Remarks of John M. Reich, Director
Office of Thrift Supervision
PITTSBURGH COMMUNITY REINVESTMENT GROUP
Regulatory Speaker Series
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Good Morning. It's a pleasure to be with you today. I'd like to thank Executive Director Steve Shivak and all the members of the Pittsburgh Community Reinvestment Group for this invitation to be part of the Regulatory Speaker Series. I know the topic of this morning's session, "Predatory Lenders and Their Impact on Families and Communities" is very important to you. Let me assure you that predatory lending, and the havoc it is creating in many communities, is of concern to me personally and to the Office of Thrift Supervision.

In fact, last month I testified on the subjects of predatory lending and subprime lending before the House Subcommittee on Financial Institutions and Consumer Credit. During the hearing I addressed concerns regarding predatory and abusive lending practices and described steps OTS has taken, and continues to take, to confront these issues.

This morning I'd like to cover five key areas: First I'd like to share recent data and trends in the mortgage market,

including the subprime and prime markets. Second, I'd like to discuss the importance of *responsible* subprime lending and the distinction between responsible subprime lending and *predatory* lending. Third, I'll describe examination programs and guidance the OTS and other banking agencies have issued and implemented over several years to promote and ensure safe and sound lending practices and compliance with consumer protection statutes. Fourth, I'll discuss efforts underway to limit mortgage foreclosures, including steps we are taking at the OTS. And fifth, I'll close by describing recent rule changes OTS finalized regarding the Community Reinvestment Act and programs where OTS, PCRG and your partners may be able to coordinate to enhance financial education initiatives and community development.

I'd like to begin by discussing the current mortgage market and market trends. Recent data suggest that the homeownership rate in the U.S is approximately 69 percent, up from 64 percent six years ago. Total U.S. home mortgage debt is $10 trillion. Of this amount, subprime mortgages represent $1.3 trillion or approximately 13 percent of aggregate outstanding mortgage debt – and as you know, subprime lending has increased significantly during recent years.

I want to make what I believe is a very important point here. Subprime lending and predatory lending are not necessarily synonymous. Certain practices have been associated with predatory lending, and they include (1) making mortgage loans based predominantly on the foreclosure or liquidation value of a borrower's collateral rather than on the borrower's *ability to repay* the mortgage; (2) inducing a borrower to repeatedly refinance a loan in order to charge high points and fees; and, (3) engaging in fraud or deception to conceal the true nature of the mortgage loan.

OTS and the other banking agencies have issued industry guidance and implemented examination procedures to identify and address predatory and abusive lending. For example in 2001 the banking agencies issued industry guidance on subprime lending that addressed the three practices I just described. Additionally, OTS and the other banking agencies enforce section 5 of the Federal Trade Commission Act that prohibits unfair or deceptive acts and practices through the authority of section 8 of the Federal Deposit Insurance Act.

OTS also has long-standing regulations that prohibit savings associations from using advertisements or other representations that are inaccurate or misrepresent the services or contracts they offer. Additionally, OTS conducts regular examinations of

savings associations to determine their compliance with consumer protection statutes such as the Equal Credit Opportunity Act and related fair lending laws.

It's also important to note that the OTS and the other banking agencies issued proposed guidance back in 2005 on nontraditional mortgages (including interest-only and payment-option, adjustable-rate loans) that addressed weakening underwriting standards the agencies had observed, such as the growing prevalence of reduced documentation combined with low or no down payment. The banking agencies reminded institutions that such underwriting practices "layer," or increase the risk that borrowers will be unable to repay. As such, the guidance advised institutions to do 3 things: (1) employ sound underwriting programs; (2) implement strong risk management systems; and, (3) provide consumers with balanced, timely and clear information concerning nontraditional mortgages to help them make informed choices. We finalized the guidance last fall and are currently examining our institutions for compliance.

On March 8, the banking agencies went a step further and we issued our proposed Statement on Subprime Mortgage Lending for public comment. The proposed guidance addresses three principle areas: First, it emphasizes criteria institutions should consider to determine whether borrowers have the ability

to repay a subprime loan. Second, it describes consumer protection issues and practices intended to protect consumers from unfair, deceptive and predatory practices. And third, it describes the need for policies, procedures and systems to ensure that lenders' subprime mortgage lending is conducted in a safe and sound manner. Montrice Yakimov, Managing Director of Compliance and Consumer Protection, will describe the guidance in greater detail in a few minutes.

The OTS and other banking agencies will carefully consider the public comments we receive in response to the proposed guidance and will continue to take steps to examine the institutions we regulate for compliance with federal consumer protection statutes and existing guidance. I am also hopeful that *state banking regulators*, who regulate entities that play a significant role in the mortgage market (including mortgage brokers, mortgage banks and finance companies) will adopt and enforce similar guidance, as many of the states have done for the nontraditional mortgage guidance. Due to the significant role that non-banks play in the mortgage market, the engagement of state regulatory authorities is very important to fully deter and address predatory lending practices.

However, it is also important to distinguish between *responsible subprime* lending programs and *predatory* lending

practices. Responsible subprime lending programs have played a role in expanding homeownership for many American families. As I mentioned earlier, subprime mortgages represent $1.3 trillion, or approximately 13 percent of aggregate outstanding mortgage debt. In 2005, subprime originations were approximately $600 billion, representing roughly 20 percent of the $3 trillion mortgages originated that year.

I believe it is extremely important to carefully address concerns regarding subprime lending programs, such as rising delinquency and foreclosure rates in the subprime market, without creating unintended consequences of choking off mortgage credit to subprime borrowers. An evaluation of foreclosure trends helps provide important perspective on this point.

For example, external data indicate the foreclosure rate on subprime mortgages nationwide for all lenders as of December 2006 was 3.63 percent of outstanding subprime mortgage products. This compares to a foreclosure rate of 2.48 percent one year earlier, representing a year-over-year increase of 46 percent.

While this large increase is clearly a concern, it's important to consider that at 3.63 percent, the current foreclosure rate is at 2003 levels and is substantially below the rate of 4.73 percent experienced in 2001. In other words, while the recent percentage

increase is significant, the recent rise in foreclosures in subprime lending is not at extraordinary levels. Nevertheless, we at OTS are encouraging savings associations to work with their borrowers to address delinquencies in an effort to prevent foreclosures. I would also like to highlight the fact that on Monday of this week, the OTS co-hosted—along with the FDIC, the OCC, the Fed, and the SEC, and OFHEO—a Roundtable discussion on *Subprime Securitizations, Issues & Solutions*, focusing primarily on how to address the current foreclosure situation, which is frankly expected to increase in the next year. We invited experts in the areas of mortgage origination, trustees, servicers, ratings services, and regulators, and had a very healthy and frank discussion that I believe was very positive and optimistic about the potential to modify many of the subprime mortgages that are past due and perhaps headed for foreclosure. It will require a lot of cooperation among the various parties involved in the securitization process, but one thing everyone agreed on is that all parties are better off if foreclosure can be avoided.

Now so far, I've briefly presented information on mortgage origination trends, the differences between predatory lending and responsible subprime lending, and a description of OTS examination programs and industry guidance to identify and

address abusive lending practices. I've also addressed guidance the agencies adopted to address potentially lax underwriting that could result in loans being originated that borrowers ultimately can't repay.

Given broad concern and focus on the potential for significant mortgage foreclosures in the subprime market, next I'd like to describe our efforts at OTS to encourage savings associations to work with their borrowers who are experiencing delinquencies, in an effort to prevent foreclosures.

OTS recently issued guidance to our examiners on home mortgage lending and servicing. The guidance advises examiners to encourage lenders involved in subprime lending to have their collection efforts focus on promptly contacting delinquent borrowers, becoming familiar with the reason for the delinquency and providing borrower counseling as appropriate. Additionally, as I noted in my testimony last month, OTS encourages our institutions to consider loan forbearance and foreclosure deterrence strategies that are effectively developed and implemented, consistent with safety and soundness and consumer protection principles.

Emphasizing the importance and availability of responsible lending programs for all borrowers, both prime and subprime, is important in order to keep homeownership within reach of

Americans from multiple walks of life. I believe this point is particularly important as we commemorate the 30th anniversary of the Community Reinvestment Act.

And I should mention that OTS has also taken action recently in the Community Reinvestment Act area. Last month we finalized a CRA rule to bring our rule back into alignment with that of the other banking agencies in several key areas. I believe the changes support core principles and policy objectives of the Community Reinvestment Act regarding lending to low and moderate income communities, making community development investments, and participating in services that stabilize and revitalize low- to moderate-income geographies. The changes will also better facilitate objective evaluation of CRA performance across banks and thrifts operating in the same markets. Over the next few weeks, we will hold a series of training sessions for the thrift industry in Jersey City and Boston on the new CRA rules, and I hope many of you will be able to participate.

And that brings me to another area I'd like to address: PCRG's efforts, in partnership with financial institutions, to revitalize low and moderate income neighborhoods through investments and loans. I recognize that many community-based organizations are stepping up their efforts to preserve and

maintain foreclosed properties in their neighborhoods to prevent the erosion of property values and related problems. Steve Shivak, I commend you and your dedicated staff for your efforts to reverse the effects of predatory lending and prevent foreclosures in the county.

Specifically, I am encouraged by the results you have produced in your Anti Predatory Lending Initiative over the past few years by assisting over 400 consumers in this program. I'm told that you succeeded in preventing foreclosures in 75 percent of these cases last year, and that is truly commendable.

I also understand that you have set ambitious goals for 2007 in your Anti-Predatory Lending Initiative, specifically, that you plan to reach approximately 117,100 residents through a public service campaign and serve 1,500 households in the county with foreclosure workout services. Additionally, you are creating the Vacant Properties Working Group, to arrest the potential adverse effects of vacant properties in Allegheny County and in the City of Pittsburgh, which is also commendable.

For any organization, the success of ambitious efforts such as these depends on hard work and partnerships. I commend those of you who provide such support. The Office of Thrift Supervision stands ready to facilitate the building of partnerships between our regulated institutions and willing partners to

preserve and revitalize our neighborhoods. We will assist in partnership building to enhance financial education, credit counseling and public awareness to prevent predatory lending. I understand that Francis Baffour, our Community Affairs Liaison for the Northeast region, with whom I know many of you are familiar, is involved in a number of related projects and initiatives as part of our agency's broader Community Affairs and community development program. I hope you will call on us for assistance that we may be able to provide.

As part of our national Community Affairs program at OTS, we continue to work on our own and cooperatively with other agencies and organizations to promote consumer education and informed choices among financial services products. We also have various initiatives to improve financial literacy and we work closely with our institutions to encourage them to do the same.

For example, you will find on our website several new brochures and materials we have developed both independently and in coordination with other banking agencies on a broad range of financial education topics. These materials include information we provided in February for National Consumer Protection Week, such as (1) the importance of managing and protecting one's credit score; (2) information on the growing popularity of gift cards, and tips on shopping for and utilizing gift

cards; and, (3) information on mortgage programs such as interest only and payment option ARM loans.

Additionally, in partnership with our sister banking regulatory agencies, the OTS is sponsoring a forum on nontraditional mortgage products here in Pittsburgh on May 16. I encourage you to attend this event because it will address subprime lending issues, analyze the secondary markets that help to fuel these products, and discuss educational and outreach efforts to enhance consumers' ability to make informed decisions. This forum is free of charge and you can register at our main website, www.ots.treas.gov under News & Events.

With that, I'd like to thank you again for this opportunity to be with you today and I'll turn the program over to our distinguished panel.