Statement of

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Members of the Commission, thank you for this opportunity to address your questions regarding national banks, subprime lending, federal preemption, and the supervision of Citigroup, all of which focus on the problems caused by deep losses on residential mortgages.

While the lack of adequate consumer protection contributed to the record levels of these losses, there was a more fundamental problem: poor underwriting practices that made credit too easy, especially by unregulated mortgage lenders and brokers. These included "stated income" loans; the lack of meaningful cash down payments; "payment option" loans; and "teaser-rate" adjustable mortgages.

In addition, without any "skin in the game," brokers and originators had every incentive to apply the weakest underwriting standards that would produce the most mortgages that could be sold to mortgage securitizers. And unlike banks, most mortgage brokers in the United States were virtually unregulated, so there was no supervisory check on imprudent underwriting practices.

The rapid increase in market share by these unregulated brokers and originators pressured regulated banks to lower their underwriting standards, which they did, though not as much as unregulated mortgage lenders. The OCC took a number of steps to keep national banks from engaging in the same risky underwriting practices as their nonbank competitors. That made a difference, but not enough for the whole mortgage system.

All these factors produced the worst underwritten mortgages in our history. When house prices sharply declined, it led to record levels of delinquency, default, foreclosures, and loss.

<u>However</u>, the weak lending standards that caused the crisis were <u>not</u> the result of federal preemption of state mortgage lending laws. If it had been, the vast majority of subprime lending and Alt-A lending would have been done in national banks and federal thrifts. But just the opposite was true. As described in my written statement, national banks and their subsidiaries made only 10 percent of subprime mortgages and only 12 percent of all non-prime mortgages from 2005 through 2007.

Conversely, 72 percent of all non-prime mortgages were made by lenders that were subject to state law. Well over half were made by mortgage lenders that were exclusively subject to state law – and it is widely recognized that these were the worst underwritten loans with the highest levels of foreclosure.

I'm not suggesting that national banks played no role in the subprime lending crisis. They did. Some national banks originated poor quality non-prime mortgage loans; some purchased badly underwritten subprime mortgage-backed securities; and some had significant exposure to subprime mortgage risk that they did not understand or anticipate – all of which produced very large losses. But the relatively smaller share of non-prime mortgages made by national banks, and their relatively better performance, belie the argument that national banks' federal preemption caused the mortgage crisis.

Let me turn briefly to Citigroup, the critical role that subprime mortgage losses played in its problems, and the OCC's supervision of its national bank subsidiary, Citibank. The overwhelming majority of Citigroup's mortgage problems did not arise from mortgages originated by Citibank, and indeed, the bank's financial performance throughout the crisis was consistently better than it was for Citigroup as a whole. Instead, the huge mortgage losses arose primarily from the collateralized debt obligations structured by Citigroup's securities broker-dealer with mortgages purchased from third parties. By far the largest exposure of Citibank to these CDOs came from its liquidity puts that supported the CDO's super-senior tranches. In the summer and fall of 2007, the $25 billion exposure to the bank from these liquidity puts came as a surprise to the senior management of Citigroup and to the OCC. Subsequent review and investigation showed this to be both a risk management and an internal reporting breakdown by the company. It also revealed some of the supervisory problems caused by the legally segregated responsibilities of different regulators, and the undue reliance on high credit ratings. Citigroup, Citibank, the OCC, and other regulators have since taken a number of steps to address these issues.

In closing, there are many lessons to be learned from the mortgage problems that precipitated the crisis, but the one I would like to leave you with is this:

I believe the government should establish minimum, common sense underwriting standards for mortgages that can be effectively applied and enforced for all mortgage lenders, whether they are regulated banks or unregulated mortgage companies. If we had had such basic, across the board rules in place ten years ago on income verification, down payments, and teaser rate mortgages, I believe the financial crisis would have been much less severe than it was.