FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

November 7, 2008

Honorable Charles Grassley
Ranking Member
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Senator Grassley:

Thank you for your letter regarding discussions between the Department of the Treasury and the Federal Deposit Insurance Corporation on a plan to assist distressed homeowners. In your letter, you ask that the Treasury and the FDIC ensure that no taxpayer dollars are used to assist homeowners who obtained their mortgages improperly.

I strongly agree that any plan to assist distressed homeowners needs to focus on helping legitimate borrowers stay in their homes. As you are aware, mortgage credit distress and falling home prices are at the heart of the uncertainty plaguing our financial markets. Two factors are driving down U.S. home prices: 1) an "overhang" of excess vacant homes estimated at between 1.1 million and 1.3 million units, and 2) distress sales of foreclosed properties, which are taking place at a rate of hundreds of thousands per year. There is no doubt the mortgage crisis is continuing to get bigger and costlier. Thus, the FDIC believes an essential public policy goal is to promote loan modifications to prevent foreclosures.

The FDIC has been advocating loan modifications for more than a year. Meanwhile, foreclosures in the first half of this year were 77 percent above the pace of a year ago. Problem loans 60 days or more past due are rising at a rate of more than 700,000 per quarter, net of any existing problem loans that return to performing status. A program that encourages mortgage lenders and servicers to modify loans on a sustainable basis, and that does so efficiently on a large scale basis, will help us get ahead of this fundamental problem. If we can provide lenders and servicers with appropriate incentives to systematically modify their growing inventory of problem loans, there is hope that we will finally stop falling behind this problem and begin to stabilize our housing markets and our financial system.

You have asked some important questions related to how a loan modification process might be implemented under a federal program. The questions deal with whether the original loan documents will be reviewed, which criteria will be used to determine eligibility, whether fraudulent loans can be detected and excluded, and how covered loans would be managed. As the Treasury and the FDIC have not finalized the design of a loan modification proposal, I will describe the FDIC's actions to modify loans at IndyMac Federal Bank to attempt to address your concerns.

As you are aware, the FDIC has initiated a systematic loan modification program at IndyMac Federal Bank, where it is conservator. This program identifies loans with high monthly payments relative to income and makes offers to borrowers, who are living in their homes, to reduce the monthly payment to as low as 31 percent of monthly income. Modifications are undertaken according to a standard protocol based on interest rate reductions, extensions of term, and principal forbearance. Like any mortgage servicer, the FDIC must undertake a net present value (NPV) test for every modified loan to ensure that this strategy will maximize the value of that loan. One of the advantages of this approach is the ability to modify loans that have been securitized, leaving them in place under private management. The FDIC also requires confirmation of the occupancy status and verification of the current income of the borrower.

Based on this experience, the FDIC has been working with the Treasury to develop a credit guaranty program, as authorized under the Emergency Economic Stabilization Act (EESA), which would provide financial incentives for a wide range of mortgage lenders and servicers to modify high-cost mortgage loans using streamlined protocols similar to those we are applying at IndyMac. The purpose of the proposed credit guaranty program would be to focus the NPV calculation away from immediate foreclosure and toward an analysis of whether a loan modification is a less costly alternative. The credit guaranty would protect mortgage lenders and servicers for up to half of the downside risk of a redefault, a risk made less likely due to the requirement that mortgage payments under modified loans be affordable under a clear, objective standard. As at IndyMac, the FDIC has proposed that loans modified under this process would be subject to verification of borrower income and occupancy status, and the modification would be available only for loans on owner-occupied properties.

While we believe the controls in place at IndyMac are essential to ensure that program costs are contained and that homeowners are qualified to receive assistance, there are no plans to carry out an in-depth analysis of the underwriting that took place at origination. Our goal is to deal with the current crisis by reducing the number of unnecessary foreclosures and maximizing the value of these troubled loans. While such a program can verify that the current homeowner is not a speculator, the program is not designed to sort out the culpability of parties such as the broker and/or appraiser in originating the loan. However, where fraud or other irregularities appear to be issues, the matter would be referred to the appropriate state and federal authorities.

Finally, with regard to the possible purchase or management of problem loans by the federal government, the FDIC's experience has been that problem loans are generally best managed by the private sector as long as the lender or servicer retains the proper financial incentives. Accordingly, we believe that any proposal to systematically facilitate affordable and sustainable loan modifications need not involve government purchases of the underlying mortgage assets. Avoiding foreclosure through cost effective, fair, and sustainable loan modifications should be the goal of any proposal.

Therefore, any new program should provide incentives for current mortgage lenders and servicers to modify loans under their management if this strategy can be shown to maximize the value of the loans.

I hope this information is helpful. We would be happy to brief you on this matter at your convenience. Please contact me at (202) 898-6974, or Eric Spitler, Director of Legislative Affairs, at (202) 898-3837.

Sincerely,

Sheila

Sheila C. Bair

Senator -
This is a
good program
I would be
happy to discuss
with you.