Protect Consumers First and Reduce Loan Principals; We Owe it to the People who Stay

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It was music to my ears listening to President Obama talk tough to the financial sector. My organization, the National Community Reinvestment Coalition, publicly commended him for his remarks. Not surprisingly, the financial lobby didn't like his "turn in tone," and the banks still have a great deal of power in DC. Obama's tough talk must now be translated into results.

Congress must enact a full-time consumer watchdog and the Administration must reduce loan principals--not just loan paperwork--for troubled mortgage borrowers. Otherwise, the economy will continue to unravel, and Wall Street will continue to fund its get-rich-quick schemes at our expense and with our tax money. President Obama should make both the creation of a CFPA and increased foreclosure prevention policies central issues in his State of the Union address this week.

Taxing the financial sector to pay for the economic fallout it created, capping the size of banks and ending proprietary trading make sense, though I am confident Wall Street and its army of lawyers will figure out a way around these steps. That's why President Obama's reforms must put consumers first. His Consumer Financial Protection Agency is a key element of regulatory reform. Unfortunately, the House bill currently contains loopholes, exemptions and other weaknesses that undermine the prospective agency's ability to protect consumers or prevent another meltdown of the financial system.

The creation of CFPA remains under consideration in the Senate. Given the political climate, some Senators and staffers are reportedly considering merely turning over consumer protection duties to existing regulators. This should not be an option, given the regulators' poor performance not only before the crisis but during it as well. (FDIC Chairwoman Sheila Bair is, perhaps, the only exception, as the first federal regulator to support mortgage principal reductions.)

NCRC and other organizations have been calling for loan principal reductions since 2007, when the subprime crisis reared it ugly head for all to see, though Wall Street, regulators, government officials and even the news media refused to acknowledge the obvious: the growing number of foreclosures predicted earlier by dozens of consumer and community groups would choke the economy, unless government stepped in and refinanced the loans to reflect more realistic home values, not the ones pumped up by financial shenanigans.

Three years later, our economy is on life support, with $23 trillion of public funds at risk. People can't find work; states and cities are close to bankruptcy; schools are laying off teachers; the elderly are living on soured retirement funds, and demand for homeless shelters and food stamps is soaring. But we are no closer now to a solution to the foreclosure crisis than we were in 2007.

In fact, 70% of borrowers who have received loan modifications through HAMP have ended up with principal increases.

Still, as the number of mortgages "under water" grows, most of these homeowners continue to make their payments. Brent White, a professor at the University of Arizona law school, wonders why in a recent paper. He writes that borrowers think they are obligated to repay their loans because society tells them they are, even though it's not in their economic interest. Meanwhile, Wall Street thinks just because they paid off their TARP funds, all is well. Never mind the economic repercussions of their actions and behavior on regular, working people. They are, after all, doing God's work, and, well, the borrowers, they can call their 1-800 number and call it and call it and call it until someone finally answers. Only that person can't fix the problem.

Our proposal to reduce loan principal can help. It addresses many of the issues that bankers, investors, regulators and Members of Congress offer as reasons for opposing the idea.

We have proposed that the Treasury Department acquire mortgage loans at a discount through the powers granted to the Administration under TARP or through the power of eminent domain. This would allow for the permanent and sustainable modification of loans, including principal reductions, which could then be packaged and resold to the market. Professor Howell Jackson of Harvard Law School has demonstrated how the government could use eminent domain in this instance.

This may sound radical, but radical is what we need. If most homeowners were thinking like Wall Street, they would walk away from their homes in a New York minute. They don't because it's their home; it's their life, and they feel not only a legal but also a moral obligation. This is why financial reform must be more than just populist, political rhetoric. We owe it to the people who are paying their mortgage and staying in their homes--at least for now.