

For Release Upon Delivery  
10:30 a.m., September 5, 2007

**TESTIMONY OF**  
**JOHN C. DUGAN**  
**COMPTROLLER OF THE CURRENCY**  
**BEFORE THE**  
**COMMITTEE ON FINANCIAL SERVICES**  
**OF THE**  
**U.S. HOUSE OF REPRESENTATIVES**  
**SEPTEMBER 5, 2007**

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

## Introduction

Chairman Frank, Ranking Member Bachus, and members of the Committee, as the supervisor of national banks, I appreciate this opportunity to provide the OCC's perspective on recent events in the credit and mortgage markets. My testimony today will provide an overview of market conditions, their effects on the national banks we supervise, and actions that national banks and the OCC are taking in response. Before doing so, however, let me first describe the OCC's role with respect to these issues, followed by some general observations.

The OCC is the primary supervisor for the very largest commercial banks that play critical roles in virtually all aspects of today's capital markets, including the parts of the credit markets that have received so much attention in recent weeks, *i.e.*, the markets for mortgages, leveraged loans, and asset-backed commercial paper. The OCC maintains teams of examiners on-site at each of these institutions to monitor their activities. More broadly, over the last twenty years national banks across the country have become very substantial participants in residential mortgage markets, where they originate, hold, sell, buy, service, and securitize most types of mortgages. These include subprime mortgages, which have experienced so many problems recently, but let me emphasize that national banks have been proportionally less involved in that market, originating less than 10 percent of all subprime mortgages in 2006. In addition, the default rates on subprime mortgages originated by national banks are significantly lower than the national average. The OCC actively supervises national bank mortgage activities, and as we do with all our

supervision, we work closely with our colleagues at the other federal banking agencies that have overlapping jurisdiction.

From this perspective, and given that national banks account for nearly two-thirds of the total loans and leases held in the commercial banking system, the recent volatility in the mortgage and credit markets has clearly been a concern for both the OCC and the banks we supervise.<sup>1</sup> The challenging market conditions affect all market participants, including not just the largest national banks that participate actively in capital markets, but also the many mid-size and community national banks that engage in mortgage activities across the country.

Let me be very clear, however, that the worst problems we have seen in the markets – insufficient liquidity resulting in substantial declines in capital and sometimes in failure of individual firms – have occurred outside the commercial banking sector. The national banking system remains safe and sound. Unlike many non-bank lenders, national banks generally have strong levels of capital, stable sources of liquidity, and well diversified lines of business, which taken together provides them with substantial resources and flexibility to weather adverse market conditions. As a result, national banks remain active in major markets and continue to extend credit to corporate and retail customers, including mortgage credit.

With respect to general market conditions, I am encouraged by the recent actions to restore liquidity that have been undertaken by the Federal Reserve, other central banks, and various market players, including some major national banks. Nevertheless, the situation remains fluid, and it may take some time until the markets fully stabilize. As a

---

<sup>1</sup> As of June 30, 2007, national banks held \$3.976 trillion or 64.5% of the \$6.164 trillion in total loans and leases outstanding at all commercial banks.

result, we are continuing to watch conditions very closely and will continue to work with our fellow regulatory agencies to respond to issues that may arise.

While recent market conditions have certainly been painful, and may continue to be so for some time, we believe they are likely to cause some positive changes in the longer term as markets reevaluate and re-price risk. Part of today's problems in credit markets resulted from underwriting standards that had relaxed too much – whether in subprime loans or leveraged lending, to pick two examples – which was at least partly the result of investor willingness to assume greater risk to achieve higher yields. In both cases, market participants are now demanding changes in the form of more conservatism. While legitimate concerns remain about the pendulum swinging too far and too suddenly in the opposite direction, we remain hopeful that markets will stabilize at an equilibrium where lending standards are more rational and pricing more accurately reflects risk.

Such a positive outcome would apply in the future to loans that are yet to be made. Unfortunately, the same cannot be said for many loans that have already been made, and in particular, for many homeowners holding subprime mortgages. For those Americans who may be facing unmanageable mortgage obligations now or in the future, recent events are far more serious than a simple market correction or reallocation of risk. They may instead result in foreclosure and all its potentially devastating effects on families and communities. The OCC recognizes the need to do all we can to reduce the inevitability of that outcome. As a result, and as described in more detail later in my testimony, the OCC has taken concrete steps – both on our own and in conjunction with the other federal banking agencies – to encourage both lenders and borrowers to respond to these situations in ways that minimize the likelihood of foreclosure while preserving

safety and soundness. With the prospect of significantly increasing foreclosures looming on the horizon, we are fully committed to working with all interested parties to help address the many significant issues that could arise.

### **Market Background**

Let me now highlight some of the factors that have contributed to current market conditions. In brief, and as stated above, much of today's market dislocation appears to reflect an abrupt reassessment and re-pricing of risk by investors. Until recently, many market participants had been willing to invest and lend at prices and under conditions that appeared to provide less compensation for risk, at least by historical standards – no doubt fueled by a benign economic environment characterized by low interest rates, strong economic growth, rising home values, and very low rates of default. This environment, coupled with the continued globalization of financial markets that expanded the pool of liquidity and investors, spawned an array of new financial products and specialized firms. Over time, increased competition led to a loosening of underwriting standards prompted in part by capital market investors who were willing to accept higher levels of risk when purchasing credit instruments from loan originators or securitizers.

While these changing conditions were taking place throughout the financial markets, they were especially pronounced in the U.S. mortgage markets. The abundance of liquidity provided by investors searching for high-yielding financial instruments translated into new types of mortgage products for consumers, who, under prior conditions, did not have access to mortgage financing. Annual mortgage origination volumes averaged less than \$1 trillion per year in the 1990s, peaking at \$1.5 trillion in 1998. Beginning in 2001, as interest rates declined and home prices appreciated,

additional consumers became homeowners and many others refinanced existing loans, often lowering their interest rates and monthly payments while at the same time allowing them to extract cash from increased equity. The result was a three-year rapid expansion of the mortgage market that saw annual originations exceed \$2 trillion in 2001, \$3 trillion in 2002, and \$4 trillion in 2003.

The rapid expansion of this market attracted new mortgage lenders and brokers, many of whom had limited business experience or financial strength and operated with little regulatory oversight. Many of these new market entrants operated outside of the commercial banking system, relying instead on private mortgage conduits and third party investors to fund and buy their mortgage production. Indeed, many of the newly developed mortgage products were sold to private mortgage investors rather than the Government-sponsored enterprises (GSEs), which had traditionally dominated the secondary mortgage markets. For example, the share of mortgage debt securitized by private conduits over this period more than doubled, increasing from 8.5 percent at the end of 2000 to 19 percent at the end of first quarter 2007, while the share securitized by GSEs and agencies fell from 47 percent to 38 percent. Commercial banks' share of overall mortgage debt holdings (loans and securities) remained relatively stable during this period at roughly 28 percent. Bank ownership of securitized home mortgages, however, while stable at about 16.5 percent of all home mortgage securitizations, was increasingly centered in agency and GSE-issued securitizations, with banks' share of privately issued securitized mortgages declining from 15 percent to 9 percent.

As interest rates began to climb and the demand for mortgage loans slowed in 2004, many mortgage originators were left with excess capacity. To maintain production

levels and satisfy continued strong investor appetite, mortgage originators increasingly shifted to nontraditional products, often designed to help borrowers cope with rising home prices or tap increasing home equity. These products typically included one or more relaxed underwriting standards, such as smaller down payments, lower required credit scores, higher debt-to-income ratios, reduced documentation to verify income, and temporary reductions in monthly payments through such features as “teaser rates,” interest-only payments, and negative amortization. These relaxed standards – especially when combined or “layered” – increased risk for both borrowers and lenders. But that risk was largely masked by an extended period of significantly rising house prices, which made refinancing quick and easy. When house prices stopped appreciating, and in some areas began declining, the riskier subprime loans – particularly those issued in 2006 and late 2005 – began to experience sharply elevated levels of default. That in turn precipitated broader concerns about the health of the overall mortgage markets.

During this period, the OCC took preventive steps to address potential safety and soundness and consumer protection concerns in national banks. With respect to residential mortgages, by 2005 we were instructing our examiners to address the risk of products that carry the potential for significant “payment shock” – that is, mortgages where initially low monthly payments are followed by later payments that are much higher – even though home prices were continuing to escalate. We also issued strong standards on predatory lending and, as discussed in our March 2007 testimony before a subcommittee of this Committee, worked with the other federal banking agencies to issue separate guidance on both nontraditional and subprime mortgage products.

## **Current Market Conditions**

My testimony today focuses on three aspects of current market conditions that directly affect national banks: the mortgage markets, the asset-backed commercial paper market, and the corporate leveraged lending market.

### **A. Mortgage Markets**

With regard to the mortgage markets, performance in the subprime mortgage sector began to deteriorate late last year, and that deterioration has since accelerated. According to the Mortgage Bankers Association, the rate of total subprime mortgage delinquencies reached 12.5 percent as of March 31, 2007, significantly higher than the 10.4 percent delinquency rate from the prior year. As of that same date, the percentage of subprime ARMs that were seriously delinquent, defined as 90 or more days delinquent or in foreclosure, increased to 10.1 percent, compared with 6.9 percent a year earlier.<sup>2</sup> More recent data indicate that the 90-day or more delinquency rate for securitized subprime mortgages had increased to over 13 percent in June 2007.<sup>3</sup> Seriously delinquent and foreclosed subprime loans remain highest in the Gulf states affected by hurricane Katrina and manufacturing-dependent states in the upper Midwest that have struggled economically since the beginning of the decade. But increased foreclosure activity continues to spread and intensify. According to RealtyTrac, Inc., new foreclosure filings across the nation, including default notices, auction sale notices, and bank repossessions, increased to 180,000 in July 2007, 93 percent higher than reported in July 2006. Areas with the highest rates of new foreclosure activity in July reflect the declining conditions in former housing boom states, including the Southwest – particularly California, Nevada

---

<sup>2</sup> Mortgage Bankers Association National Delinquency Survey

<sup>3</sup> “Business Briefing,” Washington Post, August 25, 2007.

and Colorado; and the Southeast - including Georgia and Florida. Foreclosure rates in parts of New England are also on the rise.

Early this summer, the rapid deterioration in credit quality in subprime mortgages began translating into substantial and well publicized losses by funds heavily invested in such instruments, and by companies holding such assets on their balance sheets. In turn, the credit rating agencies began downgrading a broad range of collateralized debt obligations (CDOs) where the underlying collateral consisted of the mezzanine pieces of subprime mortgage securities. Some of the tranches of these CDOs had previously received the very highest credit ratings. The combination of these and similar events prompted a broad range of capital market investors to sharply reduce their tolerance for, and exposures to, mortgage-related credit risk – and not just from subprime mortgages, but from all mortgages not operating with credit guarantees from the GSEs or federal agencies. This widespread investor apprehension has greatly diminished available liquidity for those mortgage market participants that depend on sales of mortgages to the secondary markets.

The effect has been especially pronounced for non-bank mortgage originators that do not have the flexibility to hold mortgages on their balance sheets – through deposits or other funding sources – but instead must sell them. As a result, many such non-bank mortgage originators have been sold or forced out of business, while others remain for sale or continue to search for liquidity and capital.

The effect on subprime lending has been most dramatic. Many institutions, both banks and non-banks, have stopped making subprime mortgages altogether, or have significantly reduced the number and type of subprime products they offer. Additionally,

lenders have tightened underwriting standards by requiring higher borrower credit scores, larger down payments, and more robust documentation of income. Together, these factors have resulted in a sharp reduction in the origination of subprime mortgages.<sup>4</sup>

But the reduction in mortgage lending has not been confined to subprime. Origination of so-called “Alt-A” mortgages, which carry less credit risk than subprime mortgages, has also declined. And the broad retreat by investors from non-guaranteed mortgage-related exposures is even affecting origination of “jumbo” loans made to prime borrowers.

While much of the secondary market for mortgage products has been constrained, GSE eligible paper is one segment of the market that continues to operate smoothly, albeit at somewhat wider spreads. Indeed, conventional conforming originations rose 13 percent during the second quarter and 12 percent in first half of 2007 on a year-over-year basis.<sup>5</sup>

Within the national bank population, as I previously noted, national banks have not been dominant players in the subprime mortgage market and generally have adhered to more stringent underwriting standards than many non-bank lenders. As a result, the foreclosure and past due rates for mortgages held by national banks – including but not limited to subprime mortgages – continue to be lower than those experienced by the industry as a whole. Nevertheless, like the rest of the industry, these default rates are

---

<sup>4</sup> Subprime mortgage originations have declined significantly in 2007. According to Inside Mortgage Finance, origination of new subprime mortgages totaled \$56 billion in the second quarter 2007, down 41 percent from first quarter 2007 and off 66 percent from the \$165 billion originated in second quarter 2006. Issuance of new subprime mortgage-backed securities was 32 percent lower in the first half of 2007 than the first half of 2006. Second quarter 2007 issuance was down 12 percent from the first quarter of 2007, and down nearly 30 percent from the fourth quarter of 2006. These declines do not take into account any further reduction that is likely to have occurred in the third quarter of 2007 in reaction to current market disruptions.

<sup>5</sup> Inside Mortgage Finance

increasing, and if problems in the general housing market continue, we expect to see a further increase in mortgage delinquencies.

In terms of mortgage originations, national banks that are significant residential lenders continue to operate in the mortgage markets and are providing loans to customers. To date, while many of our community and mid-size banks report reduced volumes of new originations, they continue to be able to fund their mortgage production through existing channels or have the capacity to retain the mortgages on their books. In general, the same is true at our larger, more active mortgage banking institutions. Some institutions are seeing increases in loan applications for certain mortgage products, such as jumbo prime mortgages, through their retail mortgage channels. In part, these increases may be driven by consumers submitting mortgage applications to multiple lenders due to consumers' heightened concerns about the availability of these products. We will have a better understanding of actual new loan volume in the coming weeks as these recent applications work through the origination pipelines.

Due to the lack of secondary market liquidity and the fallout of many non-bank lenders, most banks are more focused on direct originations and have scaled back or curtailed their wholesale lending operations, which often relied on loans generated by mortgage brokers. These steps to reduce wholesale production are primarily affecting non-conforming mortgage applications and origination (*e.g.*, jumbo and certain Alt-A loans). Conforming loans continue to be packaged and sold, while retail originated non-conforming production is being held in banks' portfolios until liquidity returns to the secondary market.

Consistent with prudent risk management practices, national banks continue to reevaluate loan product terms and underwriting guidelines as market and economic conditions change. For example, some national banks are making more mortgage loan products conform to GSE and FHA standards. National banks are also making changes to comply with the recent interagency statements on nontraditional and subprime mortgages, such as clearer assessments of a borrower's credit qualifications and ability to repay. Some products, such as certain stated-income or low-documentation mortgage loans, as well as certain types of subprime ARMs, are being significantly revised or curtailed. And although national banks have not dominated the subprime market, they also have not completely abandoned this market or segment of borrowers. That is, some national banks continue to originate subprime mortgages, though at a reduced level given that such loans must now be held in portfolio rather than sold, given current market conditions.

**B. Asset-Backed Commercial Paper Markets**

One of the markets that has been most affected by the recent financial market turmoil is the asset-backed commercial paper (ABCP) market. This market represents over half of the commercial paper issued in the United States. ABCP is a highly rated, short-term money market instrument issued by a special purpose vehicle (SPV) or bankruptcy remote conduit established for that purpose. These SPVs, which are used by financial and non-financial firms, issue commercial paper with maturities of up to 270 days and use the proceeds to fund various financial assets and securities, in some cases including mortgage assets. The acquired assets serve as collateral against the ABCP. Because the maturities of the underlying financial assets are typically longer than the

maturities of the ABCP issued to fund those assets, conduits typically rely on the proceeds of newly issued commercial paper to pay down previously issued commercial paper as it matures. This process is referred to as “rolling” the commercial paper. Most ABCP programs also have a back-up liquidity facility and various forms of credit enhancement, often provided by a commercial bank. The back-up liquidity facilities provide protection to the ABCP investors in the event that a program is unable to roll maturing commercial paper.

ABCP conduits have varying degrees of asset diversification and underlying collateral quality, with higher risk assets requiring more credit enhancement. By definition, commercial paper attracts investors seeking relatively safe, liquid investments. With increasing general concerns in the financial markets regarding mortgage risk, ABCP programs backed by mortgage assets have begun to receive more scrutiny, especially those that include subprime mortgage assets. During the last month, it became more difficult for some of these programs to roll maturing commercial paper by issuing new commercial paper. In these circumstances, some of the programs’ only option was to extend the maturity of the outstanding paper, which they did, hoping to be able to roll those investments at a later time after markets had stabilized. Exercising that extension option was unprecedented, however, and resulted in ABCP investors not getting repaid on the dates they had anticipated. While these were fairly isolated events, they were well publicized and have had a further negative effect on the ability of ABCP programs to issue new commercial paper in the manner they have done historically, even in circumstances in which the conduits hold no mortgage assets. As a result, ABCP

liquidity remains tight, maturities have shortened, and spreads have widened as investors reassess their risk exposures in these products.

A number of large national banks are active in the ABCP markets, generally in either the largely operational role of administering various conduits, or as providers of back-up lines of liquidity, or both. To date, ABCP programs administered by national banks have not faced the magnitude of issues affecting certain non-U.S. bank sponsored ABCP programs, but conditions have been challenging nevertheless. In recent weeks, sales of commercial paper have resulted in shorter maturities and, in some cases, direct investment in the paper by conduit sponsors. Continued disruption in the ABCP markets could prompt sponsors of ABCP programs to provide temporary funding under existing liquidity facilities or take other steps that increase their on-balance sheet exposure to these conduits. In such circumstances, the sponsors, including commercial banks, could need to dedicate additional capital to support those assets, depending on the action taken.

### **C. Corporate Leveraged Lending Markets**

Although the commercial leveraged loan market is distinct from, and generally unrelated to, the subprime mortgage market, investors' heightened concerns about overall credit quality and underwriting standards have affected this higher risk credit market as well. Large commercial and investment banks have earned significant fees from originating and distributing leveraged loans associated with corporate buyouts. Because of strong corporate profits and cash flow, as well as their own strong liquidity and aggressive return expectations, institutional investors had been willing to accept increasingly lax repayment terms, reduced financial covenants, and higher borrower leverage on these transactions. The apparent risk to commercial banks' own loan

portfolios was limited, because such banks increasingly followed an “originate-to-distribute” model, syndicating most of these exposures to institutional investors rather than holding them on their balance sheets for extended periods.

In the past six weeks, however, the risk appetite of institutional investors has changed abruptly, especially with respect to the degree of borrower leverage and the strength of financial covenants. This has come at a time when, because of the extraordinary volume of leveraged buyout transactions pending in the market, commercial banks have an unusually large volume of loan commitments held for sale awaiting syndication. Given the abrupt change in risk appetite, the credit terms of these “pipeline” commitments mean that the loans that ultimately are made will be unlikely to clear the market at the prices that syndicating banks had hoped to achieve. The banks are therefore holding positions, or are committed to hold positions, in excess of what they planned to hold. In some cases, banks have gone back to the buyout sponsors to try to renegotiate existing terms to make the loans more marketable. In other cases, banks have decided to sell at least parts of the loans at lower prices.

Nevertheless, the fact remains that the largest national banks face the prospect of having to fund a substantial amount of leveraged loans, at least temporarily, until loans can be sold. Such an increase in balance sheet assets would necessarily result in an increase in required regulatory capital, though the national banks active in this market all have sufficient excess regulatory capital to support such positions. In addition, because the prices that investors are currently willing to pay for such loans have declined, banks holding these loans face the prospect of writing down their value through potential charges to earnings. And, of course, by holding the loans rather than selling them, banks

remain exposed to the ongoing risk posed by the underlying obligors – but, importantly, unlike the situation with mortgage-backed securities that have lost value due to increased defaults on the underlying mortgages, there is no indication at this time of systemic credit problems with the underlying borrowers on the leveraged loans likely to be held by banks.

Our assessment of the direct effect of this situation on national banks is this: while it may take some time for them to work through these excess hold positions, the principal risk is that their earnings will be reduced, rather than that there will be more significant losses that would affect the adequacy of their capital.

In terms of indirect effects, it does not appear that the difficult conditions in the leveraged loan markets have adversely affected the broader market for commercial and industrial loans. We do not believe that creditworthy commercial borrowers are having any unusual difficulty obtaining credit under prudent credit terms. While current market conditions may cause banks to tighten their overall commercial credit underwriting standards, this is not unexpected after several years of easing. Indeed, some of the recent re-pricing we have seen by lenders and investors is likely related to their expectations that today's low level of defaults may begin to return to a level closer to historical default averages. Nevertheless, while commercial credit performance remains quite strong, we have begun to see a slight deterioration in the asset quality indicators for commercial credit portfolios. Given the cyclical nature of credit risk, we are not surprised by this trend.

## OCC Actions

As I have noted throughout my testimony, the OCC has been actively monitoring and evaluating recent market developments. And in addition to our direct monitoring, we are participating in periodic conference calls with the other banking agencies and the President's Working Group, to share information, identify potential issues, and coordinate any necessary regulatory responses. Also, because the recent events are global in their scope, we are sharing information with various global supervisors, through the Basel Committee on Bank Supervision and through our London office.

During these types of market events, our major response is on the front line, through our examination force, supplemented by market intelligence obtained from various industry and market contacts and sources that our policy analysts maintain. As part of our Large Bank Supervision Program, our resident examiner teams at the largest national banks are in frequent contact with the business and risk managers of those institutions' funding, trading, and mortgage areas to enable close monitoring of market conditions, deal flow, and funding availability. Those same examiners have reviewed each bank's risk selection and management processes and taken action whenever necessary to shore up weaknesses at individual banks. Moreover, we update our supervisory guidance to banks and examiners, as necessary, to assure they are positioned to mitigate the severity of unavoidable problems and inevitable market stresses. As part of our safety and soundness supervision, we require national banks to carefully monitor their liquidity and funding levels and to have contingency liquidity and funding plans that contemplate a potential disruption to their normal funding activities and market access. Our goal in requiring these plans is to ensure that these institutions

can continue to conduct their business in an orderly fashion under a variety of stressed market conditions.

Examiners at both our large and community banks also help surface and provide input on various regulatory issues that may need a broader agency or interagency response as banks make adjustments to their balance sheet strategies or operations to accommodate customers and the market. One such issue has been clarification of the ability of mortgage loan servicers' to implement steps that should improve their ability to avoid unnecessary foreclosures against borrowers that are at a heightened risk of default. I am pleased that banking agencies' efforts with the SEC and the FASB have helped to clarify that servicers can work with severely troubled borrowers without prohibitive accounting restrictions. To provide more guidance on this important topic, the banking agencies yesterday released the Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages. We will continue to encourage national banks to take the affirmative steps to work with borrowers discussed in this and other guidance, consistent with prudent lending practices.

The lack of liquidity and price transparency in various markets is also posing challenges for, and raising questions by, bankers regarding the valuation and mark-to-market accounting assessments for various trading positions and assets held for sale. Consistent with generally accepted accounting principles (GAAP), we have been advising our institutions that the marks in these portfolios should be reasonable and supported by documented rationale. Under GAAP, a market under stress is still a market. Additionally, GAAP generally requires using observable market prices, even if trade volumes are far below normal. When models are being used because observable market

prices are not available, the assumptions used in the model should be consistent with those that a market participant would use.

More generally, we are reminding bankers that they should consult with their external auditors and examiners as accounting or regulatory issues arise. We will continue to work on such issues with the other banking agencies, the SEC, and the FASB, as appropriate.

### **Working with Customers**

Although we are confident that the national banking system remains safe and sound, I share the Committee's concern about the effect that current market conditions may have on individual homeowners who face sharply escalating mortgage payments and the possibility of foreclosure. While foreclosure obviously can have devastating effects on borrowers, it is less obvious but no less true that it can also result in steep losses for lenders. As a result, it is very often a "win-win" for both borrowers and lenders to take alternative courses of action to avoid foreclosure, including through loan modifications.

As a result, the OCC has stressed the importance of national banks prudently working with residential loan borrowers facing difficulty in meeting their contractual payment obligations. The OCC is using all available tools to encourage lenders and borrowers to work together, facilitated by supportive organizations such as counseling agencies, to maintain the smooth functioning of the residential lending industry and to help keep borrowers in their homes except where foreclosure is the only prudent course of action. To this end, we are co-hosting forums in parts of the country hit hard by foreclosures to introduce banks to the range of delinquency intervention services that community-based counseling organizations can provide.

We also are disseminating guidance to encourage national banks to work with borrowers in these unfortunate circumstances and to remind them of the regulatory incentives to do so. We recognize that many national banks are working with community partners to develop and implement strategies to help identify financially stressed borrowers, pursue workouts, and avoid foreclosure, and we support and publicize these efforts so that they may be replicated and enhanced as much as possible.

In April of this year, the OCC and the other federal regulators published the interagency “Statement on Working with Mortgage Borrowers.” This statement encourages institutions to consider prudent, safe, and sound workout arrangements that increase the potential for financially stressed borrowers to keep their homes. It emphasizes that existing guidance and standards do not require institutions to immediately foreclose on homes when a borrower exhibits repayment difficulties. The Statement also reminds financial institutions that the Homeownership Counseling Act requires institutions to inform certain borrowers who are delinquent on their mortgage loans of the availability of homeownership counseling. Finally, the statement informs lenders that they may receive favorable Community Reinvestment Act consideration for programs that transition low- and moderate-income borrowers from higher cost loans to lower cost loans, provided that the loans are made in a safe and sound manner.

More recently, in June 2007, the OCC published the report, “Foreclosure Prevention: Improving Contact with Borrowers,” which sets forth a variety of strategies lenders can use to reach borrowers for whom loan workouts may be necessary and appropriate. A number of banks are implementing initiatives to work with borrowers to avoid foreclosure and loss of their homes, for example, by contacting borrowers at an

earlier stage to inform them of reset information and potential options; offering toll free numbers for additional help; and referring them to credit counseling services or third party debt management programs if appropriate. Examples of programs that may be available to assist customers to remain in their homes include refinancing plans; repayment plans for delinquent balances; forbearance programs; and loan modification programs in which one or more of the terms are permanently changed. Examples of programs that may be available if remaining in the home is not an option include sale; short sale (a workout option where the borrower sells the secured property for an amount less than that which is owed to avoid foreclosure); auction programs with deficiency notes; or deed-in-lieu-of-foreclosure programs.

Many borrowers in default do not realize that loan workouts are an available option, in part because they avoid contact with their lenders and servicers, viewing them as adversaries once they fall behind in their payments. Yet, the record shows that a large number of delinquent borrowers can avoid foreclosure if they make that call – and the sooner the better. The OCC’s June 2007 report illustrates how lenders can work together with delinquent borrowers towards their mutual objective of avoiding foreclosure, with the ideal result of a prudently underwritten, reworked loan with terms that the borrower can afford and that keeps the borrower in his or her home.

In addition to guiding national banks in these outreach efforts, we also are working with nonprofit partners to encourage borrowers to work with their lenders. One very promising partnership is the NeighborWorks Center for Foreclosure Solutions, a partnership among mortgage lenders, insurance companies, government-sponsored enterprises, and community-based nonprofits. The Center, which builds capacity among

foreclosure counselors through training, researching borrower behavior, working with the industry, and conducting public outreach campaigns, is sponsored by NeighborWorks America and the Homeownership Preservation Foundation. As a board member of NeighborWorks America, I am especially hopeful that the work of the NeighborWorks Center will get critical information to borrowers having difficulty paying their mortgages in a timely and effective manner.

Once contact is established, the NeighborWorks Center and its foreclosure prevention coalitions are able to help many borrowers negotiate loan workouts with their lenders. Local nonprofit housing counseling groups then work with these borrowers to help ensure that they have the personal financial and money management tools to meet their restructured obligations under these workout plans.

Because early contact is so important, the OCC helped to launch NeighborWorks America's national ad campaign, made up of TV, radio, print, and web Public Service Announcements (PSAs), all of which were aimed at encouraging delinquent mortgage borrowers to contact their lenders or a trusted housing counselor in order to avoid foreclosure. The OCC also produced its own radio and print PSAs, which ran in both English and Spanish and reached a potential audience of 100 million people in 35 states. Both sets of PSAs encourage homeowners having difficulty paying their mortgages to call the Center's toll-free hotline – 888-995-HOPE – which is open twenty-four hours a day, seven days a week. Calls flow into a national call center staffed by HUD-approved English- and Spanish-speaking counselors for borrowers to discuss their problems. The hotline, which has been in operation since April of 2005, has received over 100,000 calls from borrowers in distress and has lately been averaging 1,000 calls each day.

Depending on the nature of the problem, counseling can be provided as part of that initial call or through a series of follow-up calls or in-person visits to a local housing counseling service. These on-the-ground referrals are fielded by community-based nonprofits, including a growing number of local NeighborWorks America® and consumer credit counseling organizations. If a workout can be arranged with the lender, then these groups' counselors can provide budgeting assistance and other financial education to help ensure that these borrowers are able to meet the terms of their workout agreements.

### **Conclusion**

While the recent instability in the financial markets has had profoundly negative consequences for a number of specialized lenders and their customers, national banks remain strong and well capitalized. With their diversified funding and earnings streams, national banks have sufficient liquidity and are well positioned to work through these market conditions. Together with our peer regulatory agencies and the Treasury Department, the OCC will continue to closely monitor developments in the markets and to pursue any policies or actions that may be needed so that banks can continue to serve the needs of their communities and provide loans to creditworthy retail and commercial borrowers.