FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

April 7, 2008

Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Request for Comment on the Proposed Amendments to the Mortgage Provisions of Regulation Z (Docket No. R-1305)

Dear Mr. Chairman:

On behalf of the Federal Deposit Insurance Corporation, we commend the Board of Governors of the Federal Reserve System (FRB) for proposing amendments to Regulation Z, which implements the Truth in Lending Act (TILA) and Home Ownership and Equity Protection Act (HOEPA), to help address the numerous consumer protection concerns that have arisen in the context of residential mortgage lending. In recent years, a wide segment of the U.S. residential mortgage market experienced a systematic breakdown in lending standards—fed in large part by regulatory arbitrage between bank and nonbank originators. This breakdown in standards has harmed the nation as a whole, and has triggered a severe disruption in global credit markets. The uncertainty that now pervades the marketplace—which is directly attributable to weak underwriting practices—has seriously disrupted the functioning of the securitization markets and the availability of mortgage credit. Lax underwriting contributed to the housing market bubble, just as widespread foreclosures are now contributing to the market's precipitous decline, creating long-term adverse consequences for communities across the country.

These events demonstrate that credit provided on irresponsible or abusive terms does not benefit consumers, and does not provide a firm foundation for economic growth or stability. Restoring the mortgage credit markets to their proper functioning requires clear definition and enforcement of the principles of sound underwriting for mortgage loans. Thus, the FRB has an important opportunity with this rulemaking to establish strong, clear standards for responsible mortgage lending practices that will help prevent these problems from recurring. The FDIC appreciates the opportunity to provide the following comments on the proposed amendments:

1. Scope of the Proposed Rules

The FDIC agrees that the definition of a higher-priced mortgage loan should include transactions secured by the consumer's principal dwelling for which the annual percentage rate (APR) on the loan exceeds the yield on comparable Treasury securities by at least three percentage points for first-lien loans, or five percentage points for subordinate lien loans. We think that the APR triggers are appropriate and the FRB should not consider raising them. However, the FDIC recommends that the FRB also incorporate an alternative fee trigger into the definition of a higher-priced mortgage loan, similar to the one currently applicable to HOEPA loans. The risk is great that creditors will circumvent the proposed APR restrictions by lowering interest rates below the APR trigger and instead charging consumers more and higher fees on their loans. This would significantly harm consumers.

As noted above, HOEPA loans as currently defined have not only an APR trigger but also an alternative points and fees trigger to help avoid circumvention. The points and fees trigger defines a HOEPA loan as one in which total points and fees paid by the consumer exceed the greater of 8 percent of the loan amount or a set dollar amount ($561 for 2008).[1] Points and fees are defined to include all finance charges except interest, as well as non-finance charges, such as closing costs paid to the lender or an affiliated third party.[2] In fact, because HOEPA coverage is based not only on the APR but also on points and fees charged by the lender, some loans qualify only because of the fees charged. Thus, including a fee trigger for higher-priced loans will eliminate the ability of lenders to shift charges to fees not included in the calculation of the APR, thereby avoiding the APR trigger for higher-priced mortgage loans and circumventing the intended protections of the new rules.

In addition, the FDIC recommends that the prohibitions against extending credit without considering a borrower's ability to repay, stated income underwriting, and teaser rate underwriting should apply to negative or deferred amortization products such as the interest-only and payment-option adjustable rate mortgages (ARMs) described in the interagency nontraditional mortgage guidance, regardless of whether they would meet an interest rate or fee trigger.[3] These points are discussed in more detail below.

Finally, the FDIC recommends that the FRB consider extending the protections proposed in § 226.35(b) to reverse mortgages. The FRB excluded reverse mortgages from this proposal because it has not identified significant abuses in the reverse mortgage market.[4] However, there is evidence that significant abuses do exist in the reverse mortgage market and are on the rise.[5] Reverse mortgages are becoming increasingly popular with seniors, and unscrupulous lenders are taking advantage of that fact by promoting products that are not always in their best interest. This is reminiscent of the behavior of unprincipled subprime and nontraditional mortgage lenders as those products gained in popularity. Because reverse mortgages present some unique potential drawbacks for seniors, including high costs that are not clearly disclosed or understood, the FRB should address these problems sooner rather than later. If the FRB does not reconsider

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[1] The exact dollar amount is adjusted annually, based on the Consumer Price Index.

[2] The fee-based trigger also includes amounts paid at closing for optional credit life, accident, health, or loss-of-income insurance, and for other debt-protection products written in connection with the credit transition.

[3] See *Interagency Guidance on Nontraditional Mortgage Product Risks (Nontraditional Mortgage Guidance)*, 71 Fed. Reg. 58609, 58617 (Oct. 4, 2006).

[4] 73 Fed. Reg. 1672, 1682 (Jan. 9, 2008).

[5] For example, on December 12, 2007, the Senate Special Committee on Aging held a hearing on reverse mortgages, during which Committee members and witnesses discussed the increase in abusive practices directed towards seniors, particularly with respect to advertising. Also, the AARP recently released a report on reverse mortgages, finding that loan costs are extremely high. *See* Donald L. Redfoot, Ken Scholen, and S. Kathi Brown, "Reverse Mortgages: Niche Product or Mainstream Solution?" Report on the 2006 AARP National Survey of Reverse Mortgage Shoppers. AARP Public Policy Institute, Washington, DC. December 2007.

including reverse mortgages in this proposal, then at the very least the FRB should quickly analyze the abuses associated with reverse mortgages and provide timely regulations and guidance so that it can curtail those abuses before they become widespread.

2. Ability to Repay

The FRB's rulemaking proposes prohibiting creditors from engaging in a "pattern or practice" of extending credit for higher-priced mortgage loans without regard to a borrower's ability to repay the loan. The FDIC strongly urges the FRB to eliminate the pattern or practice requirement of this provision and simply prohibit outright the practice of making higher-priced mortgage loans without taking into account consumers' ability to repay.[6] As indicated above, we recommend that the FRB extend this prohibition to include all nontraditional mortgages, even those that do not qualify as higher-priced mortgage loans.

The preamble to the FRB's proposal describes the significant injuries that unaffordable loans inflict on individual borrowers, neighborhoods, and all consumers who are in the market for a mortgage loan. The FRB concludes that "[t]here does not appear to be any benefit to consumers from loans that are clearly unaffordable at origination or immediately thereafter."[7] The FDIC strongly agrees with this point and believes this is exactly why the pattern or practice requirement should be dropped.

Moreover, the pattern or practice requirement inappropriately limits regulatory enforcement as well as civil liability. The FRB's existing commentary indicates that pattern or practice violations depend on the totality of the circumstances in each particular case.[8] Further, pattern and practice violations cannot be established by isolated or individual acts. Thus, proof of a pattern or practice violation requires a wide-ranging or institutionalized policy of making loans without considering a borrower's ability to repay. Meeting this high standard is difficult and costly for both regulatory agencies and consumers.[9] Though the FRB indicates that the pattern or practice requirement is intended to balance potential costs and benefits of the rule,[10] it clearly favors lenders by limiting the number of individual consumer lawsuits and the ability of regulators to pursue individual violations.

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[6] Though the Truth in Lending Act (TILA), as amended by the Home Ownership and Equity Protection Act (HOEPA), currently prohibits lenders from engaging in a pattern or practice of extending HOEPA loans based on consumers' collateral without regard to their repayment ability, the FRB's rulemaking authority allows it to prohibit outright acts or practices that are unfair, deceptive, or designed to evade the provisions of HOEPA. *See* Section 129(h), 15 U.S.C. § 1639(h); Section 129(l)(2), 15 U.S.C. § 1639(l)(2).

[7] 73 Fed. Reg. at 1687.

[8] *See* Official Staff Interpretations of 12 C.F.R. § 226.34(a)(4).

[9] *See* National Consumer Law Center, Truth in Lending Manual § 9.5.2 (6th ed. 2007), observing that the requirement that a lender engage in a pattern or practice of making HOEPA loans without regard to the borrower's repayment ability "makes such cases difficult and expensive by extending the scope of relevant discovery in an individual case to include the lender's general underwriting practices, and, essentially, its entire loan portfolio." *Also see* Baher Azmy and David Reiss, *Modeling a Response to Predatory Lending: The New Jersey Home Ownership Security Act of 2002*, 35 Rutgers L. J. 645, 695 n. 242 (2004), explaining that "[t]raditionally, the "pattern or practice" element of the prohibition has been a hard one for plaintiffs to satisfy, requiring proof of several instances of prohibited conduct in a short period of time."

[10] 73 Fed. Reg. 1672, 1688 (Jan. 9, 2008).

A substantial proportion of subprime mortgage loans made during the past few years were underwritten without adequate consideration of the borrowers' ability to pay their mortgage and other housing-related expenses, such as real estate taxes and insurance. This has led to widespread turmoil in the residential mortgage markets and is resulting in significant losses to consumers, lenders, and the secondary market. Thus, we believe lenders should not make loans that they know or have reason to believe a borrower cannot repay. Indeed, recent guidance issued by the federal financial regulators instructs lenders to evaluate a borrower's "ability to repay the debt by its final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule."[11] By incorporating this guidance into its regulation, the FRB will be able to help level the playing field for bank and nonbank lenders.

While we recognize the FRB's concern for potential civil liability that lenders may face if making unaffordable loans is prohibited outright, we believe those concerns can be substantially mitigated by clarifying in the final regulation that: (1) a subsequent default, in and of itself, could not constitute evidence of inability to repay; and (2) borrowers are presumed to have the ability to repay if their ratio of housing-related and all recurring monthly debt to income (DTI) is no more than 50 percent at mortgage origination. (See the discussion below regarding the use of a 50 percent, or alternative, DTI ratio to measure repayment ability in the context of mortgage lending.) We believe this approach would better balance the possible adverse consequences of such civil liability with the very real injury that will result from failing to establish an enforceable legal standard.

As noted above, we also recommend making the ability to repay requirement applicable to nontraditional mortgages. Nontraditional mortgage products, such as payment option ARMs and interest-only mortgages, carry inherent risks of payment shock and negative amortization. While some institutions have offered these products with appropriate risk management and sound portfolio performance, in recent years more lenders have offered nontraditional mortgages to a wider spectrum of borrowers without adequate risk management, including failure to determine whether borrowers can repay these mortgages assuming a fully amortizing repayment schedule. The combination of risk layering with the broader marketing of nontraditional mortgage loans significantly increases the risk for both consumers and lenders. Requiring lenders to consider repayment ability for nontraditional mortgages within Regulation Z would ameliorate this risk.

Therefore, the FDIC recommends that the FRB utilize its broad rulemaking authority under section 129(l)(2) of TILA to apply the ability to repay standard to both higher-priced mortgage loans and nontraditional mortgage loans without requiring that borrowers or regulators establish a "pattern or practice" of unaffordable lending.

3. Debt-to-Income Ratio

The FRB's proposal also makes a "pattern or practice" of failing to consider DTI a presumptive violation of the proposed prohibition against engaging in a pattern or practice of

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[11] *See Statement on Subprime Mortgage Lending (Subprime Statement)*, 72 Fed. Reg. 37569, 37574 (July 10, 2007); *Interagency Guidance on Nontraditional Mortgage Product Risks (Nontraditional Mortgage Guidance)*, 71 Fed. Reg. 58609, 58617 (Oct. 4, 2006).

making higher-priced mortgage loans without regard to borrowers' repayment ability.[12] We commend the FRB for recognizing the importance of a borrower's DTI ratio, and we agree that consideration of a borrower's DTI ratio "generally is part of a responsible determination of repayment ability."[13] However, we believe that the FRB's proposal does not go far enough.

Specifically, we recommend that the FRB also eliminate the "pattern or practice" requirement in connection with consideration of a borrower's DTI ratio and instead require lenders to consider a borrower's DTI ratio when determining repayment ability for all higher-priced mortgage loans, as well as for nontraditional mortgage loans. The primary way lenders ascertain ability to repay is by determining if a borrower has sufficient income to meet his or her housing-related and other recurring monthly expenses.[14] Moreover, quantifying a borrower's repayment capacity by the DTI ratio is a widely accepted approach in the mortgage industry.

To that end, the FRB could set forth a presumption that borrowers have the ability to repay if their DTI ratio is no more than 50 percent at mortgage origination. A loan with a back-end DTI ratio above 50 percent is generally recognized within the industry as one that merits additional scrutiny. Such mortgages also are deemed unaffordable under a number of state laws,[15] and HOEPA currently prohibits prepayment penalties for covered loans where the borrower's DTI ratio at consummation exceeds 50 percent.[16] As an alternative DTI measure, the FRB could consider using the back-end DTI ratios specified under the mortgage loan programs of the government-sponsored enterprises (GSEs), the Federal Housing Administration (FHA) or the Department of Veterans Affairs.[17] In view of the common use of DTI ratios as a guide to affordability, it seems incongruous that there is not a DTI-based presumption of affordability in the FRB's proposed rule for higher-priced mortgage loans, as well as for nontraditional mortgages. We note that a presumption-based approach provides appropriate flexibility to allow higher DTI ratios in certain limited circumstances, such as where a borrower's disposable income after payment of back-end debt is substantial or where a borrower has significant capital assets or net worth. Conversely, a borrower might be able to show a violation with a lower DTI ratio where, for instance, the lender knew the borrower's income would be declining through an impending divorce or job change. At the same time, the presumption would provide greater

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[12] 12 CFR § 226.34(a)(4); 73 Fed. Reg. at 1725.

[13] 73 Fed. Reg. at 1689.

[14] The *Subprime Statement* specifies that institutions should maintain qualification standards that include a credible analysis of a borrower's capacity to repay the loan according to its terms.

[15] As of February 2008, 11 states had specified that a DTI ratio of more than 50 percent rendered a loan unaffordable. *See* National Conference of State Legislatures http://www.ncsl.org/programs/banking/predlend_intro.htm#Laws, accessed on March 17, 2008.

[16] Section 129(c) of TILA, 15 U.S.C. § 1639(c).

[17] For example, the GSEs and FHA have established back-end DTI ratios ranging from 36 percent to 45 percent for various loan programs. A back-end DTI ratio is calculated by adding monthly housing-related expenses to the total of other monthly obligations and dividing it by monthly gross income. The maximum back-end DTI ratio for Freddie Mac is 45 percent. *See*, Freddie Mac Single-Family Seller/Servicer Guide, ch. A34.9(d). Fannie Mae's "benchmark debt-to-income ratio is 36 percent of the borrower's stable monthly income," however, it "may occasionally specify a maximum allowable debt-to-income ratio for a particular mortgage product." Fannie Mae Selling Guide, Part X, 703. Moreover, Fannie Mae recognizes that a DTI of 45 percent or greater "significantly increases risk." *Id.* at 302.08. The back-end ratio for mortgages insured by the Federal Housing Administration cannot exceed 43 percent unless the lender explains in writing why the mortgage presents an acceptable risk. *See* HUD Mortgagee Letter 2005-16 & HUD Handbook 4155.1, REV-5, Paragraph 2-12 and 2-13.

clarity for both borrowers and lenders in meeting the ability to repay standard to help address the FRB's concerns about litigation risk.

The FDIC also recommends requiring disclosure of the DTI ratio to borrowers if it is greater than 50 percent. The inclusion of this information in loan disclosure documents would not only benefit consumers by helping them determine the affordability of loan products, but would facilitate investors' ability to conduct due diligence and identify riskier loans, which would help restore credibility and discipline in the secondary market.

4. "Stated Income" Loans

The FDIC recommends that the FRB prohibit "stated income" underwriting outright for higher-priced first- and second-lien mortgage loans, as well as nontraditional mortgage loans such as interest-only loans and payment-option ARMs. The proposed rule currently requires creditors to verify income or assets before making higher-priced mortgage loans. However, the rule provides a safe harbor for creditors who fail to verify income or assets before extending credit if they can show that the amount of income or assets relied on was not materially greater than what the creditor could have documented at consummation. We strongly recommend that the FRB eliminate this safe harbor. Verifying a borrower's income and assets is a fundamental principle of sound mortgage loan underwriting that protects borrowers, neighborhoods, investors, and the financial system as a whole. The proposal does not explain why the safe harbor is necessary or what potential problem it is designed to remedy. We believe the safe harbor is unnecessary, particularly given the flexibility that the FRB has built into the verification requirements. In our view, the safe harbor creates a loophole that will undermine the effectiveness of the stated income prohibition.

Information about income is critical for establishing a reasonable basis that a borrower has sufficient capacity to repay the loan, particularly in the case of subprime and nontraditional loans. The more risk a loan presents, based on its features or the borrower's credit characteristics, the more important it becomes to verify the borrower's repayment capacity. Furthermore, as the FRB points out, consumers typically "pay more for [stated income] loans than they otherwise would" if they had simply provided documentation verifying their income.[18] And brokers and other participants in the mortgage origination process have failed to inform many consumers of that cheaper alternative, even though most borrowers can readily document their income through W-2 statements, pay stubs, bank statements, or tax returns.

Both the *Subprime Statement* and the *Nontraditional Mortgage Guidance* caution lenders against making "stated income" loans. However, these guidelines set forth a minimum standard and permit exceptions when "there are mitigating factors that clearly minimize the need for direct verification of repayment capacity."[19] We believe the FRB should eliminate the proposed safe harbor and stand firm in requiring lenders to adequately verify borrowers' income and assets. Requiring borrowers to document their income will make it far less likely that consumers will receive loans that they cannot afford to repay. Documentation also will provide the markets with greater confidence in the quality of pools of higher-priced and nontraditional mortgage

[18] 73 Fed. Reg. at 1691.
[19] 71 Fed. Reg. at 58614; 72 Fed. Reg. at 37573.

loans and their projected income streams. Thus, both consumers and the economy as a whole will benefit.

If the FRB does not eliminate the safe harbor, the FDIC recommends requiring disclosures for stated income loans regarding the availability of lower cost fully-documented loans. This disclosure would help give consumers enough information to choose the most appropriate loan product for their needs and would facilitate investors' ability to conduct due diligence and identify riskier loans, which would help restore credibility and discipline in the secondary market.

5. Underwriting for Interest-Only Loans and Payment-Option ARMs

In addition to the preceding recommendations, the FDIC proposes that the FRB prohibit underwriting based only on the initial "teaser rate" for all mortgages described in the *Nontraditional Mortgage Guidance*, such as interest-only mortgage loans and payment-option ARMs. Over the past few years, lenders have offered an increasing variety of mortgage products—including interest-only loans and payment-option ARMs—to a broader spectrum of borrowers. A substantial number of these loans were underwritten without adequate consideration of the borrowers' ability to repay over the entire term of the loan. Instead, borrowers were qualified at low introductory or teaser rates. Such loans have proven to be unstable long-term financing structures for homeownership, particularly for new or unsophisticated homeowners.

So-called "teaser rate" underwriting is a pervasive and dangerous practice. In effect, it is tantamount to not considering affordability. Many consumers do not understand the payment shock features of their ARMs. Qualifying borrowers based on a low introductory payment rather than a fully indexed, fully amortizing repayment schedule is almost invariably a fatal underwriting flaw that is harmful to both consumers and lenders. Indeed, as previously mentioned, both the *Subprime Statement* and the *Nontraditional Mortgage Guidance* instruct lenders to evaluate a borrower's "ability to repay the debt by its final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule."[20] Thus, the FRB should exercise its rulemaking authority and prohibit "teaser rate" underwriting outright for interest-only loans and payment-option ARMs.

6. Prepayment Penalties

The FDIC believes that the FRB should consider banning prepayment penalties outright for higher cost loans. Prepayment penalties can cause substantial financial injury as borrowers are faced with the difficult choice of either: (1) paying a large penalty to refinance their loan; or (2) continuing with a loan they cannot afford and, by doing so, stripping their home of equity or losing their home through foreclosure. As the FRB observed, "[t]he injuries prepayment penalties may cause consumers are particularly concerning because of serious questions as to whether borrowers knowingly accept the risk of such injuries."[21] These risks are particularly devastating to borrowers trapped in mortgages that are, or shortly will be, unaffordable because

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[20] *Id.*

[21] 73 Fed. Reg. at 1694

they can significantly hinder efforts to refinance or otherwise structure loan work outs. As a practical matter, many subprime borrowers are not offered the choice of a loan without prepayment penalties. Moreover, unlike the prime market, most subprime loans include a prepayment penalty. For example, whereas about 70 percent of the balance of subprime loans over the past four years included a prepayment penalty, prepayment penalties are comparatively rare (about 3 percent) among prime mortgage loans.[22] Therefore, banning these penalties will ensure that consumers—particularly subprime consumers—will be able to refinance or sell their homes within a reasonable amount of time.

If the FRB does not prohibit prepayment penalties outright, it should at least reduce the amount of time that prepayment penalties are permitted for higher-priced mortgage loans from five years, as is currently proposed, to two years. The proposal explains that a five-year period "would prevent creditors from 'trapping' consumers in a loan for an exceedingly long period."[23] We believe that five years *is* an exceedingly long period.

One of the reasons that the agencies issued the *Subprime Statement* was their concern about the growing popularity of ARM products that had low initial payments based on an introductory rate, which expired after a short period of time and adjusted to a variable rate for the remainder of the loan.[24] Many lenders aggressively marketed these loans as "credit repair" products. They assured consumers that they would qualify for a lower-priced product at the time that the introductory rate expired—often in two years. Prepayment penalties that extend beyond that timeframe have made such representations illusory. Borrowers who have demonstrated a positive payment history and could qualify for a lower interest rate are not likely to be able to refinance their loans due to the sheer cost of prepayment penalties, which often can amount to six months' worth of interest. In addition, many fixed subprime loans currently have prepayment penalties with terms of 25 to 36 months.[25] Therefore, we recommend alternatively that the FRB limit prepayment penalties for higher-priced mortgage loans to two years or less.

Further, if prepayment penalties are not banned altogether, the FDIC recommends that the FRB prohibit them for higher-priced mortgage loans at least 180 days before the reset date, rather than 60 days as currently proposed. This longer period provides a more realistic timeframe than 60 days, particularly for subprime borrowers, because it affords consumers more time to refinance into a mortgage product that meets their financial needs. Unlike the prime market where interest rates are widely published, interest rates in the subprime market are nontransparent, making it more difficult and time-consuming for consumers to determine the costs of refinancing. Finding competitively priced refinancing is particularly challenging when housing prices are decreasing or mortgages are less available. In recognition of that fact, HOPE NOW Alliance members have agreed to contact at-risk borrowers 120 days prior to the initial ARM reset for all 2/28 and 3/27 products.

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[22] FDIC calculations using the Loan Performance Securities Database. Data for prime loans represent nonagency originations.
[23] *Id*
[24] 72 Fed. Reg. at 37569.
[25] FDIC calculations using the Loan Performance Securities Database.

7. **Yield Spread Premiums (YSPs)**

The FDIC recommends that the FRB prohibit the use of YSPs to compensate mortgage brokers. The current proposal merely provides for additional disclosures and the consumer's written consent to the maximum amount of compensation that he or she will pay the broker. We do not believe that such disclosures will be effective. Disclosures alone will not address the fundamental problem with YSPs, which is that they provide an inappropriate financial incentive for mortgage brokers to steer consumers to unaffordable loans. The FRB describes a yield spread premium as "the present dollar value of the difference between the lowest interest rate the wholesale lender would have accepted on a particular transaction and the interest rate the broker actually obtained for the lender."[26] We think a ban on YSPs, as the FRB has defined them, would eliminate compensation based on increasing the cost of credit and make the amount of the compensation more transparent to consumers.

The inherent conflicts presented by a broker compensation system that rewards increasing the cost to the borrower have been debated for years. To be sure, mortgage brokers can provide valuable services and should receive fair compensation. However, there are ample alternative means of compensation available, such as flat fees or fees based on the total principal amount of the mortgage, which would not present skewed incentives to increase borrower costs and which would be much more transparent and understandable to borrowers. The same can be said for commissions paid to loan officers. Borrowers should continue to have the option to finance the broker's compensation. However, a ban on YSPs will ensure that broker compensation will not be based on steering the consumer to a loan that is more expensive than one for which he or she would otherwise qualify. Thus, the FRB should ban any amount of compensation based on increasing the cost of credit, including compensation that is tied to the APR, or that is not a flat or point-based fee.

8. **Advertising**

While the FDIC generally supports the advertising provisions proposed by the FRB, we recommend that the FRB restrict use of the term "fixed," or similar terms, in marketing information for adjustable rate or hybrid mortgage products. The term "fixed" has long been used to describe traditional mortgage products with no payment shock features. Using the term to describe adjustable rate products, which have "fixed" rates for only a few years, or interest-only products, which may have "fixed" rates but also the potential for significant payment shock, can be inherently misleading.

9. **Escrows**

The FDIC strongly supports the FRB's proposal to require escrows for real estate taxes and insurance and believes it would be appropriate to extend the time period to opt out beyond the 12-month period currently proposed. Real estate taxes and insurance are required expenses that lenders should always consider in evaluating a borrower's capacity to repay a mortgage loan. The failure to pay taxes and insurance is a form of default that can lead to foreclosure, causing substantial financial injury to borrowers. Requiring escrows ensures that borrowers will

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[26] 73 Fed. Reg. at 1698.

have sufficient funds set aside to meet their obligations and avoid the potentially dire consequences for failing to pay their taxes and insurance in a timely manner. The requirement also benefits the economy overall, as fewer foreclosure actions will result if borrowers are able to afford all housing-related expenses, not just principal and interest. We applaud the FRB for making this proposal.

10. State Law

The FDIC also agrees that the proposed rules should not preempt state laws unless they are inconsistent. Many states have proven to be innovative laboratories for the development of consumer protections in recent years. They have been especially active in efforts to address predatory mortgage lending, loan flipping, prepayment penalties, the fiduciary obligations of mortgage brokers, and many other areas. States should not be prevented from providing their citizens with strong consumer protections, and we applaud the FRB for allowing them to continue to do so.

We appreciate the opportunity to comment and encourage the FRB to consider the FDIC's recommendations, which will help eliminate the mortgage lending practices that have hurt so many consumers and led to deterioration and uncertainty in our financial markets. We commend you for your leadership in moving decisively to apply common sense rules of underwriting to all mortgage originators, as well as your advocacy for market innovations to serve the mortgage credit needs of low and moderate income communities. We believe that these simple, basic rules will allow substantial flexibility and latitude to provide affordable mortgage options to lower income populations within a prudential framework that will assure their long term affordability.

Sincerely,

[redacted]

Sheila C. Bair

cc: Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
Washington, D.C. 20551

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

May 1, 2008

Honorable Christopher J. Dodd
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your recent letter enclosing questions subsequent to my testimony on the "State of the Banking Industry" before the Committee on March 4, 2008.

Enclosed is my response to your questions. Also enclosed are responses to questions from Senators Crapo and Reed.

If you have further questions or comments, please do not hesitate to contact me at (202) 898-6974 or Eric Spitler, Director of Legislative Affairs, at (202) 898-3837.

Sincerely,

[redacted]

Sheila C. Bair

Enclosure

Response to questions from the Honorable Christopher J. Dodd
from Sheila C. Bair, Chairman,
Federal Deposit Insurance Corporation

<u>Q1: Anti-Union Regulation</u>

Last year, the Department of Labor issued a regulation drastically expanding the personal financial information union officers and employees must submit to the Department. The new LM-30 rule will require more than 150,000 union volunteers, employees, and their families to report the terms of mortgages, car loans, and even student loans. To determine whether they must report such interests, these individuals must ascertain (1) whether the bank providing a loan does any business with the person's union, or (2) whether the bank does 10 percent of its business with firms whose employees are in the same union. The regulation requires individuals to write to banks asking for this info, and, then, if banks won't provide such information, to contact the Department of Labor for assistance. In the meantime, individuals are required to make good faith estimates of the bank's business with their unions and unionized firms.

- **Given your agency's expertise in the regulation and practices of banks, do you believe that banks are able--and willing--to inform their customers whether they do business with particular unions and how much of their "business" and "business receipts" are with particular unionized firms?**

- **Are banks obligated or prohibited by any federal or state law to disclose to their customers how much "business" or "business receipts" they have with particular unionized firms? Can banks simply refuse to answer these written inquiries?**

- **What type of administrative burden will this LM-30 rule, and the hundreds of thousands of resulting inquiries, place on banks and are banks currently prepared to respond to these inquiries?**

- **If banks don't provide this non-public information, is there any "information reasonably available" to the public that union officers, employees, and members could use to make good faith estimates?**

A1: The Labor-Management Reporting and Disclosure Act (LMRDA) requires public disclosures of certain financial transactions and financial interests of labor organization officers and employees (other than employees performing clerical or custodial services exclusively) and their spouses and minor children. It is our understanding that the purpose of this disclosure is, among other things, to make public any actual or potential conflict between the personal financial interests of a labor organization officer or employee and his or her obligations to the labor organization and its members.

The U.S. Department of Labor's Office of Labor-Management Standards (OLMS) issued a final rule in 2007 implementing section 202 of LMRDA. *See* 72 FR 36106 (July 2, 2007). The final rule revised Form LM-30, Labor Organization Officer and Employee Report and its instructions. The final rule became effective for fiscal years beginning August 16, 2007, although no reporting is due under the rule until November 16, 2008. *See* 72 FR 38484 (July 13, 2007).

The FDIC understands that financial institutions are expressly relieved of any reporting responsibilities of payments or loans under section 203 of the LMRDA (*see* 72 FR at 36119 and 36136). Therefore, banks are not required to report customer information.

The final rule deals with Form LM-30, which requires reporting by the union officers and employees covered under the LMRDA. The final rule, as revised, does not require union officers to report most bona fide loans, interest, or dividends from financial institutions. However, the final rule may require that union officers report these types of transactions if the bank does a specified level of business with a company that employs members of the same union. The OLMS is the agency responsible for implementation and interpretation of this regulation and the FDIC defers to its determination of the exact parameters of the categories where union employees are required to report bank loans.

We know of no federal law that either requires or forbids a financial institution from informing its customers whether they deal with businesses that are unionized and what union represents the employees of those businesses, assuming that no customer information is disclosed. We see nothing in the Department of Labor rule that would require financial institutions to make those disclosures. We note, however, that banks typically build certain reporting codes into their information management systems to facilitate the creation of both regulatory related filings, such as call reports, as well as internal management reports. The basis for distinguishing and reporting based upon the type of union-related activity at issue here would not be a part of this reporting framework thereby creating issues regarding the practicality of disclosure.

The FDIC will continue to analyze the impact of the final rule on our supervised banks as we approach the November 2008 reporting deadline.

Q2: Commercial Real Estate

In December 2006, three agencies, the FRB, OCC, and FDIC, issued final guidance highlighting the risks to banks from concentrations in commercial real estate. In issuing the guidance, the regulators specifically emphasized that they were not setting any limits on banks' commercial real estate lending. Yet now we understand from the Comptroller of the Currency and the Chair of the FDIC that over a third of community banks have commercial real estate concentrations exceeding 300 percent of their capital.

- **Are any community banks going to fail because of their overexposure to commercial real estate, including commercial real estate mortgage backed securities?**
- **Was it the correct policy not to set concentration limits in the guidance?**
- **What are examiners doing when they find these levels of concentrations?**
- **What off-balance sheet vehicles are banks using to invest in commercial real estate?**
- **Are the regulators approving these kinds of transactions?**

A2: As noted in the FDIC's testimony, weakness in the housing market will affect institutions with significant exposures to commercial real estate (CRE) loans -- particularly construction and development loans. Given deteriorating conditions and excess supply in certain housing markets such as Florida, California, Arizona, and Nevada, construction and development lending could cause some community banks to fail in 2008 and 2009. While we do not currently anticipate a sharp increase in failures, the protracted nature of real estate downturns may challenge the earnings capacity and capital levels of institutions with concentrated exposure to construction and development projects. At present, the various sectors of the commercial real estate market including apartments, office buildings, retail, and industrial have performed adequately and are not expected to cause bank failures in the near term. However, if we experience a significant economic downturn, commercial real estate mortgages could cause losses for insured institutions that may lead to failures.

The December 2006 interagency commercial real estate guidance provided an appropriate, timely message to the industry regarding risk management standards, loan concentration reporting thresholds, and capital adequacy. Bankers are very aware of the monitoring thresholds stated in the guidance, and the document positively influenced commercial real estate credit risk management. The establishment of specific concentration limits would have been prescriptive and could have caused an unintentional aversion to commercial real estate lending. A limit on commercial real estate lending would have had negative consequences for the market and exacerbated the credit availability challenges in the current environment.

In March 2008, the FDIC issued a Financial Institution Letter (FIL) to all banks under its supervision re-emphasizing the importance of strong capital and loan loss allowance levels, and robust credit risk-management practices for state nonmember institutions with significant concentrations of CRE loans, and construction and development loans. The FIL recommends that state nonmember banks with significant CRE loan concentrations increase or maintain strong capital levels, ensure that loan loss allowances are appropriately strong, manage portfolios closely, maintain updated financial and analytical information, and bolster loan workout infrastructures.

FDIC examinations of institutions with significant commercial real estate loan concentrations, as defined by the 2006 interagency guidance, focus on each bank's credit risk management program, internal measurement and reporting on concentrations, examiner review of individual credit relationships, and an assessment of capital and loan loss reserve adequacy. Examiners undertake a thorough review of commercial real estate lending policies and underwriting processes and gain an understanding of management's risk-taking philosophy. Departures from prudent policies, underwriting, risk selection, or concentration management may be subject to examiner criticism. Significant deficiencies related to commercial real estate loan concentrations sometimes result in formal or informal enforcement actions.

From an investment standpoint, banks are generally limited in their acquisitions of commercial real estate to property that will only be used as bank premises. There are certain exceptions to this limitation that are permitted under the investment authorities for national banks. Otherwise, a bank must apply to the FDIC (under section 24 of the Federal Deposit Insurance Act (FDI Act)) for permission to invest in commercial real estate on the balance sheet. An off-balance sheet investment in commercial real estate would be unusual.

From a lending standpoint, commercial real estate loans or interests therein are typically originated and held directly by the bank, or a bank subsidiary, on the bank's balance sheet. Off-balance sheet holdings of interests in commercial real estate loans are generally rare and limited to the largest institutions that securitize such loans. In a commercial mortgage backed security, a bank that securitizes commercial real estate loans sells the loans (on a non-recourse basis) to a trust that then distributes these credits on to third party investors. Depending on the governing securitization documents, the bank that originated a commercial real estate loan could be liable for the loan's performance under certain circumstances, as well as be required to prudently carry out the duties of special servicer if the bank retained servicing. It is theoretically possible that sold loans could be put-back to the originating bank if the governing documents or courts permitted such recourse. Such situations are relatively rare. The bank regulators do not approve securitization transactions, which are accounted for as loan sales. Large institutions that trade credit derivatives also could have a commercial real estate credit exposure off-balance sheet. However, most derivative positions are now booked on the balance sheet according to accounting rules.

Q3a: **<u>Basel II</u>**

There was extensive conversation on what would have been the capital status of banks going into this crisis period had Basel II capital standards been in effect. Fed Vice-Chairman Kohn said that if, "we had the same safeguards in place, and if we started implementing in 2004 with the same safeguards that are in place in 2008 and 2009, I do think on balance we would have been better off." Mr. Gronstal answered differently, stating: "I think the answer to your second question is that we probably would have had lower dollar amounts of capital per asset, and that makes it more challenging to deal with issues when times get rough."

Can you explain in writing, whether you believe that banks would have had more or less capital in place for this current down turn had Basel II been implemented during the time frame that Vice-Chairman Kohn mentioned in his response? Can you also explain why you believe that to be the case, citing any empirical data on both the effects of Basel II on capital requirements and what we have experienced during this economic crisis, as it relates to assets?

A3a: I believe that banks would have had less capital in place for the current downturn had Basel II been implemented during 2004. The U.S. Quantitative Impact Study-4 (QIS-4) estimated the advanced approaches would reduce capital requirements for mortgages and home equity loans by 73 percent to 80 percent. In addition, for certain securitization exposures, the advanced approaches slash the capital requirements significantly compared to the current rules and would have encouraged banks to hold more highly rated collateralized debt obligations (CDOs) and other complex securities that have caused losses in the tens of billions of dollars for large financial institutions. For many of these exposures, the capital requirements are reduced by almost two thirds—from 1.6 percent to 0.56 percent of face value.

There is every reason to assume that banking organizations would have reduced their actual regulatory capital holdings in an amount commensurate with this reduction in minimum capital requirements. A case in point is given by Northern Rock, the British bank with assets of about $200 billion that was recently nationalized. We understand that the British regulators provided banks that were interested, and deemed ready, the opportunity to implement certain aspects of the advanced approaches in 2007. In reference to the 44 percent reduction in risk-weighted assets Northern Rock reported using the advanced methodologies for its retail portfolio, its CEO wrote:

> We are pleased to have achieved approval for use of our Basle II rating systems. This means that the benefits of Basle II enable us to increase our 2007 interim dividend by 30 percent. Going forward our dividend payout rate increases to 50 percent of underlying EPS from around 40 percent. Future capital planning, including the reduction of capital hungry assets, will allow us to return capital to shareholders through a share buyback programme. The medium term outlook for the Company is very positive.
>
> — CEO Adam Applegarth, Northern Rock Interim Results, June 30, 2007

Q3b: During the discussion of Basel II, Comptroller Dugan told the Committee: "The irony of this whole situation is that the very high--most highly rated best securities, the ones that were thought to be least likely to default was where all the--a huge share of the losses have been concentrated." Given Basel II's reliance on ratings of securities, does this observation give you reason for concern over the current Basel II structure? If so, what do you recommend be done; if not, why not?

A3b: The unprecedented downgrades and massive losses incurred by banks on AAA rated structured securities such as CDOs and asset backed securities (ABS) are a prime example why models cannot be relied upon to set capital requirements that are meant to protect and preserve the solvency of our nation's financial institutions. The models used to assign a AAA rating to these securities were no more than estimates that attempted to apply past performance to predict future events. However, the assumptions used to assign these ratings did not capture the true stresses that accompanied the current credit market crisis.

In some cases, the models that failed the ratings agencies are similar to the models used by banks to set capital requirements on a wide range of exposures under Basel II. What is even more troubling is that these AAA rated structured securities that played a prominent role in contributing to the hundreds of billions of dollars in write-downs have been awarded sizable capital reductions under Basel II. Under the new rules, the capital requirement for these securities is a mere fraction of the losses incurred to date with banks only required to set aside 56 cents for every $100 in exposures. Under the existing U.S. rules that apply to all but the largest banks, the capital requirement for these same securities is $1.60 for every $100 in exposures.

The Basel Committee has acknowledged some of the deficiencies with the Basel II framework, especially as it relates to the complex structured securities discussed above. However, the lesson to be learned from the credit market turmoil should be applied well beyond CDOs. The major issue is that the models did not perform adequately, and Basel II is heavily reliant upon models for determining capital requirements. Fixing the risk weights on complex securities is a good start but that alone will not address the larger scale problems with Basel II.

In this respect, U.S. bank regulation benefits considerably from our statutory framework of Prompt Corrective Action (PCA), including regulatory constraints on bank balance sheet leverage. The PCA framework provides a base of capital to absorb losses in the event the risk-based models are overly optimistic and helps limit the exposure of governmental safety nets during difficult times. In addition, a leverage ratio, or similar clear-cut supplementary capital requirement to complement the risk-based approaches and constrain excessive leverage, would greatly benefit the effectiveness of global financial regulation.

As you know, the regulation issued by U.S. banking agencies does not allow any bank to exit its risk-based capital floors until the completion of an interagency study on the impact of the new advanced approaches. This interagency study will be extremely important in that it provides a structured process for the agencies to evaluate potential weaknesses of these new rules and decide how to address them.

Q4: <u>Too Big to Fail</u>

I am concerned about the potential ramifications of the failure of a very large institution. Is your agency prepared today to handle the failure of a large systemically significant insured financial institution? What steps are you taking to prepare for this contingency?

A4: The FDIC has been taking a number of steps to ensure our ability to handle the failure of a large financial institution. For example, several years ago we started a project to facilitate the claims process at the very largest and most complex banks. This includes a process to hold some fraction of large deposit accounts in the event of failure, to have the ability to produce depositor data for the FDIC in a standard format, and to be able to automatically debit uninsured deposit accounts to share losses with the FDIC. In January 2008 we issued a notice of proposed rulemaking to solicit comments in consideration of a final rule. We hope to issue a final rule as early as mid-year.

In recent months, the FDIC also has begun hiring additional staff to ensure that we are prepared for any type of increased bank resolution activity. This hiring is a mix of temporary appointments that can lapse once any problems are addressed, retirees who can provide experience from past failures, and new skill sets (such as capital markets expertise) that are relevant to resolving troubled institutions in today's market.

Finally, the FDIC has been working with other regulators to improve information sharing processes and procedures regarding troubled financial institutions to ensure that all of us have the information we need to fulfill our roles in the event of bank failures. Our participation as part of the President's Working Group is a welcome improvement to this communication.

Q5: Data on Loan Modification

Please provide comprehensive data on mortgage delinquencies, foreclosures, repayment plans and modifications for the mortgages being serviced by the institutions you regulate for the past 12 months. Please provide this information by the following loan categories: subprime, Alt-A, and prime. Please describe the types of repayment plans and modifications that servicers are employing and the numbers of loans in each category.

A5: Because most FDIC-supervised institutions do not service securitized loan pools, we do not collect data for the categories requested. Nevertheless, the available data so far seems to indicate that too many modifications involve repayment plans that only act to defer problems rather than create long-term sustainable mortgages.

Publicly available data from the HOPE NOW Alliance estimate that, on an industry-wide basis, mortgage servicers provided loan workout plans for over 2 million loans during 2007 and first quarter 2008. Subprime loans account for the majority of these workouts, at 60 percent of the total. Prime loans account for the remainder; there is no breakout for Alt-A loans. Loan workouts have numbered nearly three times more than foreclosure sales.[1]

The following tables summarize borrower foreclosure sales and loan workout plans on an industry-wide basis from first quarter 2007 through first quarter 2008.

Foreclosure Sales (thousands of residential loans)

	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2008 Q1	Total
Foreclosure Sales						
Total	110	117	135	151	205	718
Prime	48	49	54	60	84	295
Subprime	62	69	82	92	121	426

Borrower Loan Workout Plans (thousands of residential loans)

	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2008 Q1	Total
Borrower Workout Plans*						
Total	324	340	399	475	503	2,041
Prime	135	132	150	173	206	796
Subprime	189	208	248	301	296	1,242
Formal Repayment Plans Initiated						
Total	271	275	323	333	323	1,525
Prime	111	102	120	136	159	628
Subprime	160	173	203	197	165	898
Loan Modifications Completed						
Total	54	65	76	141	179	515
Prime	24	30	30	37	48	169
Subprime	29	35	46	104	132	346

* Workout plans are the sum of formal repayment plans initiated and loan modifications completed.
Note: Numbers may not add due to rounding.
Source: HOPE NOW Alliance.

[1] HOPE NOW mortgage servicers cover almost two-thirds of the mortgage industry for both prime and subprime loans. All data are from their release of quarterly 2007 and 2008 data at:
http://www.csbs.org/Content/NavigationMenu/Home/StateForeclosureApril2008.pdf.

According to the Mortgage Bankers Association's National Delinquency Survey, the performance of prime mortgages deteriorated from the prior quarter. In fourth quarter 2007, 5.82 percent of all mortgage loans were 30 days or more past due. The percentage of all mortgages that were seriously delinquent (loans that are 90 days or more past due or in the process of foreclosure) was 3.62 percent. The survey reported that 3.24 percent of conventional prime mortgages were 30 days or more past due. The percentage of prime mortgages that were seriously delinquent was 1.67 percent.

Delinquency and foreclosure rates for subprime mortgages continue to rise. In fourth quarter 2007, 17.31 percent of subprime mortgages were 30 days or more past due, while 14.44 percent of these mortgages were seriously delinquent. Subprime ARMs continue to experience the greatest stress. In fourth quarter 2007, 20.02 percent of subprime ARMs were 30 days or more past due, while 20.43 percent of these mortgages were seriously delinquent. The Mortgage Bankers Association does not provide a breakout for Alt-A loans.

At FDIC-insured banks and thrifts, the ratio of noncurrent (90 days or more past due or on nonaccrual) 1–4 family residential mortgage loans increased to 2.06 percent in fourth quarter 2007. This level is double that of one year ago, when the ratio was 1.05 percent, and is the highest noncurrent level since at least 1991.

Response to questions from the Honorable Mike Crapo
from Sheila C. Bair, Chairman,
Federal Deposit Insurance Corporation

Thank you for getting back to me and Senators Johnson, Hagel, and Tester on items that you believe should be included in a regulatory relief package. At the ILC markup, I filed and talked about a regulatory relief amendment that I think should be the starting point for discussions of a package that we should move this year. It included items that would expand community development investments, relief from privacy notifications for financial institutions that have not changed their policies in the past year and do not share personal consumer information, and a combination of items for community banks and credit unions.

Q1: Although not all the items that you suggested were included in this package and there might need to be a few tweaks, are there any items in this package that your agency cannot support or are these all items that would increase regulatory efficiency without compromising safety and soundness and important consumer protections?

A1: With one exception discussed below, the package of regulatory burden relief amendments generally does not raise significant safety and soundness or consumer protection concerns for the FDIC. In addition, our staff has identified a few technical issues that may merit further staff-to-staff discussion. FDIC staff will contact your staff to address issues regarding the bill's provisions that would eliminate the current statutory requirement for notice to the FDIC of certain public welfare investments by banks. We also would like to discuss some technical drafting suggestions to avoid unintended consequences from the bill's provisions regarding the applicability of section 404 of the Sarbanes-Oxley Act to small banks.

The one provision the FDIC does not support is the proposal to raise the small institutions exception threshold for annual examinations from less than $500 million to less than $1 billion in total assets. Current law requires the banking agencies to conduct a full-scale, on-site examination of the depository institutions under their jurisdiction at least every 12 months. There is an exception for certain small institutions (i.e., institutions with total assets of less than $500 million) that requires examinations of these qualifying smaller institutions at least every 18 months. At this time, the FDIC would not support raising the threshold and extending the examination cycle for institutions of $500 million or more. The threshold was only raised to $500 million in late 2006 and it would be useful to have more experience with this change, especially in the current challenging economic times, before considering expanding the exception.

Q2: Since all of these items have been vetted and reviewed in past hearings before the Banking Committee, is there any reason to not move quickly forward with a package along these lines?

A2: With the exception of the issues regarding increasing the exception threshold for annual exams for small institutions, it is likely that remaining issues regarding the regulatory relief proposal could be resolved fairly easily. In addition, we would recommend consideration of items from the legislative package provided to you by the FDIC in response to your previous request that should help reduce regulatory burden and improve regulatory efficiency.

Response to questions from the Honorable Jack Reed
from Sheila C. Bair, Chairman,
Federal Deposit Insurance Corporation

Q1: How accurate and predictive were the risk models used by banks and ratings agencies in identifying the risks now unfolding in the current market turmoil?

A1: Banks, ratings agencies, and regulators vastly underestimated the risks in mortgage markets and in complex highly-rated securities. Even today, it is difficult to quantify these risks. Models did not forecast the significant deterioration in the credit markets, nor did they predict the fact that adverse events would be highly correlated, making a bad situation worse. The models failed to capture what is referred to as "tail risk," the risk of loss associated with extreme events. Yet it is those same events that can threaten the solvency of our financial system. The models that will be used by banks in determining capital requirements under the advanced approaches are based largely on the same models that are used by the ratings agencies that failed to capture the massive losses in the credit markets.

If the advanced approaches could have been put in effect immediately after they were published by the Basel Committee in June, 2004:

Q2a: Would banks using these approaches have been required to hold more capital against their mortgage portfolios?

A2a: No. The U.S. Quantitative Impact Study-4 (QIS-4) estimated the advanced approaches would reduce median capital requirements for mortgages and home equity loans by 73 percent and 80 percent respectively. If banks had been allowed to implement such reductions in capital requirements for their mortgages, they would have been much more vulnerable going into the current problems.

The QIS-4 result likely reflects that the formula underlying the advanced approach mortgage capital requirements was developed during a period of benign credit conditions and historically robust house price appreciation. Banks calculate their mortgage capital requirements in the advanced approaches by inputting certain key parameters (probability of default (PD), loss given default (LGD) and exposure at default (EAD)) for the various pools of mortgages they hold, reflective of their own historical credit loss experience for similar mortgages, into a function prescribed in regulation.

Some have argued that the advanced approaches would require more capital than QIS-4 estimated. No one has disputed, to our knowledge, that any reasonable approach to estimating historical mortgage credit losses over a long period of time prior to the current crisis would result in PD, LGD and EAD values that, if input into the advanced formula, would result in extremely large reductions in mortgage capital requirements compared to Basel I levels. The problem with this result, as we have seen in the current environment, is that perceptions of minimal risk based on historical statistics can induce lenders to change underwriting standards and develop new products that may sharply elevate losses compared to historical norms.

Q2b: Would the advanced approaches have generated sufficient capital requirements to account for the risks present in highly rated CDOs and other complex securities that have caused losses in the tens of billions for large financial institutions?

A2b: No. The advanced approaches reduce the capital requirements significantly compared to the current rules and could well have encouraged banks to hold more AAA-rated CDOs. For many of these exposures, the capital requirements are reduced by almost two thirds -- from 1.6 percent to 0.56 percent of face value, or equivalently from a 20 percent risk weight down to a 7 percent risk weight. This result is not unique to CDOs. Under the advanced approaches most AAA-rated securities are expected to receive this same reduction in capital requirements. The new framework thus risks giving banks an incentive to rely on ratings to an even greater extent than before.

The Basel Committee recently announced that it will revisit the 7 percent risk weight for certain types of resecuritized assets such as CDOs. While worthwhile, it is noted that this effort should be considered a response to current events rather than an aspect of the advanced approaches that would have forestalled or mitigated the development of those events.

Q2c: Would the advanced approaches have provided a regulatory capital incentive for banks to avoid the use of off-balance sheet conduit financing arrangements such as SIVs?

A2c: No. The advanced approaches require no capital for bank SIV structures in which the bank has no legal commitment to support such entities. In recent months we have seen banks around the world take large volumes of assets back on their balance sheets -- assets that were held in SIVs or other conduits. In many cases it appears there was no contractual legal obligation for banks to do this and, consequently, the banks were not required to hold capital against these exposures. There is nothing in Basel II that would require banks to hold capital before the fact against off-balance sheet entities in cases where the bank has no contractual legal obligation to provide support. After the bank has provided support, supervisors can determine the bank has de facto risk exposure and can require capital, yet even this is not a hard and fast requirement.

The advanced approaches treatment of off-balance sheet entities where the bank does have a legal obligation to provide support also is of interest. Historically, Basel I provided a loophole where banks were required to hold capital against off-balance sheet liquidity facilities with maturities of one year or more but were not required to hold capital where the liquidity facilities had maturities of less than one year. Not surprisingly, many banks began using 364-day maturity renewable liquidity facilities to avoid the capital requirement. The U.S. banking agencies closed this loophole in 2004. Outside the U.S., however, the loophole remained open, and Basel II does have the advantage in those countries of closing that loophole.

With respect to the amount of capital required for off-balance sheet exposures, extreme caution is warranted in asserting Basel II is an improvement. FDIC calculations based on the QIS-4, for example, showed that the total amount of capital required for off-balance sheet exposures was considerably less under the advanced approaches than under the current rules. This reflects the greater flexibility banks have in the advanced approaches both to model the amount of their exposure and to use their own risk estimates to determine the appropriate risk weight for the exposure.

Q2d: Would the advanced approaches have provided a regulatory capital incentive for banks to avoid excessive dependence on bond insurers?

A2d: No. The advanced approaches give significant new capital relief for banks entering into credit default swaps with bond insurers. Under the advanced approaches, banks would be able gain significant capital benefits under the assumption that they can transfer significant amounts of their credit risk to insurance companies and other parties through complex structures such as credit derivatives. The new rules also provide capital benefits that assume that there is very little correlation between the creditworthiness of the insurer and that of the banks' exposure. During the recent credit market turmoil, we have witnessed a significant deterioration in the creditworthiness of many of the financial guarantors that banks rely upon to cover losses. Further, the fortunes of both the banks' exposures and that of the insurer appear to be tied much more closely than we had anticipated. Under these conditions, the capital requirements might not fully be capturing that connection and might not fully reflect this risk.

Q2e: Would the advanced approaches have required banks to hold more capital against commercial real estate?

A2e: No. The QIS-4 estimated banks would have to hold about half the capital (median decline) against their commercial real estate (CRE) exposures. As described above for mortgages, banks calculate their CRE capital requirements by inputting their own estimates of the PDs, LGDs and EADs applicable to their CRE exposures into supervisory formulas. The capital requirements generated by such formulas depend upon these inputs, which in turn are heavily influenced by historical credit loss experience.

The roughly 50 percent median reduction in capital requirements for CRE estimated by the QIS-4 was surprising to many observers because CRE is historically a relatively risky bank asset class. However, a large reduction in CRE capital requirements is exactly what the advanced approaches can be expected to deliver during a period of strong economic conditions. If such a reduction in CRE capital requirements had been put into effect in the years leading up to the current crisis, banks would be much less well positioned to deal with credit losses.

Q2f: Would the advanced approaches have required banks to hold more capital against leveraged commercial loans?

A2f: Capital for C&I loans, in general, declined (median) in the QIS-4 by about a third. In addition, please see our answers to questions 2a and 2e.

Q2g: Would the advanced approaches have required more capital overall, so that large banks would have been better capitalized going into the current market turmoil?

A2g: No. The median decline in risk-based capital requirements reported by the 26 U.S. banks in QIS-4 was 26 percent, with a number of banks reporting declines of 30 percent to 50 percent. Significant reductions in capital requirements were reported across all major loan categories with the exception of credit cards. Significant reductions in capital requirements also were reported for securitization exposures. The 26 percent median reduction in capital requirements includes the effect of Basel II's new capital charge for operational risk, indicating that the additional capital reported for the new charge was swamped by the large reductions in capital requirements for credit risk. The 26 percent median reduction in capital requirements did not include the effect of a 1.06 "scaling factor" applied to the credit risk charge under the final rule that would dampen these reported capital reductions but not qualitatively change the overall result of large reductions in capital requirements.

To reiterate points made in responses to earlier questions, had large U.S. banks been permitted during the years leading up to the current crisis to implement reductions in capital requirements of the magnitudes suggested by the advanced approaches, the banking system would be much more vulnerable today.

Q3: Would banks reduce their actual capital in response to the advanced approaches?

A3: Yes. We believe the evidence suggests banks would use the leeway available to them under the advanced approaches to reduce their capital.

A comparison of the capital levels of large European banks versus large U.S. banks provides strong evidence that banks will reduce their capital levels when given a regulatory opportunity to do so. Ratios of tier 1 capital to balance sheet assets of large European banks typically are in the range of two percent to four percent, with the very largest institutions typically being closer to two percent. These banks have no direct regulatory constraint on financial leverage. U.S. banks, in contrast, do face leverage ratio requirements under the Prompt Corrective Action regulations, and the insured banks hold tier 1 capital well in excess of five percent of balance sheet assets as a direct result of these regulations.

Capital regulation matters a great deal for the capital banks actually hold. Throughout the development of Basel II, most banks involved in the discussions understood Basel II and especially the advanced approaches to be an opportunity to lower their capital requirements. This accounts for the almost universal endorsement by large banks of the core elements of Basel II, which was tempered when constraints on capital reductions became part of the U.S. discussions.

A case in point is given by Northern Rock, the British bank with assets of about $200 billion that was recently nationalized. We understand that the British regulators provided banks that were interested, and deemed ready, the opportunity to implement certain aspects of the advanced approaches in 2007. In reference to the 44 percent reduction in risk-weighted assets Northern Rock reported using the advanced methodologies for its retail portfolio, its CEO wrote:

> We are pleased to have achieved approval for use of our Basle II rating systems. This means that the benefits of Basle II enable us to increase our 2007 interim dividend by 30 percent. Going forward our dividend payout rate increases to 50 percent of underlying EPS from around 40 percent. Future capital planning, including the reduction of capital hungry assets, will allow us to return capital to shareholders through a share buyback programme. The medium term outlook for the Company is very positive.
>
> — CEO Adam Applegarth, Northern Rock Interim Results, June 30, 2007

Q4: Would the advanced approach require banks to raise capital substantially during a downturn?

A4: The advanced approaches capital requirements could rise sharply during a downturn compared to pre-downturn levels. This could cause banks to be either out of regulatory compliance or forced to raise substantial capital when they are least able to do so.

Response to questions from the Honorable Michael B. Enzi
by Sheila C. Bair, Chairman,
Federal Deposit Insurance Corporation

Q1. I was happy to note in your testimony that you discussed the need to stop unnecessary foreclosures. You mentioned the FDIC's work as conservator of IndyMac and your participation in the Hope for Homeownership program as recent examples of your effort. Does the FDIC plan to develop a new program to extend loan modifications to a broader pool of mortgages than those held by IndyMac? How would such a program work and what would its impact be on mortgage investors? Where would the FDIC derive authority for such a program?

A1. In mid-November, the FDIC announced a new proposal for loan modifications that is similar to the program we developed at IndyMac. Both target borrowers who are 60 days or more past due, and both seek to apply a consistent standard for affordable first-lien mortgage payment. The new FDIC proposal has a 31 percent debt-to-income ratio, whereas IndyMac modifications are designed to achieve a 38 percent debt-to-income ratio, but can go as low as 31 percent.

The FDIC's proposal is designed to promote wider adoption of systematic loan modifications by servicers through the use of payment incentives and loss-sharing agreements, and thus reach more troubled borrowers. Specifically, to encourage participation, funds from the Troubled Asset Relief Program (TARP) would be used to pay servicers $1,000 to cover expenses for each loan modified according to the required standards. In addition, TARP funds would be used to provide guarantees against the losses that lenders and investors could experience if a modified loan should subsequently redefault. The guarantee would be paid only if the modification met all prescribed elements of the loan modification program, if the borrower made at least 3 monthly payments under the modified loan, and if the lender or servicer met the other elements of the program.

The impact of this new proposal will be less costly than the lengthy and costly alternative of foreclosure, where direct costs can total between 20 and 40 percent of a property's market value. We expect about half of the projected 4.4 million problem loans between now and year-end 2009 can be modified. Assuming a redefault rate of 33 percent, this plan could reduce the number of foreclosures during this period by some 1.5 million at a projected program cost of $24.4 billion.

We believe that Section 109 of the EESA provides authority for this proposal. Section 109 provides that "the Secretary may use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures."

Q2. Has the FDIC given any further consideration to the FDIC's own Home Ownership Preservation Loan program? I believe this program is a good way to avoid foreclosures and severe mortgage modifications at the same time. If this program is no longer being considered, why?

Q5. Each agency represented at the hearing has aggressively used the tools at their disposal in dealing with the crisis. However, sometimes the use of those tools has led to unintended consequences. For instance, when the Treasury Department guaranteed money market funds, it led to a concern on deposit insurance and bank accounts. When the FDIC guaranteed bank debt, it had an effect on GSE borrowing costs, which in turn directly affects mortgage rates.

Acknowledging that there is often a need to act quickly in these circumstances, please explain what steps and processes you have employed to inform other agencies about significant actions you undertake to ensure that there are not serious adverse unintended consequences and that your actions are working in concert with theirs.

A5. The FDIC's Temporary Liquidity Guarantee Program was created during intensive discussions between the FDIC, the Department of the Treasury and the Federal Reserve over the Columbus Day weekend (October 11 - 13) and announced on October 14. Over the next several weeks, the FDIC adopted an Interim Rule, an Amended Interim Rule and a Final Rule. The FDIC's Interim Final Rule adopted on October 23 specifically requested comments on the Temporary Liquidity Guarantee Program and the FDIC received over 750 comments, including comments from other government agencies. During this process, the FDIC had frequent discussions with the Treasury, the Federal Reserve, the Office of the Comptroller of the Currency and the Office of Thrift Supervision about various aspects of the program and its potential consequences.

With regard to concerns that the actions by the FDIC to guarantee bank debt had an effect on GSE borrowing costs, as discussed above, the spread of debt issued by Government-sponsored enterprises (GSEs), including Fannie Mae, Freddie Mac, and Federal Home Loan Banks (FHLBs), over Treasuries increased considerably in October and November although the overall cost of funding declined. According to Merrill Lynch data on U.S. bond yields, the spread between AAA-rated agency debt and Treasuries increased by nearly 40 basis points between September and November 2008. We believe these developments primarily reflect broad financial market uncertainty and a generally unfavorable market sentiment towards financial firms. In fact, the spread of debt guaranteed by the FDIC under the Temporary Liquidity Guarantee Program over Treasuries is larger than the spread on GSE debt.

Financial firms, including those with a AAA-rating, saw their borrowing costs increase sharply, both in absolute terms and relative to Treasury yields, during the same two months, even as the Federal Reserve continued to lower the federal funds target rate. Merrill Lynch data show that the effective yield on AAA-rated corporate debt issued by financial firms increased by 140 basis points between September and October, before declining somewhat in November. Lower-rated corporate debt experienced even more significant increases over the same period of time. The primary purpose of the FDIC's Temporary Liquidity Guarantee Program is to provide liquidity in the inter-bank lending market and promote stability in the long-term funding market where liquidity has been lacking during much of the past year. While the FDIC's action was focused primarily on helping to restore a stable funding source for banks and thrifts, we believe that such liquidity can, in turn, help promote lending to consumers and small businesses, which would have a considerable benefit to the U.S. economy, in general, and financial firms, including mortgage lenders and GSEs. Nevertheless, partly to mitigate any potential effect of the FDIC guarantee on funding costs for GSEs, the federal banking agencies have agreed to assign a 20 percent risk weight to debt guaranteed by the FDIC (rather than the zero risk weighting that is assigned to debt guaranteed by a U.S. Government agency that is an instrumentality of the U.S. Government and whose obligations are fully and explicitly guaranteed as to the timely repayment of principal and interest by the full faith and credit of the U.S. Government).

LA 08-098

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510-6075

April 8, 2008

FDIC
APR - 8 2008
OFFICE OF LEGISLATIVE AFFAIRS

The Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Ms. Bair:

Thank you for testifying before the Committee on Banking, Housing, and Urban Affairs on March 4, 2008. In order to complete the hearing record, we would appreciate your answers to the enclosed questions as soon as possible.

Please repeat the question, then your answer, single spacing both question and answer. Please do not use all capitals.

Send your reply to Ms. Dawn L. Ratliff, the committee's Chief Clerk. She will transmit copies to the appropriate offices, including the committee's publications office. Due to current procedures regarding Senate mail, it is recommended that you send replies via e-mail in a MS Word, WordPerfect or .pdf attachment to Dawn_Ratliff@banking.senate.gov.

If you have any questions about this letter, please contact Ms. Ratliff at (202)224-3043.

Sincerely,

[redacted]

CHRISTOPHER J. DODD
Chairman

CJD/dr

Questions for the Hearing on "The State of the Banking Industry"
March 4, 2008

Questions for the Honorable Sheila Bair, Chairman, Federal Deposit Insurance Corporation, from Senator Crapo:

Thank you for getting back to me and Senators Johnson, Hagel, and Tester on items that you believe should be included in a regulatory relief package. At the ILC markup, I filed and talked about a regulatory relief amendment that I think should be the starting point for discussions of a package that we should move this year. It included items that would expand community development investments, relief from privacy notifications for financial institutions that have not changed their policies in the past year and do not share personal consumer information, and a combination of items for community banks and credit unions. Legal

1. Although not all the items that you suggested were included in this package and there might need to be a few tweaks, are there any items in this package that your agency cannot support or are these all items that would increase regulatory efficiency without compromising safety and soundness and important consumer protections?

2. Since all of these items have been vetted and reviewed in past hearings before the Banking Committee, is there any reason to not move quickly forward with a package along these lines?

Questions for the Hearing on "The State of the Banking Industry"
March 4, 2008

Questions for the Honorable Sheila Bair, Chairman, Federal Deposit Insurance Corporation, from Senator Reed:

1. How accurate and predictive were the risk models used by banks and ratings agencies in identifying the risks now unfolding in the current market turmoil?

2. If the advanced approaches could have been put in effect immediately after they were published by the Basel Committee in June, 2004: DSC

a) Would banks using these approaches have been required to hold more capital against their mortgage portfolios?

b) Would the advanced approaches have generated sufficient capital requirements to account for the risks present in highly rated CDOs and other complex securities that have caused losses in the tens of billions for large financial institutions?

c) Would the advanced approaches have provided a regulatory capital incentive for banks to avoid the use of off-balance sheet conduit financing arrangements such as SIVs?

d) Would the advanced approaches have provided a regulatory capital incentive for banks to avoid excessive dependence on bond insurers?

e) Would the advanced approaches have required banks to hold more capital against commercial real estate?

f) Would the advanced approaches have required banks to hold more capital against leveraged commercial loans?

g) Would the advanced approaches have required more capital overall, so that large banks would have been better capitalized going into the current market turmoil?

3. Would banks reduce their actual capital in response to the advanced approaches?

4. Would the advanced approach require banks to raise capital substantially during a downturn?

Questions for the Hearing on "The State of the Banking Industry"
March 4, 2008

Questions for the Honorable Sheila Bair, Chairman, Federal Deposit Insurance Corporation, from Chairman Dodd:

Anti-Union Regulation

Last year, the Department of Labor issued a regulation drastically expanding the personal financial information union officers and employees must submit to the Department. The new LM-30 rule will require more than 150,000 union volunteers, employees, and their families to report the terms of mortgages, car loans, and even student loans. To determine whether they must report such interests, these individuals must ascertain (1) whether the bank providing a loan does any business with the person's union, or (2) whether the bank does 10 percent of its business with firms whose employees are in the same union. The regulation requires individuals to write to banks asking for this info, and, then, if banks won't provide such information, to contact the Department of Labor for assistance. In the meantime, individuals are required to make good faith estimates of the bank's business with their unions and unionized firms.

Legal

- Given your agency's expertise in the regulation and practices of banks, do you believe that banks are able–and willing–to inform their customers whether they do business with particular unions and how much of their "business" and "business receipts" are with particular unionized firms?

- Are banks obligated or prohibited by any federal or state law to disclose to their customers how much "business" or "business receipts" they have with particular unionized firms? Can banks simply refuse to answer these written inquiries?

- What type of administrative burden will this LM-30 rule, and the hundreds of thousands of resulting inquiries, place on banks and are banks currently prepared to respond to these inquiries?

- If banks don't provide this non-public information, is there any "information reasonably available" to the public that union officers, employees, and members could use to make good faith estimates?

Commercial Real Estate

In December 2006, three agencies, the FRB, OCC, and FDIC, issued final guidance highlighting the risks to banks from concentrations in commercial real estate. In issuing the guidance, the regulators specifically emphasized that they were not setting any limits on banks' commercial real estate lending. Yet now we understand from the Comptroller of the Currency and the Chair of the FDIC that over a third of community banks have commercial real estate concentrations exceeding 300 percent of their capital.

DSC

Questions for the Hearing on "The State of the Banking Industry"
March 4, 2008

- Are any community banks going to fail because of their overexposure to commercial real estate, including commercial real estate mortgage backed securities?
- Was it the correct policy not to set concentration limits in the guidance?
- What are examiners doing when they find these levels of concentrations?
- What off-balance sheet vehicles are banks using to invest in commercial real estate? Are the regulators approving these kinds of transactions?

Basel II

There was extensive conversation on what would have been the capital status of banks going into this crisis period had Basel II capital standards been in effect. Fed Vice-Chairman Kohn said that if, "we had the same safeguards in place, and if we started implementing in 2004 with the same safeguards that are in place in 2008 and 2009, I do think on balance we would have been better off." Mr. Gronstal answered differently, stating: "I think the answer to your second question is that we probably would have had lower dollar amounts of capital per asset, and that makes it more challenging to deal with issues when times get rough."

Can you explain in writing, whether you believe that banks would have had more or less capital in place for this current down turn had Basel II been implemented during the time frame that Vice-Chairman Kohn mentioned in his response? Can you also explain why you believe that to be the case, citing any empirical data on both the effects of Basel II on capital requirements and what we have experienced during this economic crisis, as it relates to assets? DSC

During the discussion of Basel II, Comptroller Dugan told the Committee: "The irony of this whole situation is that the very high--most highly rated best securities, the ones that were thought to be least likely to default was where all the--a huge share of the losses have been concentrated." Given Basel II's reliance on ratings of securities, does this observation give you reason for concern over the current Basel II structure? If so, what do you recommend be done; if not, why not?

Too Big to Fail

I am concerned about the potential ramifications of the failure of a very large institution. Is your agency prepared today to handle the failure of a large systemically significant insured financial institution? What steps are you taking to prepare for this contingency? DRR

Questions for the Hearing on "The State of the Banking Industry"
March 4, 2008

Data on Loan Modification

DIR

Please provide comprehensive data on mortgage delinquencies, foreclosures, repayment plans and modifications for the mortgages being serviced by the institutions you regulate for the past 12 months. Please provide this information by the following loan categories: subprime, Alt-A, and prime. Please describe the types of repayment plans and modifications that servicers are employing and the numbers of loans in each category.

FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429
Office of Legislative Affairs

May 2, 2008

Honorable Marcy Kaptur
House of Representatives
Washington, D.C. 20515

Dear Representative Kaptur:

Thank you for your letter with questions regarding the former Superior Bank of Hinsdale, Illinois.

The Federal Deposit Insurance Corporation's Legal Division prepared the enclosed response.

Your interest in this matter is appreciated. If you have further questions, the Office of Legislative Affairs can be reached at (202) 898-7055.

Sincerely,

[redacted]

Eric J. Spitler
Director
Office of Legislative Affairs

Enclosure

Q6. Which attorney(s) or accounting firms created the securitization process that Superior employed? Did Superior develop the process internally or contract the development of its process externally? If externally, with whom?

A6. The accounting firm of Ernst & Young audited the securitization process that Superior employed. Superior personnel created the securitization process internally.

Q7. Please provide a list of the majority and minority shareholders of Superior Bank during its existence. Alliance Funding? Coast-To-Coast Financial?

A7. Alliance Funding was a division of Superior, and Coast-To-Coast Financial was Superior's holding company. As of July 2001, the Pritzker family owned 50 percent of Coast-To-Coast and the Dworman family owned the other 50 percent. Additional information may be available from the OTS.

Q8. Please provide a list of the earnings and other benefits (compensation, stock options, dividends, etc.) of Board members and shareholders of each during those years.

A8. The records of the FDIC indicate that as of February 2001, Superior's Board of Directors had five members. These members were Neal T. Halleran, the President of Superior; Monte N. Kurs, the President of the Consumer Finance Division of Superior; Stephen T. Mann, the Chairman of the Board of Directors; Glen Miller and Marc Weisman. Nelson Stephenson was a director until January 14, 2001. Directors' fees for each director were $24,000 a year as of 2001. Total compensation for Mr. Halleran included a salary of $170,000 and other remuneration totaling $129,359 and for Mr. Kurs, a salary of $280,000 and other remuneration of $606,421. Additional information may be available from the OTS, the primary regulator of Superior during its existence.

Q9. During the 1990's, Superior grew from $200 million in loan volume to $2.2 billion by 1999. The value of its securities reached $9.4 billion, and the return on its assets averaged 12 times that of the industry. How was it possible that the Office of Thrift Supervision and the Federal Deposit Insurance Corporation allowed these fraudulent practices to continue for almost a decade with no effective regulatory oversight?

A9. In the Department of Treasury's Material Loss Review, the Office of Inspector General indicated that Superior's primary regulator, the OTS, did not reflect supervisory concern over Superior's risk exposure until 2000. Examination staff believed that Superior's management had the expertise to manage and monitor the activity, with Superior enjoying high earnings and adequate capital. In addition, as noted in the same review, there was no uniform federal guidance on subprime lending issued by the Federal regulators until March 1, 1999. The Material Loss Review states that "OTS generally accepted Superior's assurances that residual

Response to an Inquiry by
The Honorable Marcy Kaptur

The following information is provided by the Federal Deposit Insurance Corporation's Legal Division

The Federal Deposit Insurance Corporation was appointed Receiver for Superior Bank on July 27, 2001 by the Office of Thrift Supervision (OTS), Superior's primary regulator.

Superior Bank was originally established in 1988 when certain investors acquired Lyons Bank of Countryside, Illinois. The acquisition was made possible with assistance from the former Federal Savings and Loan Insurance Corporation (FSLIC). Superior was a wholly owned subsidiary of Coast-To-Coast Financial Corporation. As of July 2001, Coast-To-Coast Financial was owned by the Pritzker and Dworman families. At the time of its closing in July 2001, Superior had just over $1.9 billion in recorded assets, with FDIC insured deposits of about $1.5 billion. Following are the FDIC's responses to each of the questions in your April 1st letter.

Q1. Are all legal issues of a federal nature resolved concerning Superior Bank, Hinsdale, Illinois related to the subprime mortgage market crisis?

A1. The FDIC has resolved a number of legal issues related to the failure of Superior Bank, including settlements of several professional liability claims. A contract claim against the FDIC relating to the sale of various Superior assets by the Receiver remains pending in the United States District Court for the District of Columbia. *Beal Bank, S.S.B. v FDIC as Receiver for Superior Bank,* Civ. Action No. 1:02CV02146 (D.C.D.C.). The causes of Superior's failure were determined by the Inspector General of the Department of the Treasury to be improper accounting and inflated valuation of residual assets, asset concentration, rapid growth, deficient risk management systems, liberal underwriting, unreliable loan loss provisioning, economic factors and non-responsive management. A copy of the *Material Loss Review of Superior Bank, FSB,* is attached.

Q2. Please summarize, by year, the criminal and civil charges brought against Superior, those resolved and those pending. This bank also had two subsidiaries, Alliance Funding and Coast To Coast Financial. Were any charges filed against these instrumentalities and, if so, are those charges resolved or pending?

A2. To our knowledge, there have not been any criminal charges brought against Superior, or against Superior's holding company, Coast-To-Coast Financial or Alliance Funding, a division of Superior. Our records do not indicate any civil actions pending against Coast-To-Coast Financial as of the date the FDIC was appointed Receiver, but there was an action filed against several entities, including Coast-To-Coast Financial, after Superior's failure. *Courtney v. Halleran*, 485 F.3d 942 (7th Cir. 2007). The claims filed in that action were dismissed by the court, and that case is now closed. Our records indicate thirteen cases pending against Alliance Funding as of the date of the Receivership and two cases pending against Superior. The Alliance Funding matters are no longer open matters on our records and only one of the two cases shown as pending against Superior is shown as open on our records. The FDIC does not know if Coast-To-Coast Financial is still a corporation active in any state.

Q3. The largest insured U.S. financial institution to fail between 1992 and 2000 was Superior Bank, Hinsdale, Illinois. Please provide a name list of that Bank's Board of Directors, Board Committees, and Chief Executive Officer for each year from 1988-2002.

A3. The records of the FDIC indicate that as of February 2001, Superior's Board of Directors had five members. These members were Neal T. Halleran, the President of Superior; Monte N. Kurs, the President of the Consumer Finance Division of Superior; Stephen T. Mann, the Chairman of the Board of Directors; Glen Miller and Marc Weisman. Nelson Stephenson was a director until January 14, 2001. Stephen Mann, Glen Miller, and Neal Halleran were members of the Audit Committee and Stephen Mann, Monte Kurs, and Neal Halleran were members of the Executive Committee. The Asset Review Committee was led by Neal Halleran, with officer Walter Rusnak as the other member. The Benefits Committee members were Neal Halleran and Monte Kurs, with officer Linda Jelinek as the third member. Information concerning members of Superior's Board and Board Committees prior to the date of the FDIC's appointment as Receiver may be available from the OTS, the primary regulator of Superior during its existence.

Q4. In the subprime abuse of mortgage securitization, how significant was Superior Bank among the U.S. firms that engaged in these fraudulent practices during the 1990's? Would you say it was "an industry leader," and what evidence do you have to justify your reply?

A4. Superior began to shift its focus to nationwide subprime mortgage banking in 1992, packaging and securitizing loans in the secondary market. Superior ended its securitization activities by June of 2000. There is no indication in the findings of the Treasury Department's Inspector General that Superior engaged in any fraudulent activities related to its mortgage securitization activities or that it was an industry leader in mortgage securitizations.

Q5. Was Superior the first, or among the first such U.S. banking institutions, to engage in these fraudulent securitization practices at such significant volumes?

A5. There is no indication in the findings of the Treasury Department's Inspector General that Superior engaged in any fraudulent activities related to its mortgage securitization activities or that it was an industry leader in mortgage securitizations.

assets would be sold or upstreamed to the holding company and, if not, the residual assets would be properly managed. Besides relying on management commitments, examiners and senior OTS officials believed that the principal owners would provide financial assistance should the risks adversely affect Superior."

Q10. When Superior opened for business in 1988, as part of the Federal Home Loan Bank Board's Resolution Trust Corporation's refinancing of Lyons Thrift, how was it that Superior received $645 million in federal tax credits as incentives to buy Lyons? Was that tax benefit negotiated administratively as part of the purchase agreement within the purview of the RTC, or was that incentive the result of separate legislation passed by Congress?

A10. The history of the acquisition of Lyons Thrift is set forth in great detail by the United States Court of Federal Claims in its decision in *Coast-To-Coast Financial Corp. et al. v. United States*, 52 Fed.Cl. 352 (Ct. Fed. Cl. 2002). A copy of that decision is attached. As the court noted, the provision of tax benefits was explicitly discussed by negotiators for the former Federal Savings and Loan Insurance Corporation (FSLIC) as an incentive to acquirors of Lyons Savings. The benefits as discussed were based on three provisions of the Internal Revenue Code of 1986 referenced in the court's opinion.

Q11. Name the specific individuals at the Resolution Trust Corporation, and any regulatory agencies involved in the Lyons-Superior transaction, responsible for negotiating that tax incentive.

A11. The FDIC was not a party to these negotiations. The negotiation is described in some detail in the court's opinion in *Coast-To-Coast Financial Corp. et al. v. United States*, with representatives of FSLIC meeting with potential investors to discuss the terms of any acquisition of Lyons Savings.

Q12. Superior began specializing in selling securities backed by subprime mortgages in 1992 through Alliance Funding Corporation. Please name the individuals on this Corporation's Board of Directors and its chief executive officers from 1992 to the present.

A12. Alliance Funding Corporation was a division of Superior Bank and was part of the Bank's corporate structure. It did not have a separate Board of Directors.

Q13. Did Superior/Alliance/Coast To Coast Financial sell tranches of subprime mortgage instruments to Fannie Mae and Freddie Mac during its existence? If so, can your agency provide a paper trail for these transactions including the year and date of such sales, the dollar volume of each transaction, and which individuals at Superior and the secondary markets signed these transactions?

A13. The FDIC is not aware of any such sales during Superior's existence. Superior's primary regulator, the OTS, may have additional information that could be responsive to this question.

Q14. In what year, and by what means were Superior's mortgage securities moved to market through Merrill Lynch? Who were the individuals involved in those transactions at Superior and at Merrill? Were third parties or other brokerages or investment banks employed to move this paper? If so specify. By year, what volume and amount of such mortgage securities were sold to Merrill Lynch? Were Fannie Mae and Freddie Mac engaged, and how and when?

A14. The court's decision in *Merrill Lynch Mortgage Capital, Inc. v. FDIC,* 293 F.Supp.2d 98 (D.C. D.C. 2003) references the agreement between Merrill Lynch and Superior entered into in 2001 that allowed Merrill Lynch to purchase pools of residential loans originated by Superior. A copy of that decision is attached.

Q15. In 1986, Congress passed a new Tax Reform Act which created the Real Estate Mortgage Investment Conduit to facilitate collateralized mortgage obligations. Knowing everything your agency knows today about the subprime crisis, to what extent did this act contribute to the mortgage crisis America is facing today? Why?

A15. The passage of the Tax Reform Act of 1986 created the Real Estate Mortgage Investment Conduit or REMIC. REMICs can be used to structure a mortgage-backed securities offering as a sale of assets, thereby removing, for accounting purposes, the loans from the originating lender's balance sheet. They consist of a fixed pool of mortgages with the principal and interest payments sold to investors as individual securities. The Tax Reform Act eliminated the double taxation of the income earned by an issuer at the corporate level and the dividends paid to the holders of the securities held in a REMIC. These financing structures have been used for more than 20 years and they have increased the sources of capital available to the mortgage markets.

There is no question that private mortgage-backed securities (MBS) have been an engine of growth for subprime and Alt-A mortgages in recent years. However, a number of factors contributed to the ensuing credit problems in these portfolios, including weak underwriting practices, poor consumer disclosure practices, mispricing of the credit risk, and faulty risk management practices in general. Given these diverse contributing factors, it is difficult to single out REMICs as a primary cause of the current mortgage crisis.

Q16. During its existence, do records indicate Superior, or any of its subsidiaries, conducted any major financial transactions through or with the following firms: Wasserstein Perella, Dresdner Bank, Carlyle Group?

A16. The FDIC is not aware of any transactions between Superior and the named firms.

Attachments

MATERIAL LOSS REVIEW
OF
SUPERIOR BANK, FSB

OIG-02-040 February 6, 2002

Office of Inspector General

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The Department of the Treasury

H
Coast-To-Coast Financial Corp. v. U.S.
Fed.Cl.,2002.

United States Court of Federal Claims.
COAST-TO-COAST FINANCIAL CORPORATION, Coast Partners, UBH, Inc., Plaintiffs,
Federal Deposit Insurance Corporation, as Receiver for Superior Bank FSB, Hinsdale, Illinois, Substituted Plaintiff,
v.
THE UNITED STATES, Defendant.
No. 95-525C.

April 18, 2002.

Investors who acquired an ailing thrift brought suit against the United States, alleging that enactment of a section of the Omnibus Budget Reconciliation Act of 1993 breached agreements entitling them to take tax deductions for losses incurred as the result of the sale of certain thrift assets. After the thrift was placed in receivership, the Federal Deposit Insurance Corporation (FDIC), was substituted as plaintiff. On cross-motions for summary judgment, the Court of Federal Claims, Bruggink, J., held that: (1) government breached implied covenant of good faith and fair dealing when, after inducing investors to enter into a contract to acquire ailing thrift, in part by advertising the availability of a covered asset loss tax deduction, Congress targeted the same deduction for retroactive appeal when it passed the Guarini legislation in 1993; (2) government was precluded from asserting defense of prior material breach to thrift's claim that government breached covenant of good faith and fair dealing; and (3) breach of contract claim asserted by the Federal Deposit Insurance Corporation (FDIC), as receiver of insolvent thrift, against the United States presented a "case or controversy."

Plaintiffs' motions granted; defendant's cross-motion denied.

West Headnotes

[1] Contracts 95 ⇐168

95 Contracts
95II Construction and Operation
95II(A) General Rules of Construction
95k168 k. Terms Implied as Part of Contract. Most Cited Cases
Every contract has an implied condition that neither party to the contract will do anything to prevent performance thereof by the other party or that will hinder or delay him in its performance.

[2] United States 393 ⇐73(1)

393 United States
393III Contracts
393k73 Performance or Breach of Contracts
393k73(1) k. In General. Most Cited Cases
When the government is one of the parties to a contract, it impliedly promises to act in good faith and invoke its great power of a sovereign act when and only when and to the extent necessary to carry out its essential governmental functions.

[3] United States 393 ⇐73(22)

393 United States
393III Contracts
393k73 Performance or Breach of Contracts
393k73(22) k. Acts or Conduct Constituting Breach in General. Most Cited Cases
Government breached implied covenant of good faith and fair dealing when, after inducing investors to enter into a contract to acquire ailing thrift, in part by advertising the availability of a covered asset loss tax deduction, Congress targeted the same deduction for retroactive appeal when it passed the Guarini legislation in 1993. Omnibus Budget Reconciliation Act of 1993, § 13224, 26 U.S.C.A. § 165 note; 26 U.S.C.A. §§ 362, 597.

[4] United States 393 ⇐73(3)

C
Merrill Lynch Mortg. Capital, Inc. v. F.D.I.C.
D.D.C.,2003.

United States District Court,District of Columbia.
MERRILL LYNCH MORTGAGE CAPITAL, INC., Plaintiff,
v.
FEDERAL DEPOSIT INSURANCE CORPORATION, Defendant.
No. CIV.A. 02-01123(HHK).

Nov. 6, 2003.

Background: Depositor brought suit challenging determination by Federal Deposit Insurance Corporation (FDIC), as receiver of defunct savings and loan institution, that depositor's custodial account was general deposit, subject to pro rata recovery, and not special deposit, subject to full recovery before other creditors.

Holdings: On cross-motions for summary judgment, the District Court, Kennedy, J., held that:

(1) New York law, and not federal rules promulgated under the Federal Deposit Insurance Act (FDIA) and Office of Thrift Supervision (OTS), applied to determination of whether depositor's custodial account constituted special deposit, and

(2) depositor's custodial account constituted direct deposit, as evinced by agreement between depositor and savings and loan institution.

Plaintiff's motion granted.
West Headnotes
[1] Banks and Banking 52 ⇐129

52 Banks and Banking
52III Functions and Dealings
52III(C) Deposits
52k128 Title to and Disposition of Deposits
52k129 k. In General. Most Cited Cases

Banks and Banking 52 ⇐153

52 Banks and Banking
52III Functions and Dealings
52III(C) Deposits
52k153 k. Special Deposits. Most Cited Cases
Specific bank deposits are like bailments in which bank becomes bailee and depositor retains title to things or money deposited; special deposits are not property of bank.

[2] Banks and Banking 52 ⇐77(.5)

52 Banks and Banking
52II Banking Corporations and Associations
52II(E) Insolvency and Dissolution
52k77 Assets and Receivers on Insolvency
52k77(.5) k. In General. Most Cited Cases

Banks and Banking 52 ⇐80(6)

52 Banks and Banking
52II Banking Corporations and Associations
52II(E) Insolvency and Dissolution
52k80 Presentation and Payment of Claims
52k80(6) k. Special or Segregated Deposits. Most Cited Cases
If bank fails, "special deposits" do not become part of receivership estate, and therefore special depositors are entitled to be paid in full before other creditors of the bank.

[3] Banks and Banking 52 ⇐129

52 Banks and Banking
52III Functions and Dealings
52III(C) Deposits
52k128 Title to and Disposition of Deposits
52k129 k. In General. Most Cited

LA08-094

COMMITTEE ON APPROPRIATIONS
Subcommittee on Defense
Subcommittee on Transportation, HUD, and Related Agencies
Subcommittee on Agriculture, Rural Development, FDA and Related Agencies
COMMITTEE ON THE BUDGET
DEMOCRATIC STEERING AND POLICY

U.S. HOUSE OF REPRESENTATIVES

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http://kaptur.house.gov

April 1, 2008

FDIC
APR - 8 2008
OFFICE OF LEGISLATIVE AFFAIRS

The Honorable Sheila C. Bair
Chairwoman
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429-9990

Dear Chairwoman Bair:

As the subprime mortgage securitization crisis deepens, Congress is evaluating various measures to deal with its financial impact on our citizens and economy.

In order to gain a more thorough understanding of the process that led our nation to this juncture, I am writing to determine if your agency may have information that can enlighten my understanding. I am particularly interested in obtaining more information about one of the early and more publicized cases that has been litigated, Superior Bank of Hinsdale, Illinois. Any information you can provide in response to the questions that follow will be appreciated.

1. Are all legal issues of a federal nature resolved concerning Superior Bank, Hinsdale, Illinois related to the subprime mortgage market crisis?

2. Please summarize, by year, the criminal and civil charges brought against Superior, those resolved and those pending. This bank also had two subsidiaries, Alliance Funding Corporation and Coast to Coast Financial. Were any charges filed against these instrumentalities and if so, are those charges resolved or pending?

3. The largest insured U.S. financial institution to fall between 1992 and 2000 was Superior Bank, Hinsdale, Illinois. Please provide a name list of that Bank's Board of Directors, Board Committees, and Chief Executive Officer for each year from 1988-2002.

4. In the subprime abuse of mortgage securitization, how significant was Superior Bank among the US firms that engaged in these fraudulent practices during the

1990's? Would you say it was "an industry leader," and what evidence do you have to justify your reply?

5. Was Superior the first, or among the first such US banking institutions, to engage in these fraudulent securitization practices at such significant volumes?

6. Which attorney(s) or accounting firms created the securitization process that Superior employed? Did Superior develop the process internally or contract the development of its process externally? If externally, with whom?

7. Please provide a list of the majority and minority shareholders of Superior Bank during its existence. Alliance Funding? Coast to Coast Financial?

8. Please provide a list of the earnings and other benefits (compensation, stock options, dividends, etc.) of Board Members and shareholders of each during those years.

9. During the 1990's, Superior grew from $200 million in loan volume to $2.2 billion by 1999. The value of its securities reached $9.4 billion, and the return on its assets averaged 12 times that of the industry. How was it possible that the Office of Thrift Supervision and the Federal Deposit Insurance Corporation allowed these fraudulent practices to continue for almost a decade with no effective regulatory oversight?

10. When Superior opened for business in 1988, as part of the Federal Home Loan Bank Board's Resolution Trust Corporation's refinancing of Lyons Thrift, how was it that Superior received $645 million in federal tax credits as incentives to buy Lyons? Was that tax benefit negotiated administratively as part of the purchase agreement within the purview of the RTC, or was that incentive the result of separate legislation passed by Congress?

11. Name the specific individuals at the Resolution Trust Corporation, and any regulatory agencies involved in the Lyons-Superior transaction, responsible for negotiating that tax incentive.

12. Superior began specializing in selling securities backed by subprime mortgages in 1992 through Alliance Funding Corporation. Please name the individuals on this Corporation's Board of Directors and its chief executive officers from 1992 to the present.

13. Did Superior/Alliance/Coast to Coast Financial sell tranches of subprime mortgage instruments to Fannie Mae and Freddie Mac during its existence? If so, can your agency provide a paper trail for these transactions including the year and date of such sales, the dollar volume of each transaction, and which individuals at Superior and the secondary markets signed these transactions?

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

May 5, 2008

Honorable Barney Frank
Chairman
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I appreciated the opportunity to testify before the Committee on Financial Services on April 9, 2008, at the hearing "Using FHA for Housing Stabilization and Homeownership Retention."

Enclosed are responses to questions received from Congressman Barrett following my testimony. If you have further questions or comments, please do not hesitate to contact me at (202) 898-6974 or Eric Spitler, Director of Legislative Affairs, at (202) 898-3837.

Sincerely,

[redacted]

Sheila C. Bair

Enclosure

Response to questions from the Honorable J. Gresham Barrett
from Sheila C. Bair, Chairman,
Federal Deposit Insurance Corporation

Q1. What should be the goal of federal regulations? Should we just aim to ensure that fraud and malfeasance are punished? Or should the goal in regulations be stable growth?

A1. Federal banking regulations should not have a single focus. The central objectives of federal banking regulations are to maintain public confidence in the banking system; to support financial intermediation, credit availability, and competition; to enforce the public laws; and to protect consumers and encourage compliance with the Community Reinvestment Act. Capital requirements and other prudential regulations are tools used by bank regulators to promote safe and sound banking operations and to discourage excessive risk-taking. Banking regulations also attempt to minimize the risk of fraud.

Maintaining economic stability is a consideration in bank supervision, and the federal banking agencies recognize the importance of encouraging credit availability during periods of slower economic growth. While the Federal Reserve Board, in its domestic monetary role, is the federal entity primarily concerned with economic growth and stability, the other federal banking agencies also have a role by encouraging financial institutions to make credit available in the communities they serve on appropriate terms.

Q2. How much do you think our current mortgage crisis was caused by regulatory failures or lack of enforcement?

A2. As I mentioned in my testimony, the problems facing the U.S. markets are attributable to a complex set of interrelated causes. These include weakened lending standards, inadequate consumer protections, regulatory arbitrage, and speculative activity, as well as deficient surveillance by rating agencies and inadequate due diligence by originators and investors. The current turmoil in the credit markets also has been exacerbated by liquidity troubles that typically are not identifiable until funding problems emerge.

A significant volume of subprime mortgages were originated by companies (primarily mortgage brokers and stand-alone finance companies) not subject to federal supervision. In 2005, 52 percent of subprime mortgages were originated by companies not subject to federal supervision. An additional 25 percent were made by lenders affiliated with a regulated, deposit-taking bank or thrift, and 23 percent by regulated banks and thrifts. The FDIC estimates that the share of such loans made by nonbank entities not subject to federal supervision in 2006 was 46 percent.

For mortgage loans made by federally supervised depository institutions, the federal banking agencies issued a number of cautionary statements beginning in 1999 on a number of topics, including subprime lending, non-traditional mortgage lending, and commercial real estate loan concentrations. The purpose of these statements was to alert financial institutions to the risks involved and to encourage strong underwriting policies, prudent risk selection, and robust

concentration management procedures. Overall, the regulatory agencies strongly encouraged insured banks and thrifts to be cautious in their origination and management of subprime and non-traditional mortgage products.

From an enforcement standpoint, Congress has mandated routine on-site examinations for all insured institutions, which the federal bank regulatory agencies follow. Any institution that a regulator finds is performing poorly or has taken on excessive risk is typically directed to improve conditions or face enforcement action, including possible closure.

Q3. Are there any areas where onerous regulations led to evolution towards exotic products helping to cause the financial crisis?

A3. Financial innovation (including non-traditional mortgage lending and structured financial instruments/vehicles) and the abundant liquidity in global credit markets together fueled the development of non-traditional mortgages and financial structures. The development of these financial products was not precipitated by onerous regulation, but by financial innovation and abundant capital seeking higher returns. The highly liquid credit market environment from 2005 until mid-2007 led investors to seek higher returns by taking on increased credit risk and liberalizing repayment and loan terms.

Q4. If the government intervenes in the private market, do we have any additional regulatory duties to prevent this from happening in the future?

A4. I believe that we do have the duty to prevent a recurrence of the problems we now face. As I mentioned in my testimony, with regard to preventing practices in the future that contributed to the current issues in the mortgage markets, strong final rules by the Federal Reserve Board under the Home Owners Equity Protection Act (HOEPA) that impose basic principles of sound underwriting on both bank and non-bank mortgage originators are essential. An important complement to these substantive rule provisions would be the creation by Congress of a federal entity to buttress the efforts of the states to better license and police mortgage originators. The House of Representatives adopted a set of strong licensing provisions as part of H.R. 3915 last year. Similarly, the Treasury Department has proposed creating a Mortgage Origination Commission that, working with state authorities, would develop minimum national licensing qualifications for all mortgage market originators. Although these two approaches differ in some details, their best elements could be merged into a single proposal that would address this urgent issue and command widespread support.

I would emphasize that there is a particular urgency for Congress to act on legislation to establish national licensing standards for non-bank mortgage participants. As interest rates have declined, advertisements are once again promising low "teaser" rates, no-documentation and no-money-down loans, as well as using the term "fixed" in potentially misleading ways to describe the interest rate on variable-rate mortgage loans. Banks are not allowed to market, originate, or fund loans with such weak underwriting, but no such restrictions apply to non-bank mortgage participants nationally. Combined with strong final HOEPA rules from the Federal Reserve

Board, prompt passage of legislation creating a Commission to license and police mortgage originators would help prevent these practices from again misleading borrowers and adding more problems to the mortgage markets.

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

May 5, 2008

Honorable Barney Frank
Chairman
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

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Sincerely,

[redacted]

Sheila C. Bair

Enclosure

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

May 5, 2008

Honorable J. Gresham Barrett
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Congressman Barrett:

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[redacted]

Sheila C. Bair

Enclosure

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Board, prompt passage of legislation creating a Commission to license and police mortgage originators would help prevent these practices from again misleading borrowers and adding more problems to the mortgage markets.

Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Board of Governors of the Federal Reserve System
Office of Thrift Supervision

June 6, 2008

The Honorable Barney Frank
Chairman
Committee on Financial Services
U.S. House of Representatives
2129 Rayburn Housing Office Building
Washington, DC 20515

Dear Chairman Frank:

Thank you for your letter dated April 28, 2008, regarding proposed changes to the Interagency Questions and Answers Regarding the Community Reinvestment Act (CRA). Your letter raises a specific concern about a question and answer proposed by our agencies in July 2007 about information that could be used to demonstrate that an investment in a national fund meets the geographic requirements of the CRA regulation. (*See* proposed Q&A §__.23 (a)-2.)

Your letter expresses the view that the proposed question and answer limits the amount of favorable CRA consideration a financial institution may receive for its investments in multi-bank community development funds only to those activities that it can document fall within its assessment area(s). Your letter further states the view that the question and answer represents a change in policy, and that previously the agencies provided CRA consideration for such investments without regard to geography, provided that the financial institution is satisfactorily meeting the credit needs within its assessment area.

The agencies have long recognized the important role served by community development funds, and the fact that many of these funds operate on a statewide or multistate basis. In the Interagency Questions and Answers Regarding Community Reinvestment published in 2001,[1] the agencies indicated that they would give favorable consideration to a financial institution's involvement in community development activities that benefit a broader statewide or regional area that includes the institution's assessment area. (*See* Q&A §§__.12(i) and 563e.12(h)-5.)[2] The agencies further stated in Q&A §§ __.12(i) and

[1] *See* 66 Fed. Reg. 36620 (July 12, 2001).
[2] *See* 66 Fed. Reg. 36626-27.

563e.12(h)-6 that the term "broader statewide or regional area" could be as large as a multistate area, for example, the Mid-Atlantic states.[3]

As you know, the Community Reinvestment Act encourages financial institutions "to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions." 12 U.S.C. 2901(b). The goal of the proposed Interagency Q&A referenced in your letter, Q&A §__.23(a)-2, was to provide guidance to the industry and examiners alike on the type of information that could be used to show that a loan or investment in such a fund meets the necessary geographic requirements of the CRA statute and implementing regulations. The agencies did not intend to suggest a change in position on the regulatory requirements regarding CRA consideration for a financial institution's investments outside of its assessment area(s), or a modification of those requirements.

We appreciate your taking the time to write to us and bring your interest in this matter to our attention. Please be assured that your comments are being seriously considered by the agencies. We will be happy to notify you as soon as possible after we have made a decision on any final guidance on this issue.

If you have any additional questions or concerns, please do not hesitate to contact us.

Sincerely,

[redacted]

Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System

[redacted]

Comptroller
Office of the Comptroller of the Currency

[redacted]

Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation

[redacted]

John M. Reich
Director
Office of Thrift Supervision

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[3] *See* 66 Fed. Reg. 36627.

LA08-122

BARNEY FRANK, MA, CHAIRMAN

U.S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

SPENCER BACHUS, AL, RANKING MEMBER

FDIC
APR 28 2008
OFFICE OF LEGISLATIVE AFFAIRS

April 28, 2008

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th & C Streets, NW
Washington, DC 20551

The Honorable John C. Dugan
Comptroller
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

The Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

The Honorable John M. Reich
Director
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Dear Chairman Bernanke, Comptroller Dugan, Chairman Bair, and Director Reich:

As the Financial Services Committee focuses on legislation to help alleviate the current housing crisis, I am troubled by the possibility that proposed changes to the Interagency Questions and Answers ("Guidance") implementing the Community Reinvestment Act (CRA) could undermine efforts to expand affordable housing in the United States.

For over twenty years, banks have successfully partnered with non-profits like Massachusetts Housing Investment Corporation, Mass Housing Partnership, Local Initiatives Support Corporation, and dozens of large lenders through investments in pooled debt and equity community development funds. These funds are attractive because they spread and diversify risk among multiple lenders and investors, and over broad geographic areas which helps to facilitate the flow of private capital to under-served areas and people with acute needs. Unfortunately, there is increasing evidence that the proposed Guidance is chilling banks' investment in certain funds that have been so critical to financing affordable multi-family housing projects.

In contrast to the long-established practice of most federal banking agencies, the proposed Guidance limits the amount of CRA credit a bank may receive for investments in multi-bank community development funds only to those activities it can document fall within its assessment areas. I understand that regulators have traditionally granted full CRA credit for individual bank investments in these funds without regard to geography provided that the bank is satisfactorily meeting the credit needs within its assessment areas. This policy shift, which appears to discount and even eliminate banks' investment in state, regional and national community development funds, is likely to have far-reaching and negative implications for the supply of apartments affordable to low- and moderate-income Americans.

At a time when losses by the nation's largest financial companies have prompted them to scale back their participation in the Low Income Housing Tax Credit program, regulators should put forward policies that help ameliorate, rather than exacerbate, the crisis in the multi-family housing sector. I would appreciate you investigating this matter and reporting back on the efforts your agency and other FFIEC members are making to address the concerns raised in this letter.

[redacted]

BARNEY FRANK
Chairman

E-Mail Viewer

Message | Details | Attachments | Headers | Source

HTML

From: "mfrancis@goldenvalleybank.com" <mfrancis@goldenvalleybank.com>
Date: 3/11/2009 11:42:27 PM
To: "ca02ima@mail.house.gov" <ca02ima@mail.house.gov>
Cc:
Subject: Contact form Yes-response

<APP>CUSTOM
<PREFIX>Ms.</PREFIX>
<FIRST>Mark</FIRST>
<LAST>Francis</LAST>
<ADDR1>190 Cohasset Rd</ADDR1>
<CITY>Chico</CITY>
<STATE>CA</STATE>
<ZIP>95926</ZIP>
<PHONE>(530) 894-1000</PHONE>
<EMAIL>mfrancis@goldenvalleybank.com</EMAIL>
<ISSUE>Financial Services</ISSUE>
<MSG>Mark Francis
President & CEO
Golden Valley Bank
190 Cohasset Road
Chico, CA 95926-2268

March 5, 2009

The Honorable Wally Herger
House of Representatives
242 Cannon House Office Building
Washington, DC 20515-0502

Dear Representative Herger:

I appreciate the opportunity to comment on the FDIC's interim rule that would impose a special assessment of 20 basis points in the second quarter.

I have serious concerns about this proposal, but first wanted to emphasize that I fully support the view of the FDIC that we need a strong, financial secure fund in order to maintain the confidence depositors have in the system. However, how this is done is very important to my bank and my community.

The special assessment is a significant and unexpected cost to my bank that will devastate earnings.

Banks like mine that never made a subprime loan and have served our communities in a responsible way for years and years are being unfairly penalized.

The special assessment is completely at odds with my bank's efforts to help my community rebuild from this economic downturn.

Given the impact that the proposed assessment will have on my bank and my community, I strongly urge you to consider alternatives that would reduce our burden and provide the FDIC the funding its needs in the short term.

THOMAS MANUFACTURING CO., LLC.
♦♦♦
1308 West Eighth Ave. Chico, CA 95928
Phone 530-893-8940 Fax 530-893-2943
info@thomaswelding.com

March 11, 2009

Congressman Wally Herger
242 Cannon House Office Building
Washington, DC 20515

Dear Congressman Herger:

This letter is to offer my comments on the FDIC's interim rule that would impose a special assessment of 20 basis points in the second quarter.

Although I fully support the view of the FDIC that we need a strong, financially secure fund in order to maintain the confidence of depositors, I have serious concerns about this proposal.

Our Bank is less than three years old. We are a traditional community bank that supports local business, the community and its residents with traditional banking services. We have not participated in sub prime lending, not invested in anything other than Government Sponsored Agency securities and have been well embraced by our community. Last year we increased the amount of loans in the community by 42% and are on the verge of finally becoming profitable.

The special assessment is a significant and unexpected cost to my bank that will devastate earnings and reduce our capital significantly.

We are already dealing with a deepening recession, accounting rules that overstate economic losses and unfairly reduce capital, regulatory pressure to classify assets that continue to perform, and a significant increase in regular quarterly FDIC premiums.

Each of these is a big challenge on its own – but collectively, they are extremely burdensome. Banks like mine that never made a sub prime loan and have served our communities in a responsible way are being unfairly penalized. The special assessment is completely at odds with my bank's efforts to help my community rebuild from this economic downturn. The reduction in earnings will make it harder to build capital when it is needed the most.

We will also be forced to look at ways to lower the cost of other expenses, which may limit our ability to sponsor community activities or make charitable donations – something that we are very compassionate about.

[redacted]

Thomas M. Dauterman
Board Member
Northern California National Bank

TD:lm

WALLY HERGER
2ND DISTRICT, CALIFORNIA

PLEASE REPLY TO:
☐ WASHINGTON OFFICE:
242 CANNON HOUSE OFFICE BUILDING
(202) 225-3076

DISTRICT OFFICES:
☐ 2635 FOREST AVENUE, SUITE 100
CHICO, CA 95928
(530) 893-8363

☐ 410 HEMSTED DRIVE, SUITE 115
REDDING, CA 96002
(530) 223-5898

www.house.gov/herger

COMMITTEE ON
WAYS AND MEANS

SUBCOMMITTEES

RANKING MEMBER
HEALTH
TRADE

Congress of the United States
House of Representatives
Washington, DC 20515-0502

April 17, 2009

Chairwoman Sheila Bair
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429-0001

Dear Chairwoman Bair,

I recently received the attached correspondence from a group of my constituents, regarding the Federal Deposit Insurance Corporation's interim rule that would impose a special assessment of 20 basis points in the second quarter. I would appreciate your review and consideration of 's concerns, and a thorough response at your earliest possible convenience.

Thank you for your consideration of this request. I look forward to hearing from you.

Sincerely,

[redacted]

WALLY HERGER
Member of Congress

WH: jr
Enclosure

FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990 Office of Legislative Affairs

May 6, 2008

Honorable James P. Moran
House of Representatives
Washington, D.C. 20515

Dear Congressman Moran:

Thank you for your letter to Christine Davis regarding the use of the Federal Deposit Insurance Corporation facility at Virginia Square for your government procurement conference. We are pleased that the FDIC was able to accommodate the event.

I apologize for the delay that you and [redacted] experienced clearing security and entering the parking garage. Our Division of Administration has reviewed our procedures and taken the necessary corrective action to ensure that this does not happen again. b6

We hope you and the George Mason University staff will consider using our facility in the future.

Sincerely,

[redacted]

Eric J. Spitler
Director
Office of Legislative Affairs

LA08-123

HOUSE OF REPRESENTATIVES
WASHINGTON, D. C. 20515

JAMES P. MORAN
8TH DISTRICT OF VIRGINIA

FDIC
APR 29 2008
OFFICE OF LEGISLATIVE AFFAI

4/2/2008

Ms. Christine Davis
Chief, Special Services Division
Federal Deposit Insurance Corporation
3501 Fairfax Dr, Room E-3084
Arlington, VA 22206

Dear Ms. Davis,

Thank you so much for allowing us to use your facility at my recent government procurement conference. It is a wonderful facility, and we were grateful for all the assistance you and your staff provided. The large crowd in attendance thoroughly enjoyed the networking, collaboration, and information from our presentations.

I am concerned, however, that the [redacted] was subjected to a 45 minute wait to get into the parking garage despite our pre-arrangements, and that I too had to wait 20 minutes. It was the one cloud on what was otherwise a wonderful event.

b6

Again, thank you.

Sincerely

[redacted]

James P. Moran
Member of Congress

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

May 12, 2008

Honorable Claire McCaskill
United States Senate
Washington, D.C. 20510

Dear Senator McCaskill:

Thank you for your letter regarding provisions of the fiscal year 2008 Consolidated Appropriations Act (P.L. 110-161), which direct that agencies establish and maintain on website homepages a direct and obvious link to the website of their Inspector General.

The Federal Deposit Insurance Corporation concurs that providing a link to the FDIC Office of Inspector General (OIG) website is a useful tool to address fraud, waste, or abuse. The FDIC has placed a link to the website of the FDIC's Inspector General so that it appears not only on our homepage, but on every page on our website.

Section 534 also calls for a mechanism on the OIGs' websites by which individuals may anonymously report cases of fraud, waste, or abuse with respect to their agency. The FDIC OIG has such a link on its website. This link to the OIG Hotline provides individuals with information on how they may report cases of fraud, waste, or abuse regarding the FDIC and provides options should the individual desire anonymity.

If you have further questions or comments, please do not hesitate to contact me at (202) 898-6974 or Eric Spitler, Director of Legislative Affairs, at (202) 898-3837.

Sincerely,

[redacted]

Sheila C. Bair

LA08-134

CLAIRE McCASKILL
MISSOURI

(202) 224-6154
FAX: (202) 228-6326
http://mccaskill.senate.gov

COMMITTEES:
ARMED SERVICES
COMMERCE, SCIENCE AND TRANSPORTATION
HOMELAND SECURITY AND GOVERNMENT AFFAIRS
INDIAN AFFAIRS
SPECIAL COMMITTEE ON AGING
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

United States Senate

WASHINGTON, DC 20510

April 23, 2008

FDIC
MAY - 6 2008
OFFICE OF LEGISLATIVE AFFAIRS

The Honorable Sheila C. Bair
Chairman of the Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Chairman Bair:

I am writing regarding a specific provision of the Consolidated Appropriations Act for FY '08, which President Bush signed into law on December 26, 2007. Division D, Title VI, Section 534 of this Act reads as follows:

> The Departments, agencies, and commissions funded under this Act, shall establish and maintain on the homepages of their Internet websites--
> (1) a direct link to the Internet websites of their Offices of Inspectors General; and
> (2) a mechanism on the Offices of Inspectors General website by which individuals may anonymously report cases of waste, fraud, or abuse with respect to those Departments, agencies, and commissions.

As a strong supporter of our nation's Inspectors General, I was proud to introduce this provision, and I am encouraged to see that many federal departments and agencies have already taken the necessary steps to comply with this new law. These small steps could prove invaluable in assisting Inspectors General identify waste, fraud and abuse within the federal government, as well as ensure that their findings are readily available to the American people. However, it appears that your department or agency has not met at least one of these new criteria. I would like to know how and when your department or agency is planning to comply with these simple and straightforward requirements.

Again, thank you for your attention to this matter. Please direct your response to the attention of Peg Gustafson on my staff.

[redacted]

Claire McCaskill
United States Senator

339 BROADWAY
ROOM 136
CAPE GIRARDEAU, MO 63701
(573) 651-0964
FAX: (573) 334-4278

915 EAST ASH STREET
COLUMBIA, MO 65201
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FAX: (573) 442-7140

400 EAST 9TH STREET
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KANSAS CITY, MO 64106
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FAX: (314) 361-8649

324 PARK CENTRAL WEST
SUITE 101
SPRINGFIELD, MO 65806
(417) 868-8745
FAX: (417) 831-1349

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

June 4, 2008

Honorable Tim Johnson
United States Senate
Washington, D.C. 20510

Dear Senator Johnson:

Thank you for your letter regarding the interest of Dakota State University of Madison, South Dakota (DSU) in providing services to the Federal Deposit Insurance Corporation.

DSU has been in contact with the FDIC and has offered to provide a variety of services relating to information assurance for financial institutions. The FDIC is considering various research possibilities relating to information security, such as a general research paper on encryption as well as other security issues that currently confront the banking community and regulators.

In this connection, we are exploring whether it would be helpful to seek the input of an outside expert such as DSU or whether the FDIC has sufficient resources internally to adequately respond to these needs. If the FDIC finds it beneficial to seek assistance for its research needs from one or more outside sources, DSU would be certainly be considered as a potential candidate.

Again, I appreciate your interest on behalf of DSU and assure you that the FDIC's staff is reviewing DSU as a possible collaborative party in this important area.

Sincerely,

[redacted]

Sheila C. Bair

LA08-143

TIM JOHNSON
SOUTH DAKOTA

RAPID CITY OFFICE: (605) 341-3990
PO BOX 1098, RAPID CITY, SD 57709

ABERDEEN OFFICE: (605) 226-3440
PO BOX 1554, ABERDEEN, SD 57402

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April 28, 2008

FDIC
MAY 1 2 2008
OFFICE OF LEGISLATIVE AFFAIRS

Chairman Sheila Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Dear Chairman Bair:

I am writing in support of Dakota State University of Madison, South Dakota's continued advancement in the banking and finance industry. Dakota State University (DSU) is on the cutting edge of banking and financial security, having already been designated a Center of Excellence in Information Assurance Education by Department of Homeland Security and the National Security Agency. I am confident in DSU's continued progress in advancing financial information security.

In this period of globalization and heighted threat environment, the banking and finance industry is an increasingly critical, yet vulnerable, sector of our national economy that requires vigilant protection. Our country has a proud history of successful industry-government-academia partnerships, and I believe Dakota State University can play an integral role in safeguarding our nation's financial interests. The University places such an emphasis on financial security that it recently began offering a new doctorate program in information systems, underscoring information security in relation to the banking and finance industry. This new degree further solidifies Dakota State's commitment to advancing the security and safety of America's electronic financial infrastructure. As well, DSU maintains a nationally-recognized information assurance program and is committed to providing information security personnel and solutions to the financial industry.

Given the importance of the financial industry's impact on the economy, as well as our country's increased threat status, Dakota State University is well positioned to lead the charge in protecting sensitive financial information. I understand that the Federal Deposit Insurance Corporation is considering a partnership with DSU in the area of information assurance for financial institutions. I strongly support such a partnership; if I can provide you with any additional information in support of this effort, please do not hesitate to contact me or my Legislative Assistant, Erin Barry, at (202) 224-5842.

Sincerely,

[redacted]

Tim Johnson
United States Senator

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

June 4, 2008

Honorable Carolyn B. Maloney
Chairman
Subcommittee on Financial Institutions
and Consumer Credit
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Madam Chairman:

Thank you for your recent letter regarding the rules governing stock benefit plans for mutual holding companies. The Federal Deposit Insurance Corporation shares your commitment to good corporate governance practices and to the safety and soundness of the nation's banking system.

As noted in your letter, the FDIC has adopted mutual-to-stock conversion rules to prevent insiders from adopting stock benefit plans without a vote of the public shareholders. The FDIC's conversion regulations (12 C.F.R. §333.4(e)) for stock benefit plans provide for the voting rights of minority shareholders of both state nonmember banks as well as their recently formed holding companies during the first year following conversion to address the entirety of the immediate conversion transaction.

As our previous letter noted, all conversions involving minority stock offerings involve the formation of a mutual holding company (MHC). The Office of Thrift Supervision (OTS) and the Federal Reserve System are the primary federal regulators of thrift and bank holding companies (including MHCs), respectively. Thus, these conversions must adhere to the OTS rules and the Federal Reserve guidelines and policies that limit the ability of insiders in adopting stock benefit plans. The FDIC defers to the rules and policies of those agencies as they regulate conversion matters of thrift and bank holding companies. We are not aware of any MHC that is not required to adhere to either the OTS rules or the Federal Reserve guidelines and policies regarding the adoption of stock benefit plans. In view of your most recent letter, we reviewed our position on this matter and continue to view our current rule as appropriate to address the governance issue in view of the ongoing supervisory role by either the OTS or the Federal Reserve.

We recognize the complexity of this issue and appreciate the opportunity to address your concerns. If you have further questions, please do not hesitate to contact me at 898-6974 or Eric Spitler, Director of our Office of Legislative Affairs, at 898-3837. In addition, we will follow up with your staff to ensure we have thoroughly responded to your concerns.

Sincerely,

[redacted]

Sheila C. Bair

LA08-138

CAROLYN B. MALONEY
14TH DISTRICT, NEW YORK

2331 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-3214
(202) 225-7944

COMMITTEES:
FINANCIAL SERVICES

GOVERNMENT REFORM

JOINT ECONOMIC COMMITTEE

Congress of the United States
House of Representatives
Washington, DC 20515–3214

DISTRICT OFFICES:

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SUITE 311
NEW YORK, NY 10128
(212) 860-0606

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ASTORIA, NY 11102
(718) 932-1804

WEBSITE: www.house.gov/maloney

May 6, 2008

The Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th St., NW
Washington, DC 20429

The Honorable John M. Reich
Director
Office of Thrift Supervision
1700 G. Street, NW
Washington, DC 20552

Dear Chairwoman Bair and Director Reich:

Good corporate governance and safety and soundness go hand-in-hand. Safety and soundness are of the utmost importance to me. That is why I have previously written to each of you regarding your agencies' rules governing the adoption of stock benefit plans for insiders of mutual holding companies (MHCs). I am pleased that the Office of Thrift Supervision recently decided against rolling-back its longstanding rule preventing insiders from self-adopting their stock benefit plans, see 72 Fed. Reg. 35145 (June 27, 2007). However, I have concerns that the Federal Deposit Insurance Corporation has declined to interpret its analogous regulation to prevent this practice, see Letter from Chairwoman Bair, dated December 5, 2007. I am also concerned with the OTS's proposal to allow MHC insiders to adopt charter provisions disenfranchising the public shareholder vote on stock benefit plans, see 72 Fed. Reg. 35205 (June 27, 2007).

The FDIC and the OTS adopted analogous rules in 1994 to prevent insiders from self-adopting stock benefit plans without a vote of the public shareholders, embodying the strong public policy against insider self-enrichment at the expense of public shareholders. These rules are intended, as confirmed by the OTS's 2007 rule, to prevent insiders from ever self-adopting stock benefit plans. The one-year limitation on this rule by the FDIC does not appear to be consistent with a policy to prevent insiders from adopting self enriching stock benefit plans without a public shareholder vote. It is also my understanding that should the FDIC adopt a rule to perpetually limit this practice, it would not interfere with any rule of any regulator.

As you know, many MHCs are not regulated by the OTS and the Federal Reserve has no rule of its own to prevent insiders from self-adopting stock benefit plans after one year. Thus, a loophole currently exists for OTS chartered institutions to engage in regulatory arbitrage and for non-OTS chartered institutions to engage in self-enrichment. I have concerns that unless the FDIC interprets its current regulation in harmony with the OTS interpretation or revises its own rules, this could create a loophole that has the potential for abuse among insiders.

I am equally troubled by the proposed OTS rule to permit MHC insiders to adopt charter provisions which would make it easier to adopt stock benefit plans by disenfranchising the public shareholders.

Thank you very much for your attention to these matters. I look forward to hearing your solutions to these matters which are of significant concern to me.

Sincerely,

[redacted]

CAROLYN B. MALONEY
Member of Congress

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

June 13, 2008

Honorable Charles E. Schumer
United States Senate
Washington, D.C. 20510

Dear Senator Schumer:

Thank you for your letter expressing your concerns about the use of brokered deposits to fund growth. I share many of your concerns about this product.

As you note in your letter, the Federal Deposit Insurance Corporation is closely scrutinizing deposit insurance applications where the proposed bank would depend significantly on brokered deposits to fund its growth. As I stated in my testimony to the Senate Banking Committee on June 5, in light of the current difficulties facing insured institutions and recent failures, the FDIC also is considering ways to improve the risk-based pricing system's ability to account for risk in a timely manner and provide appropriate incentives. We are actively reviewing whether heavy reliance on brokered deposits–particularly when combined with rapid growth–creates risks to the fund that risk-based premium rates should reflect. As you know, any changes to the current assessment system would have to be made through a formal rulemaking with an opportunity for public comment. We will keep you informed of our progress regarding this review and appreciate your interest in the subject.

If you have further questions or comments, please do not hesitate to contact me at (202) 898-6974 or Eric Spitler, Director of Legislative Affairs, at (202) 898-3837.

Sincerely,

[redacted]

Sheila C. Bair

CHARLES E. SCHUMER
NEW YORK

COMMITTEES:
JOINT ECONOMIC
BANKING
JUDICIARY
RULES
FINANCE

United States Senate

WASHINGTON, DC 20510

June 4, 2008

Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Chairman Bair:

I write today regarding the increasing use of brokered deposits during the credit bubble. I applaud the recent steps that the Federal Deposit Insurance Corporation has taken to increase oversight of this financing mechanism for banks submitting new applications for deposit insurance. However, over the past several weeks, the failure of a number of banks that relied heavily on brokered deposits raises serious concerns that this is a serious and growing problem. The savings and loan crisis taught us that these "hot money" deposits can lead to widespread institution failures and I believe that further steps may need to be taken to mitigate losses from any future bank failures that do occur.

In your recent statements about these deposits, you have noted that not all brokered deposits are harmful, and in some cases, may actually be an important source of capital for institutions. However, many banks have been using brokered deposits to finance rapid and risky expansion to take advantage of troubled credit markets. It is these situations that seem to be especially risky, as many of the recent bank failures fit this profile. I would urge you to consider using the risk-based premium authority given to FDIC in Federal Deposit Insurance Reform Act of 2005 to increase deposit insurance premium rates for banks that rely heavily on brokered deposits to finance growth. The risk-based pricing authority gives you the discretion to target these premium increases to especially risky institutions without penalizing well-managed banks.

You have been a leader in the regulatory community's response to the subprime mortgage and credit crises. I know that you are working to maintain a vigilant watch over the deposit insurance system, and I look forward to hearing from you regarding the risks posed by brokered deposits and potential solutions that the FDIC can implement to mitigate the losses of any future failures.

Sincerely,

[redacted]

Charles E. Schumer
United States Senator

FDIC
JUN 4 2008
OFFICE OF THE CHAIRMAN

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

June 20, 2008

Honorable Carolyn B. Maloney
Chairman
Subcommittee on Financial Institutions
and Consumer Credit
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Madam Chair:

Thank you for your comments on the proposed revised Interagency Questions and Answers regarding the Community Reinvestment Act.

I appreciate your thoughtful consideration of our proposal. I can assure you that your views with respect to the value of Letters of Credit for supporting the development of affordable housing and other types of community development activities will be carefully considered as we work to finalize our Guidelines.

If you have further questions or comments, please do not hesitate to contact me at 898-6974 or Eric Spitler, Director of the Office of Legislative Affairs, at 898-3837.

Sincerely,

[redacted]

Sheila C. Bair

LA08-171

Congress of the United States
Washington, DC 20515

June 6, 2008

FDIC
JUN - 9 2008
OFFICE OF LEGISLATIVE AFFAIRS

Office of the Comptroller of the Currency
250 E Street, SW, Mail Stop 1-5
Washington, DC 20219
Regs.comments@occ.treas.gov
Docket ID OCC-2007-0012

Mr. Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Comments@FDIC.gov
RIN 3064-AC97

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Regs.comments@federalreserve.gov
Docket No. OP-1290

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Regs.comments@ots.treas.gov
ID OTS-2007-0030

Re: Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment; Notice: OOC-2007-0012; RIN 3064-AC97; OP-1290; and OTS-2007-0030

Dear Ladies and Gentlemen:

As you consider issuing revised Community Reinvestment Act Q&As to financial institutions, we urge you to give Letters of Credit (LCs) the same CRA credit as loans, as LCs are critical to the development of affordable housing. As Members of Congress representing New York who serve or have served on the Financial Services Committee, we support using CRA credits to encourage lenders to issue LCs in support of community development.

Letters of Credit serve an important function in the development of affordable housing. LCs issued by highly rated financial institutions encourage investors to buy both tax-exempt and taxable bonds issued by states for the development of affordable housing for a broad spectrum of households. LCs provide this inducement by acting as credit enhancers that, in the event of a default on the real estate, require the LC provider to pay off the bond holders and assume the role of mortgagee responsible for working out the project's difficulties.

For example, the New York City Housing Development Corporation, the city's bond financing agency, has issued bonds for 98 projects with LCs from financial institutions totaling some $1.8 billion. The HDC also has 96 more projects with permanent LCs enhanced by financial institutions in the amount of roughly $2.5 billion. The LCs that make possible this $4 billion in financing for affordable housing in New York City are provided by 14 financial institutions, including commercial banks such as Citi, JP Morgan Chase, and Bank of America.

It is very important that the CRA guidelines support and encourage regulated banks to participate in providing these credit enhancements. Unfortunately, current CRA guidelines fail to recognize that LCs are most valuable when they don't turn into actual loans. When they don't turn into loans, it means the LCs have spurred the development of successful affordable housing and the LC provider has not had to pay off the debt. Ironically, current Q&As appear to give less CRA credit for successful LCs and more credit for LCs that turn into loans to pay off the debt of troubled developments. Thus, current Q&As potentially give more CRA credit for failed community development. This would be a perverse outcome, indeed.

The Community Reinvestment Act should provide incentives that consistently support and encourage community investment. We urge you to consider giving equal CRA credit to LCs as to loans.

Sincerely,

[redacted]

Carolyn B. Maloney
Member of Congress

[redacted]

Gary Ackerman
Member of Congress

[redacted]

Carolyn McCarthy
Member of Congress

[redacted]

Gregory Meeks
Member of Congress

[redacted]

Joseph Crowley
Member of Congress

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

June 30, 2008

Honorable Charles E. Schumer
United States Senate
Washington, D.C. 20510

Dear Senator Schumer:

Thank you for your recent letter expressing your concerns and requesting information about the use of brokered deposits by IndyMac Bankcorp. I note that a number of your questions relate to the supervision of that institution and I will defer to the primary federal supervisor with regard to those issues.

As you know, the Federal Deposit Insurance Corporation does not comment on the financial condition or supervisory activities related to open and operating institutions. I would be happy to arrange a briefing for you and your staff to answer any non-institution specific questions you might have regarding our approach to the issues raised in your letter. I also would note, as you and I have previously discussed, with regard to the issue of brokered deposits, the FDIC is considering ways to improve the risk-based pricing system's ability to account for risk in a timely manner and provide appropriate incentives. We are actively reviewing whether heavy reliance on brokered deposits – particularly when combined with rapid growth – creates risks to the fund that risk-based premium rates should reflect. Your letter contains insights that we will carefully consider as part of our ongoing review.

Finally, I would note that the Deposit Insurance Fund available to protect depositors currently exceeds approximately $52 billion. As has been true for the past 75 years, no depositor has any reason to be concerned about the safety of their insured funds should their financial institution fail.

Sincerely,

[redacted]

Sheila C. Bair

LA08-195

CHARLES E. SCHUMER
NEW YORK

United States Senate

WASHINGTON, DC 20510

COMMITTEES:
JOINT ECONOMIC
BANKING
JUDICIARY
RULES
FINANCE

June 26, 2008

Sheila Bair
Chairwoman
Federal Deposit Insurance Corporation
550 17th St. NW
Washington, DC 20429

John M. Reich
Director
Office of Thrift Supervision
1700 G. Street, NW
Washington, DC 20552

Dear Chairman Bair and Director Reich,

I am writing to you out of concern for the safety and soundness risks posed by IndyMac Bancorp, Inc., one of the largest independent mortgage lenders in the United States. I am concerned that IndyMac's financial deterioration poses significant risks to both taxpayers and borrowers, and that the regulatory community may not be prepared to take measures that would help prevent the collapse of IndyMac or minimize the damage should such a failure occur.

There are clear indications that IndyMac may have serious problems with its current loan holdings, and could face a failure if prescriptive measures are not taken quickly. IndyMac's stock price has dropped almost 95 percent in the past year and its new loan production has fallen by almost two-thirds over that time period. As you know, Moody's Investors Service recently downgraded its servicer quality rating because of concerns about inadequate capital and warned of further downgrades.

You may recall that I wrote to Chairman Bair last month with concerns about the use of brokered deposits to finance rapid and often irresponsible growth. Unfortunately, IndyMac seems to have followed that growth strategy with troubling results. Between December 2006 and March 2008, IndyMac's overall deposits nearly doubled, with over 64% of that growth coming in the form of brokered deposits. Brokered deposits now make up over 37% of IndyMac's overall deposits. These are troubling figures considering the relatively higher risk levels associated with these types of assets. As IndyMac's lending portfolio delinquency rates climbed above 11% as of March 31, 2008, I am concerned that a significant move by IndyMac's depositors to redeem their deposits could leave the firm in a disastrous financial situation.

Therefore, I would like to know what steps the FDIC and OTS are taking in response to IndyMac's financial trouble. First, has the FDIC verified that insured loans are not supporting loans that do not meet the Joint Banking Guidelines on ability to repay and documentation? Second, has the FDIC considered ordering IndyMac to reduce its reliance on brokered deposits? Third, has there been any discussion between the FDIC and the OTS about IndyMac's increased reliance on brokered deposits? Fourth, what steps has the OTS taken in response to IndyMac's deteriorating loan performance?

Thank you for your consideration of this matter, and I look forward to your prompt response to the concerns that I have raised. Please don't hesitate to contact myself, or David Stoopler of my staff with any information or questions at 202-224-6542.

Sincerely,

[redacted]

Charles Schumer
United States Senator

LA08-107

Crampton, Lali

From: Taylor, Jack
Sent: Wednesday, April 16, 2008 1:24 PM
To: Crampton, Lali
Subject: FW: Questions for the record for 4/9/08 hearing

Attachments: 20080416114959530.pdf

20080416114959530.pdf (51 KB)

Please log these in and handle as usual.

Thanks

Jack Taylor
Federal Deposit Insurance Corporation
Office of Legislative Affairs
(202) 898-8915

-----Original Message-----
From: Allison, Terrie [mailto:Terrie.Allison@mail.house.gov]
Sent: Wednesday, April 16, 2008 11:55 AM
To: Taylor, Jack
Subject: Questions for the record for 4/9/08 hearing

Jack:

I just received these questions from Representative Barrett's office for Chairman Bair from the 4/9/08 hearing.

These should go with that transcript. If you have any questions, feel free to contact me.

Thanks!

Terrie Allison
Committee Editor
Committee on Financial Services
(202) 225-4548

Financial Services Committee Hearing
"Using FHA for Housing Stabilization and Homeownership Retention"
Wednesday, April 9, 2008

For The Honorable Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation

1) I believe strongly in the ability of the free market to correct itself and create economic growth and prosperity. However, I also know that the government does have a role in policing the markets.

- What should be the goal of federal regulations?
  - Should we just aim to ensure that fraud and malfeasance are punished?
  - Or should the goal in regulations be stable growth?
- How much do you think that our current mortgage crisis was caused by regulatory failures or lack of enforcement?
- Are there any areas where onerous regulations led to evolution towards exotic products helping to cause the financial crisis?

- If the government intervenes in the private market, do we have any additional regulatory duties to prevent this from happening in the future?

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

April 22, 2008

Honorable Michael N. Castle
House of Representatives
Washington, D.C. 20515

Dear Congressman Castle:

Thank you for the opportunity to provide the views of the Federal Deposit Insurance Corporation regarding H.R. 5579, the Emergency Mortgage Loan Modification Act of 2008. Congressman Kanjorski and you are to be commended for introducing this legislation to provide a safe harbor from liability for servicers that implement a loan modification or workout plan according to specific criteria.

The FDIC strongly supports H.R. 5579. Most pooling and servicing agreements (PSAs) provide servicers with flexibility to modify troubled loans. While the language varies, the majority of PSAs require that servicers pursue strategies to maximize benefits to investors as a whole, even if individual classes of bondholders are affected differently. However, despite existing industry standards and the flexibility provided in most servicing agreements, some servicers remain concerned about the potential for legal liability as a result of implementing loan modifications and indicate that this has hampered efforts to work with borrowers. H.R. 5579 should alleviate servicers' concerns and eliminate this perceived impediment to achieving long-term, sustainable loan modifications.

H.R. 5579 would encourage servicers to pursue appropriate loan modifications by setting forth an accepted industry standard for implementing a modification or workout plan for pooled residential mortgages and providing a safe harbor from liability if servicers adhere to that standard. Importantly, the bill would recognize existing contractual rights that may be contrary to the safe harbor standard. Because the bill would not abrogate existing contractual rights, this approach should avoid potential constitutional issues.

Avoiding unnecessary foreclosures benefits individuals, their communities, and the economy. To the extent that H.R. 5579 provides greater assurance to servicers that they will not incur legal liability for participating in loan modifications with troubled borrowers, it will make a valuable contribution to efforts to address current problems in the mortgage markets.

The FDIC stands ready to assist Congress in developing solutions to any remaining obstacles to loan modifications.

Sincerely,

[redacted]

Sheila C. Bair

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

April 22, 2008

Honorable Paul E. Kanjorski
Chairman
Subcommittee on Capital Markets, Insurance and
Government Sponsored Enterprises
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for the opportunity to provide the views of the Federal Deposit Insurance Corporation regarding H.R. 5579, the Emergency Mortgage Loan Modification Act of 2008. Congressman Castle and you are to be commended for introducing this legislation to provide a safe harbor from liability for servicers that implement a loan modification or workout plan according to specific criteria.

The FDIC strongly supports H.R. 5579. Most pooling and servicing agreements (PSAs) provide servicers with flexibility to modify troubled loans. While the language varies, the majority of PSAs require that servicers pursue strategies to maximize benefits to investors as a whole, even if individual classes of bondholders are affected differently. However, despite existing industry standards and the flexibility provided in most servicing agreements, some servicers remain concerned about the potential for legal liability as a result of implementing loan modifications and indicate that this has hampered efforts to work with borrowers. H.R. 5579 should alleviate servicers' concerns and eliminate this perceived impediment to achieving long-term, sustainable loan modifications.

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Avoiding unnecessary foreclosures benefits individuals, their communities, and the economy. To the extent that H.R. 5579 provides greater assurance to servicers that they will not incur legal liability for participating in loan modifications with troubled borrowers, it will make a valuable contribution to efforts to address current problems in the mortgage markets.

The FDIC stands ready to assist Congress in developing solutions to any remaining obstacles to loan modifications.

Sincerely,

[redacted]

Sheila C. Bair

cc: Honorable Deborah Pryce,
Ranking Minority Member

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

May 5, 2008

Honorable Barney Frank
Chairman
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I appreciated the opportunity to testify before the Committee on Financial Services on April 9, 2008, at the hearing "Using FHA for Housing Stabilization and Homeownership Retention."

Enclosed are responses to questions received from Congressman Barrett following my testimony. If you have further questions or comments, please do not hesitate to contact me at (202) 898-6974 or Eric Spitler, Director of Legislative Affairs, at (202) 898-3837.

Sincerely,

[redacted]

Sheila C. Bair

Enclosure

Response to questions from the Honorable J. Gresham Barrett
from Sheila C. Bair, Chairman,
Federal Deposit Insurance Corporation

Q1. What should be the goal of federal regulations? Should we just aim to ensure that fraud and malfeasance are punished? Or should the goal in regulations be stable growth?

A1. Federal banking regulations should not have a single focus. The central objectives of federal banking regulations are to maintain public confidence in the banking system; to support financial intermediation, credit availability, and competition; to enforce the public laws; and to protect consumers and encourage compliance with the Community Reinvestment Act. Capital requirements and other prudential regulations are tools used by bank regulators to promote safe and sound banking operations and to discourage excessive risk-taking. Banking regulations also attempt to minimize the risk of fraud.

Maintaining economic stability is a consideration in bank supervision, and the federal banking agencies recognize the importance of encouraging credit availability during periods of slower economic growth. While the Federal Reserve Board, in its domestic monetary role, is the federal entity primarily concerned with economic growth and stability, the other federal banking agencies also have a role by encouraging financial institutions to make credit available in the communities they serve on appropriate terms.

Q2. How much do you think our current mortgage crisis was caused by regulatory failures or lack of enforcement?

A2. As I mentioned in my testimony, the problems facing the U.S. markets are attributable to a complex set of interrelated causes. These include weakened lending standards, inadequate consumer protections, regulatory arbitrage, and speculative activity, as well as deficient surveillance by rating agencies and inadequate due diligence by originators and investors. The current turmoil in the credit markets also has been exacerbated by liquidity troubles that typically are not identifiable until funding problems emerge.

A significant volume of subprime mortgages were originated by companies (primarily mortgage brokers and stand-alone finance companies) not subject to federal supervision. In 2005, 52 percent of subprime mortgages were originated by companies not subject to federal supervision. An additional 25 percent were made by lenders affiliated with a regulated, deposit-taking bank or thrift, and 23 percent by regulated banks and thrifts. The FDIC estimates that the share of such loans made by nonbank entities not subject to federal supervision in 2006 was 46 percent.

For mortgage loans made by federally supervised depository institutions, the federal banking agencies issued a number of cautionary statements beginning in 1999 on a number of topics, including subprime lending, non-traditional mortgage lending, and commercial real estate loan concentrations. The purpose of these statements was to alert financial institutions to the risks involved and to encourage strong underwriting policies, prudent risk selection, and robust

concentration management procedures. Overall, the regulatory agencies strongly encouraged insured banks and thrifts to be cautious in their origination and management of subprime and non-traditional mortgage products.

From an enforcement standpoint, Congress has mandated routine on-site examinations for all insured institutions, which the federal bank regulatory agencies follow. Any institution that a regulator finds is performing poorly or has taken on excessive risk is typically directed to improve conditions or face enforcement action, including possible closure.

Q3. Are there any areas where onerous regulations led to evolution towards exotic products helping to cause the financial crisis?

A3. Financial innovation (including non-traditional mortgage lending and structured financial instruments/vehicles) and the abundant liquidity in global credit markets together fueled the development of non-traditional mortgages and financial structures. The development of these financial products was not precipitated by onerous regulation, but by financial innovation and abundant capital seeking higher returns. The highly liquid credit market environment from 2005 until mid-2007 led investors to seek higher returns by taking on increased credit risk and liberalizing repayment and loan terms.

Q4. If the government intervenes in the private market, do we have any additional regulatory duties to prevent this from happening in the future?

A4. I believe that we do have the duty to prevent a recurrence of the problems we now face. As I mentioned in my testimony, with regard to preventing practices in the future that contributed to the current issues in the mortgage markets, strong final rules by the Federal Reserve Board under the Home Owners Equity Protection Act (HOEPA) that impose basic principles of sound underwriting on both bank and non-bank mortgage originators are essential. An important complement to these substantive rule provisions would be the creation by Congress of a federal entity to buttress the efforts of the states to better license and police mortgage originators. The House of Representatives adopted a set of strong licensing provisions as part of H.R. 3915 last year. Similarly, the Treasury Department has proposed creating a Mortgage Origination Commission that, working with state authorities, would develop minimum national licensing qualifications for all mortgage market originators. Although these two approaches differ in some details, their best elements could be merged into a single proposal that would address this urgent issue and command widespread support.

I would emphasize that there is a particular urgency for Congress to act on legislation to establish national licensing standards for non-bank mortgage participants. As interest rates have declined, advertisements are once again promising low "teaser" rates, no-documentation and no-money-down loans, as well as using the term "fixed" in potentially misleading ways to describe the interest rate on variable-rate mortgage loans. Banks are not allowed to market, originate, or fund loans with such weak underwriting, but no such restrictions apply to non-bank mortgage participants nationally. Combined with strong final HOEPA rules from the Federal Reserve

Board, prompt passage of legislation creating a Commission to license and police mortgage originators would help prevent these practices from again misleading borrowers and adding more problems to the mortgage markets.

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

May 5, 2008

Honorable Barney Frank
Chairman
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I appreciated the opportunity to testify before the Committee on Financial Services on April 9, 2008, at the hearing "Using FHA for Housing Stabilization and Homeownership Retention."

Enclosed are responses to questions received from Congressman Barrett following my testimony. If you have further questions or comments, please do not hesitate to contact me at (202) 898-6974 or Eric Spitler, Director of Legislative Affairs, at (202) 898-3837.

Sincerely,

[redacted]

Sheila C. Bair

Enclosure

Response to questions from the Honorable J. Gresham Barrett
from Sheila C. Bair, Chairman,
Federal Deposit Insurance Corporation

Q1. What should be the goal of federal regulations? Should we just aim to ensure that fraud and malfeasance are punished? Or should the goal in regulations be stable growth?

A1. Federal banking regulations should not have a single focus. The central objectives of federal banking regulations are to maintain public confidence in the banking system; to support financial intermediation, credit availability, and competition; to enforce the public laws; and to protect consumers and encourage compliance with the Community Reinvestment Act. Capital requirements and other prudential regulations are tools used by bank regulators to promote safe and sound banking operations and to discourage excessive risk-taking. Banking regulations also attempt to minimize the risk of fraud.

Maintaining economic stability is a consideration in bank supervision, and the federal banking agencies recognize the importance of encouraging credit availability during periods of slower economic growth. While the Federal Reserve Board, in its domestic monetary role, is the federal entity primarily concerned with economic growth and stability, the other federal banking agencies also have a role by encouraging financial institutions to make credit available in the communities they serve on appropriate terms.

Q2. How much do you think our current mortgage crisis was caused by regulatory failures or lack of enforcement?

A2. As I mentioned in my testimony, the problems facing the U.S. markets are attributable to a complex set of interrelated causes. These include weakened lending standards, inadequate consumer protections, regulatory arbitrage, and speculative activity, as well as deficient surveillance by rating agencies and inadequate due diligence by originators and investors. The current turmoil in the credit markets also has been exacerbated by liquidity troubles that typically are not identifiable until funding problems emerge.

A significant volume of subprime mortgages were originated by companies (primarily mortgage brokers and stand-alone finance companies) not subject to federal supervision. In 2005, 52 percent of subprime mortgages were originated by companies not subject to federal supervision. An additional 25 percent were made by lenders affiliated with a regulated, deposit-taking bank or thrift, and 23 percent by regulated banks and thrifts. The FDIC estimates that the share of such loans made by nonbank entities not subject to federal supervision in 2006 was 46 percent.

For mortgage loans made by federally supervised depository institutions, the federal banking agencies issued a number of cautionary statements beginning in 1999 on a number of topics, including subprime lending, non-traditional mortgage lending, and commercial real estate loan concentrations. The purpose of these statements was to alert financial institutions to the risks involved and to encourage strong underwriting policies, prudent risk selection, and robust

concentration management procedures. Overall, the regulatory agencies strongly encouraged insured banks and thrifts to be cautious in their origination and management of subprime and non-traditional mortgage products.

From an enforcement standpoint, Congress has mandated routine on-site examinations for all insured institutions, which the federal bank regulatory agencies follow. Any institution that a regulator finds is performing poorly or has taken on excessive risk is typically directed to improve conditions or face enforcement action, including possible closure.

Q3. Are there any areas where onerous regulations led to evolution towards exotic products helping to cause the financial crisis?

A3. Financial innovation (including non-traditional mortgage lending and structured financial instruments/vehicles) and the abundant liquidity in global credit markets together fueled the development of non-traditional mortgages and financial structures. The development of these financial products was not precipitated by onerous regulation, but by financial innovation and abundant capital seeking higher returns. The highly liquid credit market environment from 2005 until mid-2007 led investors to seek higher returns by taking on increased credit risk and liberalizing repayment and loan terms.

Q4. If the government intervenes in the private market, do we have any additional regulatory duties to prevent this from happening in the future?

A4. I believe that we do have the duty to prevent a recurrence of the problems we now face. As I mentioned in my testimony, with regard to preventing practices in the future that contributed to the current issues in the mortgage markets, strong final rules by the Federal Reserve Board under the Home Owners Equity Protection Act (HOEPA) that impose basic principles of sound underwriting on both bank and non-bank mortgage originators are essential. An important complement to these substantive rule provisions would be the creation by Congress of a federal entity to buttress the efforts of the states to better license and police mortgage originators. The House of Representatives adopted a set of strong licensing provisions as part of H.R. 3915 last year. Similarly, the Treasury Department has proposed creating a Mortgage Origination Commission that, working with state authorities, would develop minimum national licensing qualifications for all mortgage market originators. Although these two approaches differ in some details, their best elements could be merged into a single proposal that would address this urgent issue and command widespread support.

I would emphasize that there is a particular urgency for Congress to act on legislation to establish national licensing standards for non-bank mortgage participants. As interest rates have declined, advertisements are once again promising low "teaser" rates, no-documentation and no-money-down loans, as well as using the term "fixed" in potentially misleading ways to describe the interest rate on variable-rate mortgage loans. Banks are not allowed to market, originate, or fund loans with such weak underwriting, but no such restrictions apply to non-bank mortgage participants nationally. Combined with strong final HOEPA rules from the Federal Reserve

Board, prompt passage of legislation creating a Commission to license and police mortgage originators would help prevent these practices from again misleading borrowers and adding more problems to the mortgage markets.

LA 08-189

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510-6075

June 12, 2008

FDIC
JUN 20 2008
OFFICE OF LEGISLATIVE AFFAIRS

The Honorable Sheila Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Ms. Bair:

Thank you for testifying before the Committee on Banking, Housing, and Urban Affairs on June 5, 2008. In order to complete the hearing record, we would appreciate your answers to the enclosed questions as soon as possible.

Please repeat the question, then your answer, single spacing both question and answer. Please do not use all capitals.

Send your reply to Ms. Dawn L. Ratliff, the committee's Chief Clerk. She will transmit copies to the appropriate offices, including the committee's publications office. Due to current procedures regarding Senate mail, it is recommended that you send replies via e-mail in a MS Word, WordPerfect or .pdf attachment to Dawn_Ratliff@banking.senate.gov.

If you have any questions about this letter, please contact Ms. Ratliff at (202)224-3043.

Sincerely,

[redacted]

CHRISTOPHER J. DODD
Chairman

CJD/dr

Questions for the Hearing on "The State of the Banking Industry: Part II"
June 5, 2008

<u>Questions for The Honorable Sheila Bair, Chairman, Federal Deposit Insurance Corporation, from Senator Dole:</u>

In March, the Attorney General of New York, OFHEO, and the GSE's entered into an agreement creating new appraiser requirements that are inconsistent with existing practices. Last month, I introduced an amendment to the Federal Housing Finance Regulatory Reform Act of 2008 that would require the Director of OFHEO to issue a regulation establishing appraisal standards for mortgages purchased or guaranteed by Fannie and Freddie. It would establish a common set of appraisal standards governing mortgage lenders that are federally supervised and regulated. In your opinion, would this amendment strengthen the appraisal standards of federally regulated mortgages?

Questions for the Hearing on "The State of the Banking Industry: Part II"
June 5, 2008

<u>Questions for The Honorable Sheila Bair, Chairman, Federal Deposit Insurance Corporation, from Senator Bunning:</u>

There was an article in the June 4, 2008, Financial Times (attached) that said banks could be forced to bring up to 5 trillion dollars of assets currently held off their books onto their balance sheets. This raises many questions, but I will start with three. First, in the current markets can the banks raise the capital they need to hold against these assets? Second, since you are their regulators, do you know and have you known all along what those assets are? And third, why were they allowed to move trillions of dollars of what turned out to be the riskiest assets off their books to avoid capital charges?

Questions for the Hearing on "The State of the Banking Industry: Part II"
June 5, 2008

Attachment for Senator Bunning's question:

US banks fear being forced to take $5,000bn back on balance sheets

By Paul J Davies and Gillian Tett in Cannes and Jennifer Hughes in London
Published: June 4 2008 03:00 | Last updated: June 4 2008 03:00

Accounting changes could force US banks to take thousands of billions of dollars back on to their balance sheets in the coming months in a move that is likely to curb further their lending and could push them into new capital raisings, analysts have warned.

Analysts at Citigroup said a planned tightening of the rules regarding off-balance sheet vehicles would force banks to reconsider arrangements and could result in up to $5,000bn of assets coming back on to the books.

The off-balance sheet vehicles have been used by financial institutions to keep some assets off their balance sheets, thereby avoiding the need to hold regulatory capital against them.

Birgit Specht, head of securitisation analysis at Citigroup, said: "We think it is very likely that these vehicles will come back on balance sheet.

"This will not affect liquidity because [they] are funded, but it will affect debt-to-equity ratios [at banks] and so significantly impact banks' ability to lend."

Ms Specht told a seminar at a conference on asset-backed securities in Cannes that the uncertainty about what might change was making banks uneasy about their investments. "Banks are not investing [in assets] right now because of funding issues and regulatory uncertainty."

The comments come as regulators and central bankers are intensifying behind-the-scenes discussions about the shape of the financial architecture in response to the credit turmoil.

A key component of these global talks - which are likely to come to a head in the next couple of months - will be the accounting regime for off-balance sheet vehicles, with some senior regulators pressing for a global initiative to bring these vehicles back on to the balance sheet, not just in the US but in Europe as well.

Both international and US accounting bodies are working on rule changes; the US standard-setter, the Financial Accounting Standards Board, is to decide today. US rulemakers have come under domestic pressure from regulators and policymakers who felt the rules allowed banks to hide too much of their exposure to subprime assets.

Although many leading banks have strengthened their capital, these steps have been focused on repairing the damage wreaked by credit losses - rather than offsetting any impact of new assets rolling back on balance sheets.

www.ft.com/usbanks

FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990 Division of Supervision and Consumer Protection

June 20, 2008

The Honorable James B. Lockhart III
Director
Office of Federal Housing Enterprise Oversight
1700 G Street, N.W.
Washington, D.C. 20552'

Dear Director Lockhart:

Thank you for the opportunity to comment on the Home Valuation Code of Conduct ("Code") and the Home Valuation Protection Program and Cooperation Agreements ("Agreements") entered into by the New York Attorney General, Fannie Mae, Freddie Mac, and the Office of Federal Housing Enterprise Oversight (OFHEO). As federal deposit insurer, receiver, and supervisor of state nonmember banks, the FDIC has significant interest in changes to standards for real estate appraisals that affect the banking industry.

The FDIC believes that an effective, independent appraisal process is in the best interest of financial institutions to ensure quality collateral valuations and implementation of successful real estate lending programs. Since 1990 (pursuant to the Financial Institutions Reform, Recovery and Enforcement Act of 1989), insured depository institutions have been subject to minimum federal real estate appraisal standards for approaches to value, professional competency, appraiser independence, and the Uniform Standards of Professional Appraisal Practice (USPAP). These rules promote effective appraisal processes for mortgage underwriting and can be enforced by the federal banking agencies if institutions fail to comply. Appraisers employed by financial institutions or their affiliates are also subject to these directives and federal oversight. The Code and Agreements would overlay this long-standing set of federal regulations and professional appraiser practice.

The FDIC strongly supports the concept of appraiser independence and believes that lenders should ensure that appraisers adhere to federal banking requirements and USPAP. The Code proposes strict new limitations on bank-affiliated appraisers at insured depository institutions and on appraisers selected, retained, and compensated by third parties. There may well be benefits to these new limitations, but there could also be unintended costs and consequences. We believe that both bank-affiliated and independent appraisal firms can be subject to undue influence; therefore, it is not clear that forcing business along rigid organizational demarcations is more suitable. It is also important to note that most depository institutions also do portfolio lending and the inherent financial and safety and soundness considerations that attach to their underwriting processes provide strong incentives to receive high-quality valuations, regardless of the provider. The use of bank-affiliated appraisers should not be tainted because of abuses observed in individual enforcement cases. Accordingly, we recommend permitting flexibility for appraiser independence that would accommodate professional practice standards and could be appropriately scaled to correspond with the wide variety and size of mortgage lending institutions.

Finally, although we understand OFHEO's need to act expeditiously in executing the Agreements and adopting the Code, we believe that the best way to establish comprehensive appraisal and appraiser standards that affect both insured depository institutions and other mortgage lenders nationwide is through notice-and-comment rulemaking. The FDIC would be supportive of such an interagency rulemaking process. We very much appreciate, however, the opportunity for comment you afforded for the Code and Agreements, as well as the recent public comments by your General Counsel indicating that OFHEO takes the comment process seriously and may pursue amendments to the Code and Agreements based on the comments received.

Sincerely,

[redacted]

Sandra L. Thompson
Director