NEW COMPREHENSIVE OCC REPORT ON MORTGAGE PERFORMANCE

REMARKS

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before the

AMERICAN SECURITIZATION FORUM

June 11, 2008

It's a pleasure to be here with all of you this morning. The American Securitization Forum brings together key participants in securitization markets, which have financed an extraordinary amount of economic activity over the last several decades. Many of the roughly 1,700 national banks that the OCC supervises play outsized roles in these markets, as loan originators, servicers, structurers, trustees, dealers, distributors, and investors – and that's not an exhaustive list. They have been deeply involved in the growth of securitization, and nowhere has that been more apparent than in the phenomenal growth of residential mortgage securitization markets.

For example, in 2007, national banks originated about 45 percent of all home mortgages in the United States. They also act as servicers for about 44 percent of all U.S. mortgages. About 90 percent of the mortgages they service are held by third parties via securitization by Fannie Mae, Freddie Mac, and other financial institutions. National banks also hold a substantial amount of both mortgage securities and first mortgages on their balance sheets, which together total over $1.7 trillion. In short, over the last 20 years, national banks have become much more centrally involved in the mortgage business, and as a result, the OCC has become much more centrally involved in the supervision of these activities.

Needless to say, against this backdrop, the mortgage market disruptions of the last year have been exceptionally challenging for both national banks and their supervisor. Fortunately, the banks we supervise were well capitalized going into this turmoil. In addition, their diversified businesses and strong deposit franchises have been real sources of strength, and they have benefited from the fact that they hold and service a disproportionately small share of subprime mortgages – only about 10 percent. Still, several national banks have sustained exceptionally large losses from mortgage-related assets – which they have offset by successfully raising capital – and mortgage exposure and mortgage involvement remain substantial across the national banking system.

The Need for Better Metrics

As mortgage delinquencies and foreclosures have climbed, the OCC has intensified our already heavy focus on mortgage supervision. In this context, we began to realize that the substantial amount of mortgage data we had previously collected from our banks was not giving us a sufficiently granular look at declining mortgage performance. At the same time, given their leading role as mortgage servicers, national banks began to receive numerous and differing requests for data about mortgage performance and mortgage modifications from organizations around the country, including members of Congress, news organizations, and state and local governments.

We also came to realize that there were some significant limitations with the mortgage performance data reported by other organizations and trade associations. These other sources often used differing definitions of “prime,” “subprime,” “Alt-A,” and “delinquency.” This lack of standardized definitions made comparisons difficult across different studies. The same was true with respect to the different ways in which both institutions and data collectors described "mortgage mitigations," with some counting any contact with a borrower about payment reduction or relief as a mitigation in process, while others did not count mitigation efforts until a particular mitigation plan had been formally implemented. And virtually none of the data had been subjected to a rigorous process to check for consistency and completeness – they were typically responses to surveys that produced aggregate, unverified results from individual firms. That lack of loan-level validation raised real questions about the precision of the data, at least for our supervisory purposes.

In this context, the OCC realized we had a real opportunity to improve the way that mortgage performance could be measured, producing better information for our particular supervisory purposes, and better information for policymakers, other regulators, market participants, and the public at large. That is, we realized that a relatively small number of our largest national banks – nine, to be exact – conducted over 90 percent of servicing activities engaged in by our entire national banking population. These banks service about 40 percent of all U.S. home mortgages outstanding. They are large and have in place the kind of information systems that allow them to produce significant amounts of data that can be tailored to particular requests. And perhaps most important, we as their primary federal regulator could require them to take several important steps: report to us loan-level data on roughly 23 million loans for homes in every state in the country, totaling $3.8 trillion; report such data in a common format, using standardized definitions; and validate the data submitted.

So, we seized this opportunity. The participating banks immediately understood both our needs and the value of producing more precise information using common metrics and definitions. They have worked closely with us and the third-party data aggregator we hired to begin reporting the extraordinary volume of information we have requested in the format we have established. And the aggregator has worked closely with us to translate key parts of that data into a report that can be issued to the public.

OCC's First Mortgage Metrics Report

Today, I am pleased to unveil the first OCC Mortgage Metrics Report, which covers loan-level mortgage information for the last two calendar quarters, from October 1, 2007, to March 31, 2008. In the future, we plan to issue a Mortgage Metrics Report each quarter.

Before I summarize key results from this first report, let me explain how it differs from other reports and data collection efforts, and how it addresses concerns that I previously identified.

First, OCC Mortgage Metrics are comprehensive. They reflect activities of many of the industry's largest mortgage servicers – not just holders of the mortgages. In addition, the metrics capture information on <u>all</u> mortgages, not just subprime.

Second, the report is based on "loan-level" data. In contrast with other reports that rely on surveys of lenders or interpretations of data, we collected 64 specific pieces of information on more than 23 million loans for each month of the reporting period. These include such data elements as credit score, interest rate, unpaid balance, property value, and payment history. This loan-level data can be analyzed more rigorously and in a wider variety of ways than information obtained through surveys.

Third, our Mortgage Metrics use terms and definitions that are standardized. Today, if you simply ask lenders how many subprime loans they have, you'll get answers based on different definitions, because certain loans in one lender's subprime book may be another bank's

Alt-A. Indeed, at the large national banks we supervise, the dividing line for prime, subprime, and Alt-A loans can vary widely across a range of credit scores and other characteristics of the loan and borrower. Our standardized Mortgage Metrics eliminate these disparities.

For example, the three categories of creditworthiness in the report – prime, Alt-A, and subprime – are defined using FICO credit scores at the time of loan origination. We use the following breakpoints that have often, but not always, been used by industry analysts: prime – 660 and above; Alt-A – 620 to 659; and subprime – below 620. Some may quibble with this particular segmentation, but the point is that they are the same quantifiable criteria used in every case, and as a result, "subprime" will mean the same thing for each servicer and each loan.

The metrics also establish a common – and conservative – definition for "newly initiated" loss mitigation actions. A payment plan or loan modification won't count unless the servicer and borrower have entered into an agreement. This results in fewer loss mitigation actions reported, but a better picture, we believe, of the actual occurrence of such actions.

Now, let me hasten to add that our new OCC metrics are not perfect. There has definitely been some "noise," especially in this large initial data collection looking backward for six months. For example, 20 percent of the loans fell into an "other" category, which meant that a credit score was unavailable. The inability to obtain such scores typically reflects problems with the flow of information through the systems that produce the data – purchased loan portfolios, for example, that came with databases that can't easily be read by the servicer's computer system. Now that the new data collection system has been established, we expect this problem to decline on a "go forward" basis as servicers realize that they will need this data whenever they acquire servicing portfolios in the future.

In addition to the “noise” in the overall data set, we need to be cautious about identifying trends in a six-month sample. Month-to-month data may be quite volatile and subject to fairly strong seasonal effects that can only be discerned from a longer time series that permits year-to-year comparisons. So observed changes month to month should be taken with a grain of salt.

Before turning to key results of the report, let me provide another important caveat: some of the conclusions we report here may seem different from conclusions that have been widely reported elsewhere – but there are good reasons for these differences. As I said previously, we believe the data is more precise than data reported in some other studies, and it reflects a huge proportion of the mortgages outstanding in the country. It obviously does not capture all mortgages, however, and it is not a statistically random sample.

The particular population of mortgages held and serviced by these nine national banks has some different characteristics than the overall population of mortgages. This difference can cause different results. For example, the proportion of subprime loans in the pool is smaller than in the general population – national banks service only about 25 percent of all subprime mortgages, but they service 40 percent of all mortgages outstanding. Similarly, the prime mortgages serviced by national banks include a disproportionately high number of conforming loans sold to the GSEs - about 66 percent, compared to 43 percent for the industry overall.

Finally, the standardized definitions produce different results. Other studies that don’t break out Alt-A separately will lump these loans in either the prime category – thereby elevating delinquency and foreclosure ratios for those loans – or the subprime category – where it will have the opposite effect.

In short, while there are good reasons for the differences, the summary data from this first Mortgage Metrics report in some cases vary significantly from comparable categories recently reported in other surveys.

Significant Findings

So, with that quite long wind-up, what does this first report tell us? Here are six key findings.

First, one somewhat surprising finding is that the overall mortgage servicing portfolio of the nine banks reflects credit quality that is relatively satisfactory and relatively stable. For example, the number of current and performing loans remained at about 94 percent over the entire six-month period. Serious delinquencies, which we define as bankrupt borrowers who are 30 days delinquent and all delinquencies greater than 60 days, increased just one tenth of a percentage point during the period, from 2.1 percent to about 2.2 percent. This overall quality and stability likely reflects the differences in the national bank servicing portfolio that I described above.

Second: Among the three segments of loans, we found, not surprisingly, that the majority of serious delinquencies was concentrated in the highest risk segment – subprime mortgages. Though these mortgages constituted less than 9 percent of the total portfolio, they sustained twice as many delinquencies as either prime or Alt-A mortgages.

The third finding concerns loss mitigation actions, which for purposes of this report include only loan modifications and payment plans. Consistent with other reports, payment plans predominated, outnumbering loan modifications in March by more than four to one. But loan modifications increased at a much faster rate during the period.

Servicers also indicated they are working with Fannie Mae, Freddie Mac, the Federal Housing Administration, and private investors to develop and offer new loss mitigation options. In fact, mortgage servicers reported several alternative loss mitigation actions not included in this analysis that we plan to include in future reports, including HomeSaver Advance, FHASecure, partial claims, new subsidy programs, and refinances with principal forgiveness. These actions provide banks additional alternatives to mitigate their risks and work with troubled borrowers.

Fourth: Although subprime mortgages made up less than 9 percent of the portfolio, they accounted for 43 percent of all loss mitigation actions at the end of March. Indeed, for these borrowers in that month, total loss mitigation actions exceeded newly initiated foreclosure proceedings by a margin of nearly 2 to 1.

Fifth: As in other studies, our report confirms that foreclosures in process are plainly on the rise, with the total number increasing steadily and significantly through the reporting period from 0.9 percent of the portfolio to 1.23 percent. Interestingly, the number of new foreclosures has been quite variable. While one month does not make a trend, new foreclosures in March declined to 45,696, down 21 percent from January's high and down about 4.5 percent from the start of the reporting period last October. Similarly, the ratio of new foreclosures to serious delinquencies was lower in March than in either January or October.

Sixth and finally, the data also show that seriously delinquent subprime loans had fewer new foreclosure starts than seriously delinquent prime or Alt-A mortgages. Why would troubled prime loans have more foreclosure starts than troubled subprime loans? One possible explanation is that the national emphasis on developing alternatives and assistance programs has been targeted to subprime borrowers, allowing a higher percentage of these borrowers to stave off foreclosure.

Value of Mortgage Metrics

These are just a few of the key findings from the first report, which will be available on our Web site. I urge you to review it yourselves for other information that you may find useful. That's exactly what we are doing, both with this and the other data we have collected, since we believe it will serve a variety of useful purposes.

For example, the data will help us develop supervision policy and strategies. Examiners will be able to use the information to identify anomalies; compare national bank trends to the industry; evaluate asset quality and loan-loss reserve needs; and evaluate the effectiveness of loss mitigation actions. Over time, it will allow us to drill down to look at trends in performance based on origination channels or key credit characteristics. This in turn will help us more fully assess losses, loan modifications, payment plans, and recovery efforts.

In the future, I hope that the standard definitions and methodology used in this report will be applied more broadly to an even larger proportion of the pool of outstanding mortgages. The more we can use standardized metrics across the board, the better we can measure, monitor, and manage mortgage risk.

With this thought very much in mind, we have shared these standard definitions with the Office of Thrift Supervision, which has also begun requiring the thrifts it supervises to make similar monthly reports. If we could combine our results in future reports, the coverage would extend to 60 percent of all outstanding mortgages. We would also be interested in sharing the definitions and methodologies with other interested data collectors, like the state task force that is gathering data from a range of providers.

Going forward, we think it makes sense to have a national standard for mortgage reporting. The American Securitization Forum is in a position to help advance this process, and I would encourage you to join us in working toward a common and uniform mortgage reporting regime in the U.S.

While we think these metrics are useful, we know they are not perfect. We welcome input by other regulators and industry participants to refine and improve them going forward. In the end, we will all benefit from having more accurate and standardized mortgage metrics to make better business and policy decisions, and to avoid needless foreclosures.

Thank you very much.