



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

BEN S. BERNANKE
CHAIRMAN

August 27, 2007

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

Dear Senator:

Thank you for your recent letters of August 8 and 22, in which you express concern about the potential effects of volatility in financial markets and the tightening of credit conditions on homebuyers, consumers, and the economy as a whole.

I want to assure you that the Federal Reserve, in cooperation with other federal agencies, is closely monitoring developments in financial markets. As you recognized, the Federal Reserve has also taken steps to increase liquidity in the markets. In particular, our changes to our discount window program are designed to assure depositories of the availability of a backstop source of liquidity so that concerns about funding do not constrain them from extending credit and making markets. Also, the Federal Open Market Committee has stated that it is monitoring the situation and is prepared to act as needed to mitigate the adverse effects on the economy arising from the disruptions in financial markets.

I share your concern about the potential impact of scheduled payment resets on homeowners with variable-rate subprime mortgages. Over the next several years, many such homeowners will face significantly higher monthly payments and, consequently, an increased risk of losing their homes to forced sale or foreclosure. The federal banking regulators have encouraged banks and thrifts to work actively with troubled borrowers to modify loans or to refinance as needed to avoid default or foreclosure and have jointly issued guidances to address underwriting and disclosure practices related to subprime mortgage lending.

The twelve Federal Reserve Banks around the country are working closely with community and industry groups dedicated to reducing the risks of foreclosure and financial distress among homebuyers. The Board is also engaged in these issues; for example, Governor Randall Kroszner serves as the Federal Reserve's representative on the board of directors of NeighborWorks America, which has a program to encourage

borrowers facing mortgage payment difficulties to seek help by making early contact with their lenders, servicers, or trusted counselors. And as I noted in my testimony in July, in order to strengthen consumer protections, the Federal Reserve Board is currently undertaking a comprehensive review of the rules regarding loans subject to the Home Owner Equity Protection Act as well as some rules pertaining to mortgage-related disclosures under the Truth in Lending Act.

It might be worth considering at this juncture whether the private and public sectors, separately or in collaboration, could help the situation by developing a broader range of mortgage products which are appropriate for low- and moderate-income borrowers, including those seeking to refinance. Such products could be designed to avoid or mitigate the risk of payment shock and to be more transparent with respect to their terms. They might also contain features to improve affordability, such as variable maturities or shared-appreciation provisions for example. One public agency with considerable experience in providing home financing for low- and moderate-income borrowers is the Federal Housing Administration (FHA). The Congress might wish to consider FHA reforms that allow the agency more flexibility to design new products and to collaborate with the private sector in facilitating the refinancing of creditworthy subprime borrowers facing large resets.

As you note, the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac are currently assisting in subprime refinancings. However, the GSEs' charters limit their ability to take on higher-risk mortgages and their programs are relevant only to a relatively small share of subprime borrowers. The GSEs should be encouraged to provide products for subprime borrowers to the extent permitted by their charters. The current caps on GSE portfolios--which were imposed for safety and soundness reasons--need not be lifted to allow them to accommodate new borrowers. Currently, the GSE portfolios include substantial holdings of GSE-guaranteed mortgage products, which are easily placed in the private secondary market even under current conditions. Thus, the GSEs could readily sell these securities to make space for new mortgages if they wished to do so. Policymakers may also want to encourage the GSEs to increase their mortgage securitization efforts, which are not constrained by their portfolio caps.

We will continue to keep the Congress informed of developments in the subprime markets and in the credit markets more generally. As you know, Federal Reserve governors and staff have made numerous appearances before the Congress and in other forums on subprime-related issues. Board staff members have continued to brief members of Congressional staffs on these matters. Board staff members are also assisting the Government Accountability Office in the report that they are preparing that will provide a comprehensive review of developments in the subprime mortgage market.

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Again, thank you for your interest and please be assured that we are following these issues closely.

Sincerely,

A handwritten signature in black ink, appearing to be "C. Schumer", written in a cursive style.