NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Testimony

Testimony of

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On the subject of
Promoting Bank Liquidity and Lending through Deposit Insurance, Hope for Homeowners, and Other Enhancements

Submitted to the
United States House of Representatives
Committee on Financial Services

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I. Introduction

Good afternoon, Chairman Frank, ranking member Bachus, and other distinguished members of the Committee:

I am John Taylor, the president and chief executive officer at the National Community Reinvestment Coalition (NCRC). NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families.

I am honored to testify today on behalf of NCRC before the United States House of Representatives Committee on Financial Services regarding promoting bank liquidity and lending through deposit insurance, Hope for Homeowners, and other enhancements. Chairman Frank and members of the Committee, NCRC supports the introduction of H.R. 703. This legislation is a much-needed step in the right direction toward stemming the foreclosure crisis, stabilizing the financial system, and strengthening the overall economy.

II. The Foreclosure Cycle

Inadequate consumer protection, failed regulation, and lax oversight are the initial causes of the foreclosure crisis and allowed the introduction of predatory products and abusive practices in the credit and housing markets, especially pronounced in communities of color. The foreclosures that arose from predatory lending have not only severely undermined the financial stability of working families and communities but also are now weakening the credit markets and diminishing overall economic activity and performance. Massive foreclosures are spurring a self-

reinforcing cycle of defaults, declines in home values, and rising unemployment. Widespread unemployment is accelerating the economic crisis, as evidenced in a recent report published by Credit Suisse. The study projects nine million foreclosures over the next four years, assuming an eight percent unemployment rate. Given the current unemployment rate of 7.5%, with a full 140,000 jobs lost last week alone, it seems certain that the US is on track for an eight percent unemployment rate.[1] While predatory and abusive lending drove foreclosures in the past, absent intervention, unemployment-driven foreclosures will be the catalyst spurring an economic crisis in the future larger in scale and magnitude than the current one.

III. Analysis of H.R. 703

The new and amended provisions in H.R. 703 are important measures toward stemming the foreclosure crisis, restoring bank liquidity, and rebuilding consumer confidence in the financial system and US economy.

i. Amendments to FDIC Insurance Provisions

The increase in FDIC insurance coverage from $100,000 to $250,000 will help stabilize banks by reducing the likelihood of a run on deposits. In addition, the increase in the FDIC borrowing authority from $30 billion to $100 billion will provide liquidity for the banking system and reassure investors that expanded FDIC insurance provisions will protect consumer investments and help prop up banks. These insurance provisions are particularly important in this market climate because deposits are now more valuable than in decades past. The “old fashioned bank” is now the model of choice.

[1] Credit Suisse. “*Foreclosure Update: over 8 million foreclosures expected*.” December 4, 2008.

ii. Amendments to the Hope for Homeowners Program

Amendments to the Hope for Homeowners (H4H) program will improve upon an initiative that is not reaching its intended goals. These amendments will make the program more attractive to consumers and increase its overall effectiveness as a meaningful foreclosure prevention program. The current H4H program is intended to assist distressed borrowers who face the prospect of defaulting on unaffordable mortgages. Under H4H, distressed borrowers can refinance into a home loan insured by the Federal Housing Administration (FHA). Initially, the Congressional Budget Office projected that the H4H program would assist up to 400,000 borrowers. However, since the program's inception last October, only 357 applications have been submitted.[2]

The proposed amendments in H.R. 703 will increase consumer demand for H4H by reducing its cost to consumers. In order to finance insurance, FHA charges H4H consumers an upfront premium (three percent) and an annual premium (1.5 percent of the remaining loan balance). When premiums become unaffordable, consumers are deterred from accepting FHA loans, which decreases the likelihood that lenders will offer FHA products. The proposed amendments would eliminate the upfront premium and reduce the annual premium to between .55 and .75 percent of the remaining loan balance. Moreover, the amendments would allow FHA to eliminate H4H annual premium payments once the borrower's equity reached levels consistent with standard FHA underwriting practices and products.

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[2] Michael Corkery. "Mortgage 'Cram-Downs' Loom as Foreclosures Mount." *Wall Street Journal*. December 31, 2008.

Reduced equity-sharing with the federal government is another welcomed enhancement to H4H. Under the current program and depending on the circumstances, either all or half of the equity created as a result of a refinance into an H4H loan must be shared with the federal government. , And, when a home purchased through an H4H loan is sold or the loan is refinanced, 50 percent of any future appreciation must be shared with the federal government. H.R. 703 would eliminate the future appreciation-sharing requirement and would preserve significant wealth-building opportunities for borrowers.

For example, if a house is currently appraised at $100,000 and a distressed borrower refinances into an H4H loan of $93,000, this refinance would result in a 93 percent loan-to-value ratio with a $7,000 gain in home equity, as provided by the H4H amendment in H.R. 703. If the borrower were to sell this house within one year, the borrower would have to pay the federal government the entire equity gain of $7,000 (since the federal government effectively paid the $7,000 down-payment for the borrower). Each year thereafter, the payment to the federal government would decline until year five, when the borrower would owe the federal government $3,500 or 50 percent of the $7,000 effective down-payment provided by the federal government for which the borrower would now be able to repay.

If in year five the house has appreciated to $135,000 and the borrower decides to sell the house, under the current H4H program, the borrower would have to share 50 percent ($17,500) of the future appreciation gain ($35,000) with the federal government. Under the proposed changes in H.R. 703, the borrower would not have to share any of the future appreciation gain.

iii. Safe Harbor Provision for Servicers

The safe harbor provision for servicers will increase the likelihood of meaningful loan modifications that will safeguard against lawsuits for servicers and offer monetary incentives. A current disincentive for servicers is that they are often more assured of payments if they proceed to foreclosure than if they modify loans.[3] HR 703 provides that a servicer would be protected from investor lawsuits if the servicer reasonably and in good faith believes that its loan modifications will exceed, on a net present value basis, the anticipated recovery of loan principal than can be achieved through foreclosure.[4] FDIC suggests that in many instances the net present value of loan modifications will exceed the value that can be recouped in foreclosure.[5] H.R. 703 provides servicers with a legal foundation and economic justification for enacting loan modifications, and also empowers the H4H program to offer payments to servicers for modifying loans.

IV. Broad-Scale Loan Modification Program Needed Now

While H.R. 703 is a step in the right direction, NCRC urges the Committee to consider a broad-scale loan modification program to supplement and expand the objectives of HR 703.

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[3] Alan White. "Paying (but not overpaying) the Servicers, memo appearing on Public Citizen's Consumer Law and Policy Blog." http://pubcit.typepad.com/clpblog/2008/11/paying-but-not.html. November 17, 2008.

[4] H.R. 703 also provides legal protection for servicers from consumer lawsuits contesting loan modifications. As we read the bill, NCRC interprets this provision as not providing legal protection for servicers for any abusive servicing practices prior to loan modifications nor any legal immunity for originators for abusive lending practices. This distinction should remain if H.R. 703 is enacted.

[5] http://www.fdic.gov/consumers/loans/loanmod/ and see Statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation, on Oversight of Implementation of the *Emergency Economic Stabilization Act of 2008* and of Government Lending and Insurance Facilities. U.S. House of Representatives Committee on Financial Services; Room 2128, Rayburn House Office Building, November 18, 2008. http://www.fdic.gov/news/news/speeches/chairman/spnov1808.html.

i. Homeowners Emergency Loan Program (HELP Now)

In January 2008, NCRC proposed the establishment of the broad-scale loan modification program Homeowners Emergency Loan Program (HELP Now). This program would authorize the Treasury Department to buy troubled loans at steep discounts (equivalent to roughly the current market value) from securitized pools. This would result in a relatively low cost to taxpayers. The government would then arrange for these loans to be modified through existing entities such as Fannie Mae and Freddie Mac, and then sell the modified loans back to the private market.

ii. Use the Authority of the Federal Government to Purchase Troubled Assets

Just a couple of weeks ago, I testified before you all and discussed how using the power of eminent domain would be an effective measure to require financial institutions to sell large volumes of distressed mortgages to the federal government under a program such as HELP Now. During that hearing, the point was raised that the federal government would need to preempt state law to accomplish this and that using the power of eminent domain posed a problem.

There are other approaches: For example, the federal government has the legal authority to alter and rewrite Mortgage Backed Securities (MBS) and other secondary market structures to accomplish meaningful loan modifications. Three Columbia University professors have recently asserted that the "Commerce Clause" and the "Spending Clause" of the Constitution allows the government to regulate interstate financial markets and spend federal funds for the public purpose of loan modifications. In addition, the professors maintain that the "Takings Clause" is not violated if investors and other financial institutions are compensated—as they would be under HELP Now, since the value of selling discounted loans to the federal government would exceed the value of foreclosure). Finally, the "Due Process Clause" is not violated if the

government action has a legitimate objective, such as foreclosure prevention and a strengthened economy. To justify their approach, the professors cite the US Supreme Court's decision to uphold a foreclosure moratorium in Minnesota during the Great Depression and ruled that the state's action protected the vital interests of the community.[6]

Consistent with the views of the Columbia University professors, the *Emergency Economic Stabilization Act of 2008* (EESA) codifies the authority of the federal government to purchase and/or alter the terms and conditions of lending instruments. Title I of EESA authorizes the Treasury Secretary "to establish the Troubled Asset Relief Program (TARP) to purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, *on such terms and conditions as are determined by the Secretary*, and in accordance with this Act and the policies and procedures developed and published by the Secretary."

While a broad-scale loan modification program and H.R. 703 will stem foreclosures, NCRC recommends that the Committee address the failed regulation, lax oversight, and lack of consumer protections that contributed to the current economic crisis.

NCRC urges the Committee to preserve, expand, and vigorously enforce the *Community Reinvestment Act* (CRA). CRA establishes an obligation for banks to serve the needs of all communities, particularly low- to moderate-income neighborhoods, consistent with safety and soundness. In order to build upon CRA's benefits and increase the safety and soundness of credit and capital, NCRC urges Congress to pass CRA modernization legislation—similar to the *CRA Modernization Act of 2007*—and the planned reintroduction of the *CRA Modernization Act*

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[6] Christopher Mayer, Edward Morrison, and Tomasz Piskorski, *A New Proposal for Loan Modifications*, January 7, 2009, and see Testimony of Dr. Christopher J. Mayer before the House Committee on Financial Services Hearing: Priorities for the Next Administration: Use of TARP Funds under EESA January 13, 2009. http://www.house.gov/apps/list/hearing/financialsvcs_dem/mayer011309.pdf.

of 2009 (to be sponsored by Representatives Eddie Bernice Johnson and Luis Gutierrez). The *CRA Modernization Act of 2009* would apply CRA to non-bank financial institutions, including mainstream credit unions, insurance companies, independent mortgage companies, and investment banks. Moreover, this legislation would strengthen CRA as applied to banks by enhancing publicly available data on lending activity, requiring CRA exams to consider lending to minorities, and ensuring that the great majority of bank lending activity is scrutinized.

NCRC also supports the enactment of comprehensive anti-predatory lending legislation that eliminates predatory and abusive lending practices. Hundreds of studies, legislative testimony, and print news stories document the predatory and abusive lending practices that led to millions of foreclosures across the country, but to date, nothing has been done to purge these practices from the housing and credit markets. H.R. 703 should be enacted with provisions for a broader-scale loan modification program, comprehensive anti-predatory lending legislation, and CRA expansion and modernization.

V. Conclusion

H.R. 703 is a necessary measure to stem foreclosures and stabilize the financial markets. Failed regulation, lax oversight, and predatory lending led to millions of foreclosures that formed the epicenter of the current economic crisis. However, a broad-scale loan modification program such as HELP Now, regulatory reform to enhance consumer protection, comprehensive anti-predatory lending legislation, and CRA expansion and modernization are also needed to break the cycle of foreclosures and mitigate its devastating contagion effects in working communities. The communities that suffer most are those that can afford it least. Communities hardest hit by

the foreclosure crisis and widespread unemployment are communities that were especially vulnerable to predatory lending and market misbehavior. Therefore, we must restore the strength and stability of the US markets by restoring trust and integrity to the financial system. We can accomplish this by forever purging predatory and abusive practices in lending and promoting fairness and equality in the housing and credit markets. The markets are not self-correcting, and until integrity is restored and consumer confidence is reestablished, the national economy will become increasingly unhinged absent immediate intervention.

Thank you.