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Remarks by
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Let me extend a heartfelt welcome to the many outstanding representatives of our financial, civic, philanthropic, academic, and regulatory communities gathered here today. Coming together in this forum reminds us that, despite the diversity of our backgrounds and workaday worlds, we are partners in a great and historic enterprise: expanding opportunity for our fellow citizens still struggling to enter the mainstream of American life.

Two hundred and twenty-one years ago, just up the road from where we are sitting today, Thomas Jefferson wrestled with the ideas that would serve as justification for the parting of ways between the united colonies and Great Britain. For Jefferson and most of his colleagues assembled that summer, independence contained political and economic elements. And when, in the words that sprang from his pen, America committed itself to the pursuit of life, liberty, and the pursuit of happiness, his countrymen took that pledge as he intended it--as a guarantee of opportunity to make one's way in the world, to pursue a career or a trade of one's own choosing, to rise or fall by one's abilities and exertions. These commitments formed one side of the compact that induced Americans, for their part, to expose their lives and property to the perils of war against mighty England. And when independence was made good, the people who had risked everything to achieve it demanded their due in return. Since then, all who have held power have assumed a solemn responsibility to safeguard and promote the cause of economic opportunity so central to American civilization and the spirit of 1776.

As the place where the contract was consummated, as the wellspring of the ideals that set us apart as a nation, Philadelphia is an appropriate setting in which to meet as we renew our commitment to the cause of affordable housing--a crucial piece of the American dream.

Nothing has been more crucial to making that dream a reality for millions of Americans than what I often refer to as the democratization of credit.

Unlike the declaration of 1776, which set the colonies free with a single bold stroke, the democratization of credit has been a slow process.

None of us in this room could have borrowed much money, if any, on the terms that banks made available at the time the Declaration of Independence was signed. Bankers of that era believed that the only really safe lending was short-term lending to an elite clientele of wealthy, landed individuals.

A century later, not much had changed. In 1863, the first Comptroller of the Currency, Hugh McCulloch, repeatedly warned national bankers to make only those types of loans that were specifically authorized by law and tradition. In practice, this meant that national banks made no real estate loans, no long term business loans, and no consumer loans. Personal loans were sometimes extended as a personal courtesy to good corporate clients. But the idea of general market for consumer credit--even for well-off consumers--attracted few converts and much derision among bankers. Without an established record of creditworthiness, ordinary Americans were assumed to be unworthy of it.

But ordinary Americans proved otherwise. Denied credit by banks, they turned elsewhere: to Morris Plan banks, building societies, pawnshops, and other nonbank providers. During the Great Depression, consumer loans outperformed commercial and industrial loans, sending a powerful message that the average American could learn how to handle credit responsibly. Bankers took this message to heart. And so the democratization of credit proceeded.

This century-long change in attitude and practice is nowhere more evident than in the mortgage market. A hundred years ago, three out of four residential mortgages were held by individual investors. Interest rates and down payment requirements for such loans were often prohibitively high. Fifty percent down was customary. It was not uncommon for mortgage loans to run for as little as two or three years. On such terms there were relatively few takers--and, consequently, relatively few homeowners. In 1890, two-thirds of all nonfarm residents in the United States were renters; only one out of three Americans was a homeowner.

Since then, a quiet revolution has taken place in American housing. Today, thanks in large part to the democratization of credit--including importantly bank credit--the numbers of a century ago have been reversed. Today, almost two-thirds of Americans are homeowners. More enter their ranks every day, often with financing obtained from a bank. As late as the 1940s, commercial banks ranked dead last among institutional lenders providing housing finance. Today, commercial banks provide more money for mortgage loans than any other financial institution.

The latest phase in the democratization of credit is taking place right before our eyes. Over the past two decades, a serious and successful effort has been underway to make credit available to low and moderate income individuals. This effort has resulted in tens of thousands of home mortgage loans to people who would otherwise not have been able to obtain them.

These loans have thus far proved to have default rates that are essentially the same as loans to upper income borrowers. In some cases, default rates have been lower.

For the vast majority of individual borrowers, this has meant a better life--a better home and a safer and more stable environment in which to live and raise children. For society, it has meant stronger neighborhoods and more productive citizens. And for lending institutions, it has meant new profitable customer relationships.

To a considerable degree, this quiet revolution in lending to low and moderate income individuals has been a dual process of breaking down past prejudices about creditworthy borrowers and replacing old lending techniques with innovative ones to make credit available. For example, we have learned that development lending--targeting lending to an entire distressed neighborhood--has great advantages over hit-and-miss lending in those same areas. Development lending has the advantage of dramatically increasing the likelihood that property values will rise in targeted neighborhoods, thus increasing the borrower's equity and the lender's collateral.

These two decades of increased lending to disadvantaged individuals coincide with the enactment and enforcement of the Community Reinvestment Act, whose 20-year anniversary will be celebrated this October 12. During this 20 year period, a number of observers have argued that the statute's goals--lending to low and moderate income individuals--conflicted with the goal of ensuring that we have strong, safe and sound banking institutions. And yet, we have found that what has been true of the democratization of credit at each stage in the process is true in this case, too: that in the vast majority of cases, lending to low and moderate income Americans is also safe lending.

Indeed, I strongly believe that the OCC's statutory responsibilities, both to enforce the Community Reinvestment Act and to ensure a safe and sound banking system, are mutually supportive. Banks do not get stronger by turning their backs on large portions of their communities that could be good, creditworthy customers. In fact, the opposite is true.

I also believe that the symbiosis between community development lending and safe and sound banking is based on facing up to real facts and dealing with those facts. We must ask hard questions and deal forthrightly with the answers. Who is really creditworthy? What innovative techniques can be used to extend credit? Which techniques work and which do not?

These questions are extraordinarily relevant to the business of today's symposium. The affordable mortgage market represents one of the great challenges before the private sector at a time when only the private sector has the resources available to meet the vast need for affordable housing in America.

We know that the affordable mortgage market has its complexities--particularly for lenders new to it--and that some have therefore shied away from it. The higher than average loan-to-value or debt-to-income ratios that typically characterize these loans can mean reduced opportunities for securitization. Private mortgage insurance may not be available or, for competitive reasons, lenders may decline to require it. The concentration of adjustable-rate mortgages generally found in some affordable mortgage portfolios can mean higher interest rate risk.

What have we learned recently about these markets?

In 1996 we conducted a review of national banks' affordable mortgage portfolios as part of an overall survey of credit underwriting practices. Early this year, we carried out a follow-up review of 13 banks with the largest dollar volume of affordable mortgage loans.

Here is what we found. Our evidence shows that losses for affordable mortgage loans are about the same as for all mortgage loans--less than one tenth of one percent. However in 1996, total delinquencies in the affordable mortgage portfolios of large national banks averaged 4 percent, compared to 3 percent for residential real estate portfolios as a whole. In the last six months of 1996, the delinquency rate of affordable mortgage loans at some banks increased by about 100 basis points, compared to an increase of 2 basis points for all mortgage loans. The increase in the delinquency rate was more pronounced in those affordable mortgage programs where risk was heavily layered--that is, where more than one traditional risk factor was disregarded in making the loan.

This delinquency rate must be taken seriously. But let's look at those numbers and put them into context. At year-end 1996, about 5 percent--one out of twenty--of affordable mortgage loans at some banks were delinquent. That means 19 out of 20 affordable mortgages at those banks were current.

Think of it. Ninety-five percent of affordable mortgage customers--families that would never have been able to receive a home purchase loan under conventional standards--are meeting their obligations on time and in full. Thousands of families that would never have had a chance to enjoy the economic and social benefits of home ownership are doing so today because lenders were willing to give them the chance to prove that "one size fits all" doesn't work all the time.

The OCC's surveys show that the delinquency rate for affordable mortgage loans is lowest--and the proportion of such loans in the total mortgage portfolio highest--in those banks that have held those loans the longest. Affordable mortgage programs that had been in operation for more than three years tended to have virtually no increase in delinquency rates. In short, we found that the more experience banks had with affordable mortgage loans, the better they had learned how to manage the special risks those loans entail.

What does all this suggest?

It suggests that banks that are new to the affordable mortgage area should closely monitor those programs, particularly those that layer risk factors. These banks should look for techniques that will help keep delinquencies under control. In this regard, the results of our surveys suggest banks may want to consider some if not all of the steps taken by more established programs to deal with the challenges of affordable lending programs.

What are these steps? We identified three common characteristics shared by banks with the most mature affordable mortgage programs.

- Applicants at these banks were generally required to complete a comprehensive program of pre-purchase counseling as a prerequisite for qualifying for affordable mortgages. This counseling varied from a two-hour self-study program to a four-week Fannie Mae/HUD-approved course. Banks with the most structured and comprehensive counseling tended to have the lowest delinquency rates--as much as two to three times lower than their peers with less formal programs. Conversely, banks offering little or no counseling typically had the most chronic delinquency problems.

- Banks with the lowest delinquency rates were often the same banks that had in place structured, rapid-response delinquency intervention programs enabling them to contact customers soon after a missed payment. Typically, these banks also had upgraded information systems to track loan performance and formal linkages between servicing units and counseling providers.

- Banks with the lowest delinquency rates were those which exercised care in layering risk factors. Borrowers with a single risk factor--say, a 43 percent debt-to-income ratio--were highly likely to service their loans satisfactorily. But if the borrowers had additional risk factors, the odds of delinquency increased.

Because I believe it is important that these and other findings be shared throughout the banking and affordable housing communities, we are releasing today an OCC Advisory Letter on affordable mortgage lending. It is my hope that by disseminating what we have learned, by encouraging banks to profit from the experiences of others in this field, we can simultaneously promote the growth of affordable mortgage programs, the health of our communities, and the safety and soundness of the banking system.

Sharing information is a big part of why we are here today. Our symposium is designed to encourage dialogue between all parties to the business of making affordable mortgages. Hopefully, our discussions will stimulate ideas that can lead to action on affordable mortgage performance, risk management strategies, pre- and post-purchase counseling, and many other essential issues. I look forward to hearing and learning from you.

Affordable mortgage programs are working and can be made to work better--for the banks that create them and for the borrowers who use them as a bridge to the American dream. As we roll up our sleeves and enter into our discussions today, we should draw inspiration from the American statesmen of 1776, who never shrank from a challenge they believed worth the effort. The cause of affordable housing is one challenge that is.

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