprime borrowers will continue to pay higher subprime rates even after restructuring.

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Another popular misconception is that restructuring will deny investors a large stream of interest payments that would rightfully accrue to them after the loans reset to the full contract rate. The reality is that very few hybrid borrowers actually remain in the pools after reset and pay the full contract rate. Among such loans made and securitized in 2003, only one in 30 continues to pay at the full contract rate after four years.

Clearly, these loans generally were never designed or underwritten to perform at the full contract rate after reset. Among subprime hybrid loans made in 2006, nearly half had loan-to-value ratios above 90 percent, and more than half had monthly debt service-to-income ratios above 40 percent. Given that, on average, the full contract rate on these loans is five full percentage points above the starter rate, it is clear that they are not designed for long-term repayment.

Misconception: Restructuring is Unnecessary Based on Past Levels of Credit Losses

Some have argued that standardized and widespread restructuring is unnecessary based on past levels of credit losses. However, previous experience with losses of subprime hybrid ARMs provides very poor guidance regarding how these loans will perform going forward. For example, through August 2007 the cumulative default rate (CDR) for subprime hybrid loans originated in 2004 has been 10 percent; that is, of 1.6 million such loans originated that year, 162,000 have defaulted according to the latest data. However, with the benefit of rapidly rising home prices in many areas of the country, the vast majority of 2004 borrowers were able to repay their loans through refinancing or even the sale of the property.

By contrast, loans resetting today are doing so at a time when home prices are declining in many areas of the country and lenders are making very few subprime loans. Of hybrid loans originated in 2006, the CDR is already 10.5 percent -- before any of these loans have reset. Under today's market conditions, interest rate resets are likely to drive the CDR much higher than levels experienced on previous vintages. This means that the benefits of restructuring cannot be measured against what credit losses were in previous years, but rather must be viewed in the context of how many borrowers can actually afford to pay at the full contract rate where refinancing options are extremely limited and the value of the property has decreased or not increased as anticipated.

Misconception: Standardized Loan Restructuring Cannot Be Accomplished on a Broad Basis

Critics of the proposal to restructure loans to the starter rate as described above argue that such an approach is untested and cannot be implemented on a broad basis. However, the FDIC is aware of servicers that have already begun to use a similar approach with borrowers. Those servicers are reporting that the approach is feasible and significantly reduces the cost of restructuring and its complexity.

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First, the volume of resetting loans means that, in practical terms, the choice is between foreclosures on the one hand and systematic loan modifications for eligible borrowers on the other. A loan-by-loan calibration of what each borrower can pay will take too much time and too many resources. This increases the likelihood that a loan-by-loan approach will mean more foreclosures and loss of value to borrowers and investors. In contrast, following a streamlined modifications approach for eligible borrowers, as we have suggested, will free up resources to address the historic levels of resets that will occur in the coming 18 months and the more difficult loans and borrowers, such as those already delinquent and those with loans, such as Alt-A, that have risk layering characteristics.

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Current Loan Modification Efforts

Last week, Governor Schwarzenegger announced a particularly encouraging agreement with four major subprime lenders. Countrywide, GMAC, Litton and HomeEq -- which collectively service more than one quarter of subprime loans -- agreed to work with homeowners unable to afford escalating mortgage payments. The servicers agreed to maintain the initial, lower interest rate for some subprime borrowers whose loans are scheduled to reset to a significantly higher interest rate. To qualify, borrowers must occupy their homes, have made their payments on time and prove they cannot afford payments with the higher interest rate. We believe that this is a very positive step because it is a public commitment to support stream-lined loan modifications by the governor of our most populous state and to implement that commitment by loan servicers who service loans throughout the country. We hope that this action will encourage other servicers to adopt this approach to speed up the pace of loan modifications.

Also, earlier this year, the FDIC, along with the other federal banking agencies, issued a statement to banks encouraging them to find more affordable, sustainable products for borrowers who are currently struggling with hybrid adjustable rate mortgages. In the statement, we emphasized that lenders do not face regulatory penalties if they pursue reasonable workout arrangements, and we noted that institutions may receive favorable Community Reinvestment Act consideration for programs that transition borrowers from higher to lower cost loans. The statement also reminded institutions that existing regulatory guidance and accounting standards do not require immediate foreclosure on homes when borrowers fall behind on payments and that institutions should consider working with reputable consumer-based organizations to help financially stressed borrowers avoid predatory foreclosure rescue scams.

In recent months, that some financial institutions are proactively contacting borrowers facing rate resets and seeking to modify the problem loan terms. Borrowers who anticipate having difficulty making payments should take the initiative and seek assistance even if they have not been contacted. They should contact their servicer, the entity that receives their monthly payment, as soon as possible. The contact information for the servicer can be found on the monthly billing statement.

A number of lenders and servicers have initiated programs to help ameliorate the impact on borrowers. Some lenders say they are taking steps to contact troubled borrowers and work with them. Also, the U.S. Treasury-led alliance of mortgage servicers, lenders, investors and counselors called Hope Now began sending out 300,000 letters in mid-November to offer assistance to struggling homeowners who may be in a position to move into a more affordable mortgage.

Another initiative that should be mentioned is the FDIC's Alliance for Economic Inclusion. The Alliance is the FDIC's national initiative to form a network of local coalitions around the country charged with helping underserved populations in nine particular markets across the United States. As part of this effort, the Alliance for Economic Inclusion has partnered with NeighborWorks® America's Center for Foreclosure Solutions to promote foreclosure-prevention strategies for consumers at risk of foreclosure. Within each of the nine markets, the partnership will conduct outreach to identify and help homeowners at risk of foreclosure; work to increase lenders' support for foreclosure intervention; and promote best intervention practices in mortgage servicing programs for consumers at risk of foreclosure who could qualify for alternate financing.

Efforts to Address Questionable Lending Practices

In addition to addressing the problems of current borrowers, the FDIC and other federal banking agencies have issued guidance to address many of the practices that contributed to the current situation. On June 29th, the federal banking agencies issued supervisory guidance to address the underwriting and marketing of subprime adjustable mortgages. The guidance focuses on two fundamental consumer protection principles. First, a loan should be approved based on a borrower's ability to repay according to its terms (not just at the initial rate, for example). Second, borrowers should be provided the information necessary to understand a transaction at a time that will help them decide if the loan is appropriate for their needs. The FDIC and the federal and state banking agencies feel strongly that clear, common sense standards regarding the underwriting and marketing of subprime adjustable mortgages are necessary to protect consumers and reinforce market discipline, while preserving a flow of capital to fund responsible lending.

As outlined in the guidance, we expect institutions to follow standards that: qualify borrowers at the fully indexed rate, assuming a fully amortized repayment schedule; limit risk-layering features; and permit stated income and reduced documentation only in specific, limited circumstances. The guidance also emphasizes that loan product disclosures must be clear and balanced, and that any prepayment penalties must allow for reasonable time for the borrower to refinance without penalty prior to the expiration of the initial interest rate.

Conclusion

In conclusion, as Chairman Bair has testified before Congress, we recognize the importance of subprime lending when properly underwritten and when borrowers are provided with complete and understandable disclosures. However, recent practices have resulted in many borrowers being placed in products that create financial hardship rather than building wealth. The FDIC is committed to help find solutions for borrowers already trapped in mortgages they cannot afford. That concludes my statement and I will be happy to answer any questions.

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1 Alt-A loans are those made under expanded underwriting guidelines to borrowers with marginal to very good credit. Alt-A loans are riskier than prime loans due to the underwriting standards of the loans, not necessarily the credit quality of the borrowers.

2 Loan Performance Securities Database.

3 Calbreath, Dean, "Economists Employ 'R' Word on Jobs Data," The San Diego Union-Tribune, November 17, 2007.

4 Aaron C. Davis, "California's Deficit Balloons to $10 Billion Amid Slowing Economy," The Mercury News, November 14, 2007, http://mercurynews.com/breakingnews/ci_7460596 (accessed November 20, 2007).

5 DataQuick Real Estate News & Custom Data, "Record California Foreclosure Activity," October 26, 2007, DQnews.com, http://www.dqnews.com/RRFor1007.shtm, (accessed November 19, 2007).

6 FDIC estimates are based on the Loan Performance Securities database, reflecting loans included in private MBS issues. While this source is thought to include a high proportion of all outstanding subprime hybrid mortgages, totals based on this source must be regarded as lower-bound estimates.

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