June 27, 2013
THE HUFFINGTON POST

How To Fix The Mortgage Mess 101

Here's the problem with the nation's troubled financial system in a nutshell: Americans don't have enough money to pay their mortgages.

President Bush's plan to bail-out the banks by having the US government buy troubled mortgage-backed securities is the wrong way to fix this problem. This is like handing a $700 billion blank check to the people -- bankers and investors -- whose greed and risky behavior caused the problem in the first place. The right way is to help homeowners who've already lost their homes buy them back and to help homeowners on the brink of foreclosure from losing their homes. (And then adopt strong regulations so it won't happen again.)

For the past few weeks, banking and real estate industry lobbyists have been swarming all over Washington, while mobilizing their industry members in Congressional districts to make phone calls, send emails, and write more checks to Congress to get the bail-out they wanted -- one without key pro-consumer provisions that help homeowners.

On Monday, the House of Representatives defeated the industry-backed bill by a 228-205 margin. The bill they voted on didn't include the key pro-consumer language that would provide homeowners with bankruptcy relief . Even so, the Republicans who opposed the plan thought it had *too much* regulation on lenders, while the Democrats who voted "no" believed that the bill *didn't go far enough* in helping consumers.

The banking/real estate industry couldn't win the over-all bail-out so far, but they kept the pro-consumer provision out of the bill. It is amazing that this corporate lobby can still exercise so much clout while holding out a tin cup for a $700 billion corporate give-away. The very industry that got us into the current mess in the first place still has enough credibility -- or at least enough money to provide campaign contributions -- to sway many members of Congress to hand banks a huge bail-out check without doing anything to help homeowners. If nothing else, the industry lobbyists deserve an award for chutzpah.

"We are literally spending hundreds of billions of dollars on subsidies for financial institutions," Christopher Mayer, a professor of real estate finance and vice dean at the Columbia School of Business told the New York Times recently. "This won't do anything to help the housing market. This plan is about buying mortgage-backed securities, not mortgages, and there is a big difference."

There are several ways to help homeowners, restore balance to the housing market, and stabilize the financial system. First, give homeowners cash or a one-time tax break, requiring them to use it to make their mortgage payments. Second, have the federal government buy the troubled mortgages directly and write them down, paying for it with a future tax on the financial services firms once the industry rebounds. Third, require banks to renegotiate mortgages on terms that existing homeowners can afford by lowering the interest rate or the loan amount, and by turning "adjustable rate" mortgages into long-term fixed-rate loans. (This is better than the Bush/Paulson approach, which is to urge lenders to do this voluntarily -- a scheme that so far hasn't worked, for obvious reasons.) FDIC chair Sheila Bair took this approach in July when she seizeed IndyMac bank and refinanced subprime loans at affordable rates, rather than foreclose on borrowers.

Helping homeowners directly is a lot cheaper, more direct, and more cost-effective than handing banks $700 billion. It focuses on consumers, not lenders. It stimulates demand, but requires banks to provide home loans that consumers can afford. It doesn't reward banks and investors for their greed and mismanagement, but reduces the toxic mortgages that are now turning Wall Street banks into a house of cards. (Congress could limit help to homeowners with incomes under, say, $200,000.)

Senator Barack Obama and other Congressional Democrats had proposed one tool to do this -- allow bankruptcy judges to reduce an owner's loan amount or interest rate in the same way they now decide how much money most other creditors receive. (Since 1978, bankruptcy laws have prohibited judges from changing the terms of mortgages primary residences.)

Consumer, labor, and community groups like the Consumers Union, the Center for Responsible Lending, and ACORN have been pushing for months to get Congress to take this approach (called a "cram down") as a way to cut through legal red tape and give consumers more bargaining power with banks and other mortgage lenders. This is what consumer advocates and politicians mean when they say that Congress should focus on helping "Main Street" not "Wall Street."

In a speech in Colorado on September 16, Obama said: "Unlike Senator McCain, I will change our bankruptcy laws to make it easier for families to stay in their homes. Right now, if you're a family that owns one house, bankruptcy judges are actually barred from helping you keep a roof over your head by writing down the value of your mortgage. If you own seven homes, the judge is free to write down any or all of the debt on your second, third, fourth, fifth, sixth or seventh homes. Now that may be of comfort to Senator McCain, but that's the kind of out-of-touch Washington loophole that makes no sense. When I'm President, we'll make our laws work for working people."

Not surprisingly, Wall Street -- meaning the banking and securities industries and their friends in the real estate industry -- don't agree. And in the past few weeks, they've used their lobbying clout to make sure that the Democrats' cram-down provision was removed from the bail-out bill. In particular, the American Bankers Association, the Mortgage Bankers Association, the National Association of Home Builders, and the U.S. Chamber of Commerce used every tool in their political warchest to kill the cram-down provision.

The Bush administration and Congressional Republicans, including John McCain, took the industry's side. But why did the Democrats -- who have a majority of votes in both the House and Senate -- let them get away with it? Why not pass a pro-consumer bill, put it on President Bush's desk, and dare him to veto it?

As documented by the nonprofit, nonpartisan Center for Responsive Politics, the finance, insurance and real estate sector has been the largest campaign contributor in federal politics, giving more than $2 billion to federal candidates and political parties since 1989 -- 55% to Republicans and 45% to Democrats. In this election cycle alone, members of the House and Senate have received more than $180 million from PACs and individuals associated with finance, insurance and real estate -- the industries with the most at stake in the ongoing legislative debate.

With the Democrats now in control of Congress, however, the lobby groups recalculated their partisan priorities, directing 57% of their campaign donations this year to the Democrats.

Handing out $180 million to Congress this year is a pretty sweet deal if they wind up giving the industry a $700 billion bail-out. ***That's almost $4,000 in bail-out bucks for every dollar contributed to Congress.*** Even John McCain, whom the New York Times has documented is an inveterate casino gambler, can't do that well at the black-jack table.

Republicans, including McCain, have long been in the pockets of the financial services industry in addition to sharing an ideological view that opposes government regulation of business to make them act responsibly toward consumers, employees, and the environment. But the Democrats generally support more consumer-friendly laws. Indeed, both Senator Chris Dodd (D-Conn) and Rep. Barney Frank (D-MA), the chairs of the banking committees drafting the legislation, included the "cram-down" provisions in their original bills, even though they are both major recipients of industry funds.

So what happened to gut this important pro-consumer provision from the compromise bill that the leaders of both parties hoped to enact this week, with President Bush's blessing?

Why did so many Democrats, including the leadership, support the bill even after the pro-consumer provisions had been eliminated? The fact that 140 Democrats voted "yes" to the industry-backed proposal requires a deeper look into the dynamics of the legislative process.

For sure, some Democrats believed the Wall Street "chicken little" propaganda that unless Congress passed a bail-out bill quickly, the entire U.S. economy would go into free fall. They wanted to put the bail-out on the fast track and were willing to eliminate the pro-consumer provisions in order to keep more banks from failing and the credit crunch from imploding even more.

Even Obama reluctantly agreed last week to support a bail-out bill that didn't include the bankrtupcy relief, viewing the provision as a deal-breaker. As the Los Angeles Times reported: "Some analysts saw Obama's statement as a practical recognition of political reality: Republicans would never accept the bankruptcy provision, and the bailout plan was too important to the economy to jeopardize."

Given Obama's long-standing advocacy for the cram-down law, it is probably accurate to view his willingness to compromise as political pragmatism. But it is hard to avoid the conclusion that some Democrats, especially those from "safe" districts who don't face serious contests for re-election, simply caved in to the finance lobby -- and stopped fighting to keep the pro-consumer "cram-down" provision in the bill -- because of the industry's generous campaign contributions.

As CRP documented, the 140 Democrats who voted "yes" on Monday to the bail-out package -- the version that had eliminated the pro-consumer "cram-down" provision -- have received, on average, $792,744 over their careers (since 1989, when CRP began collecting this data) from the finance/real estate/industry sector and an average of $188,572 in the current election cycle. The 95 Democrats who opposed the bill have received $420,686 over their careers and $105,878 in most recent cycle. In other words, the Dems who voted to support the industry-backed bill received significnatly more funds than those who opposed it.

The funding gap among Republicans between the "yes" and "no" voters was considerably smaller. According to the CRP, the 65 Republicans who backed the President's no-strings-attached bill have collected an average of $1,078,533 from the finance sector in their careers and an average of $185,461 in this election cycle so far. The 133 Republicans opposed the President's bailout plan have collected, on average, $705,297 over their careers in Congress and $150,381 in this election cycle alone. Despite these Republicans "no" votes this time, the corporate lobbyists are likely to keeping filling their campaign coffers anyway.

There was a time, not too long ago -- before the free-market fundamentalists like George W. Bush, Phil Gramm and John McCain took over the White House and Congress -- when Washington *did* regulate banks. The Depression triggered the creation of government bank regulations and agencies, such as the Federal Deposit Insurance Corporation, the Federal Home Loan Bank System, Homeowners Loan Corporation, Fannie Mae, and the Federal Housing Administration, to protect consumers and expand homeownership. After World War II, until the late 1970s, the system worked. The savings-and-loan industry was highly regulated by the federal government, with a mission to take people's deposits and then provide loans (at a government-regulated profit) for the sole purpose of helping people buy homes to live in. Washington insured those loans through the FDIC, provided mortgage discounts through FHA and the Veterans Administration, created a secondary mortgage market to guarantee a steady flow of capital, and required S&Ls to make predictable 30-year fixed loans. The result was a steady increase in homeownership and few foreclosures.

The deregulation frenzy that began in the 1980s -- first pushed by the S&L industry (like Charles Keating, owner of the Arizona-based Lincoln S&L, whose name will forever be associated with McCain's as part of the "Keating Five" corruption scandal), and later by the commercial banks -- wiped out the once stable and sound system of requiring banks to help homeowners buy homes rather than act like gamblers at a casino.

We're in the current mortgage meltdown mess -- the escalating wave of home foreclosures, the growing number of bank failures, and the tightening credit crunch -- because Congress tore down the last remaining legal barriers to combining savings-and-loans, commercial banking, investment banking and insurance under one corporate roof. Banks, insurance companies, credit-card firms and other money-lenders became part of a giant "financial services" industry. Washington walked away from its responsibility to protect consumers with regulations and enforcement. While federal regulators looked the other way, banks and private mortgage companies indulged in risky loans and speculative investments. They invented new "loan products"--such as subprime loans and adjustable rate mortgages (ARMs) --that put borrowers, and their own banks, at risk. Wall Street packaged these loans to investors without scrutinizing their risk. Deregulation encouraged the industry to create this house of cards. Every aspect of the financial industry was so short-sighted and greedy that they didn't see the train wreck coming around the corner. Now major Wall Street banks are imploding.

As Obama said in a speech last week, "The American people should not be spending one dime to reward the same Wall Street CEOs whose greed and irresponsibility got us into this mess."

The way to fix the problem is to require banks to act responsibly toward consumers, particularly homeowners, some of whom were victims of illegal "predatory" lending scams while others were simply seduced by lenders offering subprime loans and ARMs with too-good-to-be true interest rates, assuming that their incomes and home values would steadily increase so they could afford to make the monthly mortgage payments even after they "ballooned" upwards. But the stagnating wages of the Bush years -- along with the widening economic gap between the rich and everyone else -- turned the dream of homeownership into a nightmare for millions of Americans.

The Democrats who opposed the bail-out for Wall Street -- and who resisted the banking industry's arm-twisting -- are right. The lenders who gambled with high-risk loans and paid executives outrageous compensation packages have to be held accountable. If these lenders are to survive, they have to learn to live with more regulations that protect consumers and restrict wanton speculation. By helping homeowners keep their homes, Congress will get to the root of the problem, dramatically right-sizing the mountains of bad loans now plauging Wall Street, and removing those "for sale -- foreclosure" signs from all those Main Streets across the country.