Remarks by
FDIC Chairman Sheila Bair
at the
National Association
of
Home Builders housing affordability symposium
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Good morning and thank you for that very kind introduction. I'm delighted to be here to help kickoff your conference.

I greatly admire and respect all of you, and your efforts to tackle housing issues at the local level.

I share your interest and passion to find ways to help working families build prosperity across America.

What many of you are doing is very much in tune with our job at the FDIC.

Our core mission is maintaining public confidence in the banking system by insuring deposits.

We do this as a safety and soundness regulator, and by protecting consumers who use banking services.

I see this as two sides of the same coin.

Safe and sound lending practices help banks keep their problem loans manageable when a downturn comes.

And well-informed customers, who feel that they are being treated fairly by mainstream financial institutions, and who understand the banking products they use, make the best customers.

The American financial system today remains the largest, most diverse, most innovative in the world. The banking industry has been strong and profitable.

Subprime & housing affordability collide

Nevertheless, it is no secret that current market conditions are challenging for banks and consumers.

The source of much of the market turmoil is due to credit problems in subprime mortgage lending.

Housing affordability remains one of America's most important social issues – and it's become a greater challenge given the growing mortgage crisis.

Let me say at the outset that we firmly support affordable housing. In all that we have done over the past year to quell the mortgage meltdown, keeping people in homes they can afford has been our goal.

To do that ... and to enable more people to buy homes in the future ... we need stable and sustainable mortgage lending. We're working very hard to get the industry back on track so that you can keep building the homes that Americans want to buy.

As you know, the affordability of housing depends mainly on three factors – household incomes, the price of homes, and the cost of financing, or interest rates.

These factors vary over time in relation to the health of the economy ... with cycles in home prices ... and with financial market developments.

In the early years of this decade, we saw historically low mortgage rates help keep housing within reach for many buyers, despite slow growth in personal incomes.

But the historic boom we saw in home prices between 2000 and 2006 pushed up the price of homeownership beyond the means of many families ... particularly those at or below the median income level.

One market response to this erosion in affordability was the wider use of products that reduced monthly mortgage payments for a limited time.

Many of these loans were made to credit impaired or "subprime" borrowers ... and were poorly underwritten with multiple "layered" risk factors.

These included the widespread practice of qualifying subprime borrowers at introductory "starter" rates for adjustable rate loans instead of the fully-indexed reset rate. These 2/28 and 3/27 hybrid loans are a big part of the problems we're now seeing.

What's more, most of the problem subprime mortgages were made by non-bank lenders ... not traditional insured banks and thrifts.

Most of these lenders were lightly regulated, if they were regulated at all.

Many of the loans involved lax lending standards and terms that many consumers did not fully understand.

All too often, subprime adjustable rate loans involved marketing practices which failed to disclose the full costs of the loans after the reset and the availability of fixed rate loans at monthly payments only marginally higher than the starter rate of the adjustable rate product.

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The bottom line is that these loans are now resetting at vastly higher rates, and people cannot afford the payments.

Even at the starter rate, well more than half of these loans require borrowers to commit more than 40 percent of their gross income just to pay the mortgage.

Poor underwriting practices kept mortgage lending pipelines full, even while affordability diminished. This model worked okay, as long as home prices kept rising.

However, it failed when prices stopped rising.

Rapid home appreciation in many parts of the country allowed borrowers to refinance or sell their homes to avoid paying the higher reset rates.

But as home prices flattened out in 2006 in many areas and began declining this year, refinancing has become more difficult.

As a result, more and more subprime borrowers are facing foreclosure and are in danger of losing their homes.

Avoiding foreclosure & loan restructuring

While foreclosures are devastating for individual households, they also can put downward pressure on home prices ... causing more distress for communities and remaining homeowners.

Nationally, the foreclosure rate has nearly doubled in the past two years. Some are projecting as many as 2 million subprime borrowers could lose their homes as the reset picture plays out.

But in the months ahead, we believe that something can be done to keep people in their homes ... while maintaining value for investors who bought "pools" of these mortgages.

Specifically, we are suggesting that some of these hybrid loans – the so-called 2/28s and 3/27s -- can be restructured, and foreclosure avoided.

Borrowers that qualify would have to live in their homes, be current on their payments, and not yet had their loans reset.

Particularly for those borrowers who clearly won't be able to afford steep rate increases, loan servicers should convert them to fixed-rate mortgages.

This starter rate is typically higher than the rates on other types of fixed-rate loans.

With an estimated 2 million subprime hybrid ARMs resetting this year and next, servicers must take proactive steps if we are to avoid large numbers of defaults and foreclosures. Our proposal is designed to help borrowers avoid default and continue payments to investors by allowing servicers to stream-line how they deal with resetting mortgages where the borrower can make the starter rate but not the reset.

"Fast-tracking" refis or loan modifications for such performing loans into fixed rate mortgages will allow servicers to concentrate greater resources on other, more difficult cases and help ensure that growing foreclosures do not become a drag on our housing industry and economy.

While we think this is a reasonable approach ... it's up to mortgage servicers and investors to work together to rethink their assumptions and to implement new policies.

But I hasten to add ... this needs to be done soon ... while there's still some hope that these loans can be successfully modified.

And we need systematic approaches that will result in long term, sustainable mortgage products. "Kicking the can down the road" will only prolong borrower distress and investor uncertainty.

The future of mortgage lending

Beyond dealing with loans that have already been made, the federal regulators need to keep working on standards that will reshape future mortgage lending and avoid the mistakes of the past.

The banking regulatory agencies have already issued guidelines applicable to banks that address risky practices in non-traditional and subprime lending. These guidelines also shore up consumer protections that can help borrowers make better-informed decisions on their own.

Regulators have also encouraged bank lenders to work with borrowers to help get them into affordable mortgages.

But the ultimate solution is a national standard that covers all mortgage market participants ... including the mortgage brokers and others that were originating subprime loans.

The Federal Reserve has said it will propose such national standards by the end of the year.

The House Financial Services Committee is considering legislation introduced by Chairman Frank and others that would reform the industry and level the playing field. Chairman Dodd has also proposed uniform standards to apply across the mortgage industry.

I believe these legislative efforts will be balanced and bipartisan. Consumer groups and industry need to work with regulators and the Hill to assure that we stamp out abusive lending while assuring adequate credit to support sustainable, affordable mortgage products.

In the meantime, all of us need to work with community groups to help borrowers in distress.

- The FDIC recently signed a national partnership with NeighborWorks America's Center for Foreclosure Solutions. We'll be promoting foreclosure-prevention strategies for consumers at risk in selected markets across the nation.
- The goal is to find workable solutions to keep good-faith borrowers in their homes.

A silver lining?

Despite the current turmoil in the subprime mortgage market ... there is a silver lining when you look past the problems. We could see a renaissance in Main Street banking by seeing a return of more mortgage lending to traditional banks and thrifts.

In this regard, I would like to pay tribute to an initiative launched by the Independent Community Bankers of America this week. Working at over 1,000 locations, ICBA members will host special events where borrowers can discuss terms in their current mortgages which they don't understand and receive information about ARM refinancing options. Hopefully, efforts like these will increase the range of options available to distressed borrowers who have sufficient equity and credit histories to refinance into more traditional home loans.

Responsible subprime lending can increase access to credit for borrowers from all walks of life, who before had no or very limited access.

The economic and social benefits of home ownership are well known – home ownership has long been viewed as a primary vehicle to build savings for the future and as a gateway to the middle class American Dream.

Three decades ago neighborhood "redlining" was addressed by the Community Reinvestment Act, which motivated banks and thrifts to put money back into their communities.

Since then, lending money responsibly, especially mortgages, in low-income communities has become a successful business model for many institutions.

Unfortunately, these same neighborhoods that were once "red-lined" became disproportionately served by higher-cost non-bank subprime mortgage lenders.

Fox example, in 2006, 54 percent of Black applicants and 47 percent of Hispanic white applicants receive higher-rate home purchase loans, versus only 18 percent of non-Hispanic whites ... this according to the Federal Financial Institutions Financial Examination Council (FFIEC).

As we return to more responsible underwriting practices and impose those standards across the board to bank and nonbank lenders, I am hopeful that these numbers will change.

Home ownership should be a vehicle for accumulating wealth, not stripping it.

If there is a silver lining around the current subprime debacle, it is the emergence of a national consensus that we need to get back to basics.

Borrowers need to understand the full costs of their mortgages – which will likely be their biggest lifetime financial commitments.

And lenders need to make loans that people can repay.

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