Remarks by
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Thank you very much for the opportunity to be with you today. Back when ACB consisted almost exclusively of thrifts – and when commercial banks were relatively minor participants in the home mortgage market – it was a rare occurrence for the Comptroller of the Currency to speak at this conference. Our constituents – and our interests – were simply too different.

But times have changed.

Today, commercial banks account for nearly 20 percent of all ACB members, and banks and thrifts share a long list of concerns. No matter what your charter, each of you worries about credit quality, about regulatory compliance, and about protecting the good name of your institution. Your interests, like those of the trade groups that speak for you and the government agencies that regulate you, are increasingly intertwined.

Certainly, mortgage lending has become a mainstay for commercial banks in general, and national banks in particular. During the first two quarters of 2006, commercial banks and their subsidiaries originated nearly 60 percent of the $1.5 trillion of total mortgage originations. During the same period, national banks originated approximately $593 billion, or roughly 39 percent of the total. Mortgage lending has therefore become a key contributor to commercial bank asset growth – and an increasingly important factor in revenue and profitability.

In this context, I have two closely related subjects to discuss with you today, both involving the recently released, final interagency guidance on nontraditional mortgages. First, I want to provide a few observations concerning why we did what we did, what the guidance means, and why we believe it's important. Second, I want to focus on an issue that received a great deal of attention during the comment period: namely, that while the guidance applies to insured depository institutions and their affiliates, it does not apply to the many mortgage originators that have no such affiliations. This gap in uniform application of the guidance raises important issues of both policy and competitive equity – issues that I believe need to be addressed.

Reasons for the Guidance

So let me begin by explaining why we issued the guidance. The story begins fundamentally with a trend that will surely define the last five years in our consumer credit history: the rapid appreciation of house prices across the country. Increased house prices translated into the need for much bigger mortgages and, with traditional fixed and adjustable rate mortgages, much bigger monthly payments. During the same period, however, the growth in family income failed to keep pace with the rise in house prices. That in turn made it more difficult for borrowers to afford the higher monthly mortgage payments necessary to buy much more expensive homes.

Statistics vividly illustrate these trends. Between 2002 and 2005, the median home sale price nationwide increased from $158,000 to $212,000, an increase of 34 percent. But median family income grew only 12 percent during the same period. Expressed differently, in that same period, the median home price grew from about 3.1 to 3.7 times median income. In the hottest housing markets, such as California, home prices were up to 5.3 times median income by 2005. At those prices, according to the National Association of Realtors, only 17 percent of California households were able to afford the median-priced single family home.

This being America, lenders adjusted. They turned increasingly to products that could produce lower monthly payments than those resulting from traditional mortgages – specifically, interest only mortgages and payment option, negative amortization mortgages. They also turned to more aggressive underwriting practices that allowed borrowers to qualify for mortgages with less money down and less proof of income. The result: borrowers could qualify for larger mortgages, and they could more easily afford the lower monthly payments. That meant that consumers could buy and move into more expensive homes that otherwise might have been out of reach.

Under these circumstances, it is not surprising that these different types of loans caught on in a big way. In 2000, nontraditional loans constituted less than 2 percent of all originations. By 2005, approximately 30 percent of all mortgages fell into this category, with numbers in the 50 percent range not uncommon in the highest-priced markets.

Of course, that's not quite the whole story, because it doesn't explain how monthly payments could be lower for nontraditional mortgages. There is no magic to this. Monthly payments are lower only in the early years of such loans, with the reduced amounts offset by higher monthly payments in later years. Put another way, you pay less now, but you pay more later – and sometimes a lot more. Under very plausible circumstances for a typical payment option mortgage, for example, monthly payments could easily double after just five years.

Now, there is nothing inherently wrong with payment deferral products like nontraditional mortgages that have low early payments and high later payments. They're just riskier.

And such mortgages can work well and have worked well in particular kinds of circumstances. For example, they have worked well for borrowers with irregular income streams, or borrowers who are likely to have significant increases in income over time. But that does not mean that they will work well in <u>all</u> circumstances, which seems to be the assumption underlying the more recent mass marketing of payment deferral products to a much broader range of consumers. Indeed, for many consumers, especially subprime borrowers, payment deferral products raise the real prospect of increased defaults and foreclosures when monthly payments reset at much higher rates.

In essence, the widespread use of payment deferral products raises two fundamental concerns. First, do consumers really understand just how much their monthly payment can jump in the out-years of a nontraditional mortgage? Some lenders have taken very substantial measures to beef up their disclosures in a meaningful way. Too often, however, the marketing materials we reviewed emphasized the low initial payments, but glossed over the likelihood of much higher payments later. And too often the disclosures about higher future payments were made late in the lending process, well after consumers had made their decisions to assume this very different type of loan.

Second, and even more important, are lenders adequately assessing the risk of borrowers not being able to make much higher monthly payments in the later years of these loans? Or, instead, are lenders relying too heavily on the value of the collateral – the home – with the hope that the home's value will increase over time?

These two fundamental concerns precipitated our interagency guidance. The guidance directs financial institutions to ensure that loan terms and underwriting standards are consistent with prudent lending practices, with particular attention paid to the borrower's capacity to make the payments necessary to repay the full amount of the loan. In a nutshell, this repayment capacity analysis should include the initial loan amount, plus any balance that may accrue over time due to negative amortization, at the fully indexed, amortizing rate. The guidance further provides that, when banks rely on reduced documentation, particularly unverified income, they do so carefully. And it sets forth the expectation that banks with a portfolio of such mortgages will adopt robust risk management practices that provide early warnings of potential or increasing risks.

In terms of consumer understanding, the guidance calls for lenders to provide borrowers with disclosures about the relative benefits and risks of these products that are short, clear, and free of legal and financial jargon. This information needs to be provided to borrowers when they are shopping for loans, before they make the basic decision of what type of mortgage makes the most sense. Moreover, in response to suggestions received during the comment period, we proposed for further comment models of what such disclosures might look like. I very much encourage you to let us know whether we should adopt these or others as models to help institutions make the type of simplified disclosures envisioned by the guidance.

Now, having listed the most prominent positive attributes of the guidance, I also want to emphasize what it does not do. It is not a ban on the use of nontraditional mortgage products. It does not impose a limit on the number of nontraditional mortgages that an institution may hold. And it does not impose any new capital requirements.

Instead, the guidance acknowledges that nontraditional products have an appropriate place on the menu of mortgage options as a way to provide consumers with more choices in financing their home purchases. Indeed, financial innovation is one reason why nearly 70 percent of American households own their own homes – furthering a longstanding national goal that ACB members have done as much to advance as any institutions in America today. It would be fundamentally inconsistent with that goal, however, to condone lending practices that put consumers into mortgages that they do not understand and cannot afford. The guidance is intended to help lenders and borrowers avoid that result.

Unfinished Business: Applying Comparable Standards to All Lenders

Let me now turn to the second topic I want to address today. Our issuance of the nontraditional mortgage guidance, as important as it is, can only be viewed as unfinished business. During the comment period, banks and thrifts expressed strong concerns that the guidance would apply only to federally regulated institutions – insured depository institutions and their affiliates – but would not apply to those mortgage lenders and brokers regulated exclusively by the states, which constitute a large portion of nontraditional mortgage originators.

I agree with these concerns. There is an unlevel playing field that plainly distorts competition in the nontraditional mortgage business. And there is also a consumer protection gap with respect to the nontraditional mortgage lending practices of a broad segment of mortgage lenders.

Our interagency guidance cannot directly reach the segment of the mortgage business that is conducted by neither banks nor affiliates of banks. The guidance does call for federally regulated institutions to exercise appropriate due diligence when they use a third party to make, purchase, or service a nontraditional mortgage on behalf of the institution. But these due diligence responsibilities are no substitute for the direct application of appropriate underwriting and disclosure standards to these third party originators.

Moreover, many of these originators will have no contact with a federally regulated institution at all – so the guidance will never even indirectly touch their operations. For example, institutions may sell the mortgages they originate directly to investment banks that package and securitize them. Indeed, the appetite for mortgages to securitize is so strong that we now see investment banks and other financial intermediaries acquiring mortgage originators in an effort to lock in volume for their securitization business. In some cases, these acquisitions transform a mortgage business that had been subject to federal standards to one that is not.

So when we see this gap, this unlevel playing field, what is the solution? It cannot be, as some have suggested, that federal regulators should eliminate or lower standards that we believe are necessary for prudent and effective regulation. Instead, I believe that the standards must be raised in the part of the mortgage business that we do not regulate so that they are comparable to those applicable to federally regulated institutions.

State regulation, effectively enforced, can do this. But important work is still to be done for states to achieve this goal. It ought to be fundamental that all mortgage originators employ prudent lending practices, including credible consideration of a borrower's ability to repay a loan – as structured – from sources other than the borrower's home pledged as collateral. All mortgage originators should be providing prospective customers clear and balanced disclosures about the relative risks and benefits of non-traditional mortgages, including the risk of payment shock and negative amortization. And monthly statements provided to borrowers by all lenders and mortgage servicers should provide information that enables a borrower to make an informed payment choice.

I have been encouraged by the recent statements by the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators. These two organizations are working on a version of the nontraditional mortgage guidance that will focus on mortgage underwriting and consumer protection issues. We understand that state agencies then will be urged to adopt and apply this guidance to the entities they regulate. In so doing, it is vital that key principles of our nontraditional mortgage guidance not be watered down. We have had, and we expect to continue, constructive discussions of this challenge with state regulators and the CSBS as part of the Treasury Department's Consumer Financial Protection Forum.

I believe that it is essential for state regulators to embrace these efforts so that the standards adopted at the state level address the core risks covered by the federal guidance. It is equally important for state agencies to deploy the necessary resources to effectively enforce these standards with respect to originators that are not subject to the federal guidance.

Indeed, the need for comparable action at the state level is perhaps even more acute given the volume of nontraditional mortgages made by non-federally regulated lenders to subprime borrowers. We know, for example, that recent investigations at the state level have produced evidence that some mortgage lenders and brokers have purposely steered prospective customers, often of low and moderate income, or limited English language ability, into loans that they cannot afford, by using misleading tactics and, in some cases, by committing fraud. In the case of these customers in particular, an improperly underwritten or inappropriately disclosed non-traditional mortgage loan runs the highest risk of foreclosure, a ruinous consequence for both individuals and communities.

Let me conclude. Ensuring the home mortgage market works as it should is critical because, for most Americans, a home is their most precious financial asset. The membership of ACB is uniquely situated to appreciate this fact – and the importance of addressing the challenge I have discussed with you today. Flexible features of nontraditional mortgages reflect the creativity and dynamism of our financial markets in finding ways to expand access to credit to facilitate home ownership. But the last thing that any of us wants is for the American dream of home ownership to turn into an American nightmare of foreclosure. I worry about that happening if disparate standards applied by different lenders distort the markets of nontraditional mortgage loans. Thus, we look forward to continuing to collaborate with the states on this issue to close the gap – and level the playing field – so that all mortgage originators are appropriately addressing the same key issues raised by nontraditional mortgages.

It has been a pleasure to be with you this morning to discuss these important issues. Thank you very much.