**Remarks by**
**FDIC Chairman Sheila Bair**
**to**
**The New America Foundation conference:**
**"Did Low-income Homeownership Go Too Far?"**
**Washington, DC**
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Good morning and thank you for inviting me to speak.

What I'd like to do today is bury two myths that have been circulating lately. The first myth is that the Community Reinvestment Act caused the financial crisis. And the second myth is that working with troubled homeowners to reduce foreclosures lacks urgency and may be akin to a fool's errand.

## CRA as a scapegoat

I think we can agree that a complex interplay of risky behaviors by lenders, borrowers, and investors led to the current financial storm. To be sure, there's plenty of blame to go around. However, I want to give you my verdict on CRA: NOT guilty.

Point of fact: Only about one-in-four higher-priced first mortgage loans were made by CRA-covered banks during the hey-day years of subprime mortgage lending (2004-2006). The rest were made by private independent mortgage companies and large bank affiliates not covered by CRA rules.

You've heard the line of attack: The government told banks they had to make loans to people who were bad credit risks, and who could not afford to repay, just to prove that they were making loans to low- and moderate-income people.

Let me ask you: where in the CRA does it say: make loans to people who can't afford to repay? No-where! And the fact is, the lending practices that are causing problems today were driven by a desire for market share and revenue growth ... pure and simple.

CRA isn't perfect. But it has stayed around more than 30 years because it works. It encourages FDIC-insured banks to lend in low and moderate income (or LMI) areas, and I quote, -"consistent with the safe and sound operation of such institutions".

Another question: Is lending to borrowers under terms they can not afford to repay "consistent with the safe and sound operations"? No, of course not.

CRA always recognized there are limitations on the potential volume of lending in lower-income areas due to safety and soundness considerations. And, that a bank's capacity and opportunity for safe and sound lending in the LMI community may be limited.

That is why the CRA never set out lending "target" or "goal" amounts. That is why CRA supporters, many of you here today, have labored for three decades to figure out how to do it safely. It makes no sense to give a loan to someone under terms you know they can't pay back. That's a set up for failure.

Despite our current problems, the homeowner is still one of the best credit risks in the world. Today, the delinquency rate on all home mortgages is only 3.6 percent. For subprime loans, there is a stark difference in the type of loan. The rate of seriously delinquent subprime fixed rate loans is a little more than one-third the rate for subprime adjustable rate mortgages.

Any family willing to work, save money, pay the

mortgage on their house is a sound basis of credit and a sound basis for America.

So let the record show: CRA is not guilty of causing the financial crisis.

**The housing crisis – time to stop the bleeding**

That brings me to the other myth I want to dispel: that we can end the housing crisis without modifying troubled mortgages to make them affordable for millions of people facing foreclosure.

The housing crisis was caused by loose lending practices and unaffordable mortgages. And now unnecessary foreclosures are a very serious threat to a housing recovery.

Millions of Americans are saddled with mortgages they cannot afford and are in danger of losing their homes. The huge surge in foreclosures is hurting everyone by depressing housing values and putting more borrowers at risk. Many are suffering from the recession through lost jobs, lost savings, and lost communities.

As regulators, we need to use our authority and clout to stop it, and get the country out of the foreclosure crisis. This has got to be the top priority.

While there are no magic bullets, and a multi-prong effort is indeed needed, the core issue is lowering borrowers' monthly payments to an affordable and sustainable level. In recent months, we've seen federal and state governments, and consumer groups work with some success to encourage the industry to modify loans. And we're now seeing some larger scale initiatives being taken – something I believe is key to any solution.

But we're still very much behind the curve. We need a fast-track, nationwide effort.

We successfully launched such a program for systematically modifying loans at IndyMac Federal, a California bank we took over in July. To date, we've verified incomes and completed modifications for over 7,500 loans with thousands more in the pipeline.

Using this as a model for a "Loan Mod in a Box" national program, we think we could help 1.5 million families avoid foreclosure using $24 billion in government financing. This would help get at the root cause of the credit crunch and the economic recession.

We're gaining ground and support. The American Bankers Association endorsed our program last week. They believe that many more borrowers across the country can be helped.

**Loan mods work when done right**

There are some who question the effectiveness of loan modifications. They point to recent data suggesting that many modified loans end up re-defaulting, putting homeowners back in trouble.

I beg to differ. At the very least, the jury remains out.

Last week, the Office of the Comptroller and the Office of Thrift Supervision released a report on mortgages that has been cited to show substantial redefaults on modifications. Unfortunately, it is hard to draw conclusions from the report for three key reasons.

First, the report simply defines a modification as any change to the contract terms. Many past modifications were simply short term fixes that did not create a sustainable payment for borrowers. Comptroller Dugan agrees that sustainable modifications should perform much better.

Second, the report covers a period before most sustainable modification approaches were adopted. In November, Freddie Mac, Fannie Mae, and Hope Now announced that they were adopting many of the features of the FDIC's model.

Finally, media stories about the report focused on delinquencies after only 30 days. While those made for big numbers, the 60-day delinquency figures reported by the OCC were much lower. That's more in line with industry standards – which measures delinquencies after 60 to 90 days. Experience shows that a large percentage of 30-day delinquent mortgages will become current again.

**Affordable mortgages a must**

As we have stressed, a sustainable modification must be based on affordability. The FDIC's approach focuses on creating an affordable and sustainable monthly mortgage payment based on verified income.

Using a combination of interest rate reductions capped at a prime, conforming rate, amortization extensions, and in some cases, principal deferment produces modifications that will last and, we believe, dramatically lower the re-default rate.

Indeed, a recent Credit Suisse study found that modifications based on interest rate changes had a 15 percent re-default rate. And those that had principal forbearance had a 23 percent default rate.

We've been urging servicers to focus on affordability ... income verification ... setting mortgage related payments at 31 to 38 percent of monthly income ... and fixing interest rates and including lifetime interest rate caps.

Some investment analysts are beginning to come around. Just yesterday, Fitch Ratings announced that it was looking to well-structured modifications as a key part of the ratings for servicers. As Fitch Managing Director Huxley Somerville said: "modifications, when properly done, can benefit U.S. homeowners and ... investors."

The FDIC has been reworking troubled loans of failed banks for decades. We have a lot of practical experience. We know how to do this, and believe it needs to be done on a national scale.

**Let me raise a final issue**.

Largely because we've waited so long to act effectively, we have a new problem: scam artists preying on distressed homeowners. We need to work closely with consumer groups, prominent policy gurus like yourselves, and others to warn distressed homeowners about these scam artists offering help for a hefty fee.

A member of Congress recently called me with a heartbreaking story of a financially strapped family with an unaffordable mortgage who had paid $2,500 to a "foreclosure prevention specialist" to get a loan modification. We were able to refer the family to the proper servicing agent, who, of course, does loan modifications to qualified borrowers at no cost.

Please help us get the word out that borrowers should contact reputable housing counselors through groups such as Neighborworks of America, or work with their servicer directly. It's very important for qualified borrowers to understand that the industry best practice is loan modifications free-of-charge. They do not need to spend thousands of dollars to get help.

It's also important for borrowers to understand that if they have an affordable payment, they should keep paying on their mortgage. Even under the IndyMac program, if the net present value of a modified loan does not exceed the foreclosure value, the loan will have to go to foreclosure.

So that while we can help a lot of people, we can't help everyone. Borrowers risk losing their houses if they purposely become delinquent to try to get a lower mortgage payment. The best thing they can do is stay current on their loans.

**Conclusion**

Let me end with this: Consumer protection by bank regulators is not an oxymoron. But we need to change how we do it. The rules need reworking to match a changing industry and changing consumer needs.

Instead of playing "catch up," we need to keep pace with the times, making the way we operate flexible and nimble enough to respond quickly to changing, and often unpredictable market demands.

So I want to thank the Center for Community Capital and its many sponsors for your new study of LMI lending. We need more thoughtful, comprehensive research like this so we can design policies and programs that are more effective in delivering credit to families of modest means, which is needed now more than ever.

I look forward to working with you going forward as we work to reshape the nation's consumer protections, and bolster public confidence in our financial system. It's going to be another tough year in 2009. And we're preparing for it. But we'll work through it. And by 2010, we'll be seeing the light at the end of the tunnel.

Thank you very much.

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