Remarks by
FDIC Chairman Sheila Bair
at
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Thanks for the kind introduction, and good afternoon to all of you.

I see some familiar names on the program and familiar faces in the audience today.

We've had a lot of contact with many of you in recent months as we've been working to resolve the subprime mortgage problem, and some of the fallout it's been causing.

Thanks to all of you for stepping up to the plate, and your commitment to this pressing issue.

It hasn't been easy for any of us.

This is a very complicated market. There's a lot of money at stake. It's hurting housing. It's tightening credit conditions. It's affecting the U.S. and global economies.

And worse yet, millions of peoples' homes are on the line.

I think we're making progress in developing solutions that promote a stable secondary market, and that benefits most market participants and borrowers. But we need to do more, and do it faster.

We're strongly encouraging banks, loan servicers, and others to try to find refinancing or restructuring opportunities for people who are trapped in these adjustable rate mortgages as they reset to higher interest rates.

Last month, the federal banking agencies along with the National Credit Union Administration, and the Conference of State Bank Supervisors (CSBS), formally urged servicers to work with borrowers to mitigate losses and keep people in their homes.

Our main target is loans held in securitization structures, where restructuring can be more complicated given the many players involved in these transactions.

We're encouraging servicers to review their PSAs to determine the full extent of their authority to restructure loans that are delinquent, in default or are in clear risk of default.

We believe that the contacts may allow servicers to proactively connect with borrowers at risk of default, and assess whether default is reasonably foreseeable. And if so, apply loss mitigation strategies designed to achieve sustainable mortgages.

Such flexibility is a positive. Loss mitigation techniques that preserve homeownership are generally far less costly than foreclosure, particularly when applied before default.

The agencies took a proactive position in getting out the word given the surge in ARM resets. So far this year, over $150 billion have been reset. And there's another $300 billion in the pipeline.

As you know, these resets may result in significant payment shock to borrowers, which can increase the likelihood of default.

You were involved in meetings we held earlier this year. And the American Securitization Forum's statement in June was very helpful in bringing some order to a confusing situation.

These efforts by the agencies and the industry appear to be taking root.

We're beginning to see institutions taking a more proactive approach on loan modifications. Some have said publicly that they plan to work with borrowers to modify their loans and avoid foreclosure.

But more needs to be done, and done sooner rather than later.

Frankly, I'm frustrated that the servicing restructuring has not reached the level that I had hoped it would.

Moody's recently reported that less than one percent ... less than one percent ... of subprime mortgages that are having problems were being restructured in any meaningful way.

We have a huge problem on our hands. We can't just sit here doing this kind of case-by-case, laborious restructuring process with all these millions of subprime hybrid ARMs.

I think some categorical approaches are needed, and needed urgently. We think the flexibility is there for this.

For instance, for owner occupied housing where the loan is current ... just convert that subprime hybrid ARM into a fixed-rate mortgage. Keep it at the starter rate. Convert it into a fixed rate. Make it permanent. And get on with it.

And get proactive. Passive letter-writing won't get the job done. You need to get on the phone with borrowers. Make human contact.

And work with community groups to help build trust with borrowers.

It's in everyone's best interest to avoid massive foreclosures.

Lenders and investors will ultimately benefit. You'll come out ahead of the game with a performing mortgage that's being paid versus having a loan that's in foreclosure.

Foreclosure costs a lot of money, and it will have a depressing impact on many communities.

We're already seeing it in a number of areas around the country ... not to mention the impact that a slumping housing market is having on the broader economy.

Some have indicated that certain investors in certain securities might benefit from alternatives to restructuring.

While securitization does slice and dice exposures to meet varying investor demands, we believe that if loan restructuring are effective they can be good for subprime ABS investors across the capital structure.

Furthermore, effective loss mitigation programs will provide the best workout solution by restructuring loan terms to increase the likelihood of borrower repayment and ... consequently ... provide the best scenario for bondholder returns.

The market also needs to know when and how troubled loans are restructured. Transparency promotes market stability.

Finally, it is important to remember that significant foreclosures within a securitization could result in the erosion of subordinate classes and the downgrading and price depreciation of the more senior bonds as well.

Therefore, effective restructuring can preserve credit support, reduce credit losses, and even minimize the increases in the duration of the bonds.

With little doubt, mortgage securitization has been a net positive for many middle- and lower-income communities, as well as the broader economy.

Homeownership is at record levels. And through securitization lenders have an effective tool for managing and diversifying risk.

The liquidity provided by private label mortgage-backed securities (MBS) has been a significant factor in the growth of nontraditional and subprime mortgage lending.

We just need to make sure that borrowers whose loans reside within a securitization structure are not significantly disadvantaged compared to borrowers whose loans reside in a traditional loan portfolio.

And I believe that flexibilities exist to mitigate this disparity.

The next thing we need to do is to come up with national standards for all subprime lenders.

The Federal Reserve, to its credit, will propose new mortgage lending standards by the end of the year that ... for the first time ...will include nonbank lenders.

Hopefully, this will curb what Chuck Prince at Citibank has called "regulatory arbitrage." Because of differences in regulatory oversight, some have gamed the system, tapping the capital markets using very irresponsible practices.

What I'm talking about are those no-money-down ... no-doc ... no-credit score ... no-nothing loan offers.

Unbelievably ... I still see those kinds of offers.

This kind of lending hurts consumers and our economy. It creates market uncertainty and is reducing homeownership.

And bad underwriting that was speculative, predatory, or abusive has seriously disrupted the securitization market and the availability of mortgage credit.

The current picture clearly shows how safety and soundness and consumer protection are truly two sides of the same coin. We are doing all we can to improve consumer protection and make certain that rules are consistent for all market participants.

Strong underwriting standards will bring more stability to this market going forward. It will give investors greater certainty in the quality of loans securing their investment and it will help keep families in their homes ... and help others buy homes in the years ahead.

Subprime mortgages have benefited Wall Street, and boosted homeownership across the country, especially for millions of lower income people.

The trick now is getting all the actors working together ... from Main Street to Wall Street to Washington ... to get this market on track as an engine for sustainable homeownership.

It's no secret that current market conditions are more challenging for banks.

Nevertheless, the banking industry overall is strong, well diversified, well-capitalized and is well-positioned to make loans and help take up the slack in the credit market.

Second-quarter earnings were the fourth highest on record -- only 3.5 percent below the all-time high. And more than 90 percent of all FDIC-insured institutions were profitable.

Banks were strong entering this period.

But because of the current environment, credit quality is likely to get worse before it gets better.

For example, noncurrent 1-4 family residential mortgage loans represented 1.26 percent of all such loans at the end of June. That's the highest rate since the first quarter of 1994.

This week, several large banks disclosed losses from their leveraged lending activities and in their securities portfolios. In the third quarter, we believe that a rise in problem loans will again reduce industry earnings.

Experience shows that credit losses stemming from broad economic changes can take a few years to roll through the banking system. Given the current environment, we would expect credit quality to be a more important issue going forward.

But the silver lining may turn out to be new opportunities for insured institutions to expand market share, and to improve interest margins.

Credit needs of both businesses and individuals will need to be funded in the coming months. This presents both challenges and opportunities for FDIC-insured institutions.

Portfolio growth, if it occurs, would pose risk-management challenges for many institutions. For example, institutions that grow their loan portfolios will have to maintain sufficient capital to support that growth.

However, the industry's strong capital base means that banks can be a more significant source of financing for U.S. economic activity through this difficult period.

The recent problems in the credit markets also are a reminder that strong capital requirements are essential, and that mathematical models for assessing risk have their limitations.

These are very important lessons to remember as we approach implementation of the Basel II capital standards.

I'd like to end by pointing to the obvious.

We're all in this together. All of us bear some responsibility for the turmoil in the subprime market. And all of us need to be a part of the solution.

And let's be honest about it.

Hybrid ARMs were never made based on the assumption that the borrowers would be able to make the payment once the loan reset.

They were designed as two or three year "bullets" ... with the assumption that home appreciation would allow the borrower to refinance at, or before, reset.

Given current conditions in the housing market, this business model is no longer viable, which should come as no shock to anyone.

Let me be clear ...regulators support subprime mortgage lending.

Securitization has injected tremendous liquidity and strengthened the marketplace, while giving millions of Americans the opportunity of owning a home and building wealth.

I am hopeful that more secondary market funding can be directed at traditional 30-year fixed-rate loans.

These loans are steady and predictable, yet still provide a healthy return.

And they do not put subprime borrowers in the position of having to gamble on home price appreciation or the direction of interest rates.

I think the more subprime borrowers we can put into fixed-rate loans the better off everyone will be.

I would ask that you work with us to support national standards for responsibly underwritten subprime mortgages.

And I would ask that in making your own investing decisions, you seek out securities backed by responsibly underwritten mortgages.

I believe this is in everybody's best interest ... lenders, investors and homebuyers.

And it is in the national interest because it will go a long way to preserving the American dream of homeownership that ... in turn ... brings stability and well-being to communities and neighborhoods across the country.

Thank you very much.

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