Statement of

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Chairman Dodd, Ranking Member Shelby, and members of the Committee, my name is Wayne Rushton, and I appreciate the opportunity to answer your questions about mortgage lending in national banks, and OCC supervision of it, especially in regard to the subprime sector now so much in the news.

I bring the perspective of 42 years as a national bank examiner, during good times and bad. I've had the opportunity to examine banks throughout the country, and I've spent a number of years here in Washington working on bank supervision policy, now as the Chief National Bank Examiner.

We are very concerned about declining loan performance and rising foreclosures in the subprime market. It's easy to forget in this environment that such loans provide a path to homeownership for millions of Americans. Even today, most subprime borrowers are paying their loans on time – and are expected to continue doing so. Subprime loans are not inherently predatory or abusive. But those that are have no place in the banking system.

Underwriting standards in mortgage lending have been declining for several years. This downward trend was epitomized by the growing popularity of so-called nontraditional mortgage products such as interest-only and payment-option ARMs.

The OCC signaled its concern about those trends in a series of escalating steps. By 2005 we had instructed our examiners to aggressively address the risks of these products in national banks. Comptroller Dugan and other OCC officials spoke publicly and privately about this problem with industry leaders. And we initiated the interagency process that resulted in the nontraditional mortgage guidance issued last year.

That guidance addressed the underwriting and consumer protection issues associated with payment shock for borrowers who were qualified for loans on the basis of low start rates in effect during the early years of their loans. The guidance required financial institutions to evaluate the borrower's ability to make fully-amortizing payments at the fully-indexed rate. It also addressed the increasingly common practice of reliance on reduced documentation, especially unverified income, and directed lenders to provide better and more timely information about these products to borrowers.

Because we had not included all mortgages with potential payment shock in the nontraditional guidance, and, Mr. Chairman, in response to constructive recommendations received from you and others, we have now turned our attention to the subprime sector, and especially to hybrid ARMs, which make up the biggest portion of the subprime mortgages being originated today.

As compared to nontraditional loans, reset margins on hybrid ARMs tend to be much higher, and thus the potential for payment shock even more severe. We are also concerned about the structure of prepayment penalties that can be a major obstacle when borrowers try to refinance. As with nontraditional mortgages, the subprime statement would require lenders to adhere to higher underwriting, disclosure, and consumer protection standards.

Having said this, Mr. Chairman, we are keenly aware that any steps we take to address problems in this area -- prime or subprime -- must be sensitive to the potential impact on existing and future homeowners -- and on the broader economy.

I want to emphasize that national banks are not dominant players in the subprime market. Last year, their share of all new subprime production was less than 10 percent. We know of some subprime lenders that have abandoned their plans for a national charter rather than submit to OCC supervision. Moreover, subprime lending in national banks tends to be higher quality lending, with delinquency rates only about half the industry average. When delinquencies do occur, we strongly urge national banks to work closely with borrowers to help resolve their problems.

Unfortunately, regulatory oversight tends to be <u>less</u> rigorous in precisely those parts of the financial system where subprime practices seem most problematic. We hope our subprime guidance will inspire comparable measures by other regulators, just as occurred with the nontraditional guidance last year.

In conclusion, let me assure you that my colleagues and I at the OCC are committed to bank safety and soundness and fair treatment of consumers through supervision that addresses abuses without stifling healthy innovation.

We look forward to working with you, Mr. Chairman, and members of the Committee. I will be pleased to answer your questions.