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DRAFT

What Must Be Done to Reform Financial Systems and Resolve Economic, Banking, Derivatives, Mortgage and Foreclosure Crises

(http://www.wethepeoplenow.org/reform_financial_sys.pdf)

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This Plan outlines proposed actions to:

- Resolve economic, banking, credit, derivatives, mortgage and foreclosures crises
- Reform, regulate and vitalize financial systems
- Help identify funding sources for the jobs/work in the [What Must be Done to Put America and the World to Work¹, Jumpstart the Economy, End the Recession and Avoid a Massive World Wide Depression](#) and must be executed in coordination with this plan.

The primary causes of these ongoing crises are outlined in [Primary Causes of the Economic and Jobs Crises](#).

Reasons the current actions by the government are not helping are not helping as much as they could and should are outlined in [Primary Reasons the Current Actions by the Government Are Not Helping the True Economy](#).

Introduction

In his July 2009 report to Congress, Neil Barofsky, the Special Inspector General over the Troubled Asset Relief Program (TARP), reported that “*Since the onset of the financial crisis in 2007 through June 30 2009, the Federal Reserve, FDIC and various U. S. Government agencies have **provided or committed \$23.7 trillion¹ of taxpayers’ money** financial institutions.*

Most of these funds have gone to prop up selective, insolvent banks and other financial institutions under the guise of getting them to increase lending. Lending has not proportionally increased. Most banks, are charging exorbitant interest rates on the money that they are willing to lend. Meanwhile, foreclosures on homes, unemployment, poverty, hunger, the price of food are not getting much better and the wealth divide between the rich and poor/middle class continues to markedly increase.

If just a fraction of the of the \$23.7 trillion had been spent on jobs, there would be no recession today.

If trillions of dollars can be provided to banks and financial institutions, there is certainly enough money for health-care and jobs.

A. Key Actions To Resolve Economic, Banking, Credit, Derivatives, Mortgage and Foreclosures Crises²

Congress, the Administration, state and local governments, NGOs and business leaders, as appropriate³:

1. **Must not provide any additional government, Federal Reserve or FDIC funds to banks**

¹ **What Must be Done To Put America and the World to Work** can be downloaded or read at http://www.wethepeoplenow.org/put_america_to_work.pdf or an HTML copy at http://www.wethepeoplenow.org/put_america_to_work.htm.

² These actions are described in more detail in the various sections of this plan below

³ As needed and appropriate foreign governments should take similar actions, including in particular nationalizing their central banks that are not state owned.

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or financial institutions, or insurance companies and cease all initiatives by the government to provide funds, buy troubled assets, buy stock, make guarantees or loan money to them. Cancel the so called term asset-backed securities loan facility (TALF), the Consumer and Business Lending Initiatives, Public-Private Investment Program (PPIP)² and have the government make loans directly.

2. Restructure the TARP/bank bailout and stimulus legislation to focus remaining funds on job generation and job loss prevention.

3. Do not give the Federal Reserve any additional powers

4. Nationalize the Federal Reserve System and operate it as part of the Department of the Treasury under the direct control of Congress. In the future, Congress make all decisions about “coining,” appropriations, money supply, interest rates and loan guarantees by public laws, passed by the House and the Senate and signed by the President as required by the Constitution. (During the last Congressional session Rep. Dennis Kucinich (D-OH), introduced H.R. 6550, The National Emergency Employment Defense Act, which would have nationalized the Federal Reserve)

5. Recoup as much as possible of the over \$23.7 trillion that the Federal Reserve, FDIC, and the U. S. Treasury have provided or committed to various institutions over the past 18 months or so.

6. Establish a “federally-owned lending facility”³ to make low or no interest loans directly into the economy through states and worthwhile businesses and institutions that generate jobs.

7. Build a new banking system, around thousands of smaller banks and financial firms with executives *that respect their obligations to the broader economy.*

8. Reduce the size of large financial institutions by invoking anti-trust laws, separating investment activities into separate institutions and breaking them down into community, city and no larger than state size banks/firms.

9. Re-implement equivalent of the Glass Steagall Act of 1933 to prohibit banks from speculating with depositors' money and engaging in investment activities, speculative trading and mergers or collaborating with brokerage firms, selling insurance, etc.

10. Prohibit:

a. “Shadowy” banks, private equity accounts, hedge funds, adjustable rate mortgages, stock options, off-balance sheet accounting and more than one set of books.

b. **All trading, buying or selling of derivatives** including mortgage backed securities and actual mortgages, promissary notes, contracts and similar instruments with the possible exception that they can be “sold back” to the originator.

11. Require reasonable down payments on mortgages and loans to provide a grace period that allows a buyer to move into a more affordable home in case he/she loses a job or their economic situation changes and eliminate the fractional reserve system

12. Limit maximum annual interest rates to 4% on all mortgages, home equity, government guaranteed and other secured loans and 6% on credits cards and unsecured (signature) loans and limit late fees to \$3.00 with legislation that replaces the Depository Institutions Deregulation and Monetary Control Act (P. L. No. 96-221; 94 Stat. 132) (1980). Make these maximum interest rates and lower fees retroactive to the origination of the mortgage, credit card or loan. Recalculate amounts due and balances based on these lower rates and fees. Apply extra interest and excess fees paid to the principal as payments were made.

13. End the practice of charging individuals or businesses with lower credit ratings higher interest rate. This is predatory lending and drives individuals into bankruptcy.

14. Place a moratorium on foreclosures and evictions on primary residences, family farms, and businesses for at least one year.

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15. **Require that the current owner of troubled individual mortgages which are part of a mortgage backed security**, the local server of the mortgage and the owner of the property:

a. **Resolve any irregularities or fraud involved** in the origination and trading of the mortgage and the related mortgage backed security. Refer irregularities or fraud that can't be resolved to the appropriate authorities.

b. **Determine the amount owed on the mortgage** based on the new interest rates and late fees, the approximate market value of the home and property taxes, and all fees if the home were to be sold.

c. **Determine the market value of each property, whether or not the owner can afford it and available options.** Conduct arms length negotiations and evaluate each mortgage and situation individually at the local level with various approaches including loan modifications that could reduce interest rates and eliminate onerous fees, ARMs, prepayment penalties, stretching it out, etc., dividing the home into apartments, selling off parts of larger lots, rent to buy plans, rent only plans and/or leasehold type contracts. It is to the advantage of both parties to keep the home occupied and not have to go through an eviction or sale of the property. If an agreement cannot be reached, the home could be put on the market and the owner pay a reasonable market rate rent to stay in the home while finding another place to live and the home is sold. If the owner of the property can afford whatever the sales price becomes minus the realtor and other sales fees, then he should have the right of first refusal.

16. **Review previous foreclosures** to ensure that they were just and that applicable laws and regulations were followed including in particular that mortgage creditors had proved to the authorities involved with the foreclosures that they owned the loans.

17. **Cancel the Homeowner Affordability and Stability Plan** and redirect all related funding (\$75 billion) intended for it to state governments to use at the local level to support homeowners, not lenders.

a. A portion of the funds should be used to pay or hire someone to assist the owner in determining the market value of the home, negotiating a payment or rental schedule to stay in the home, what kind of cushion is needed in case conditions change, alternatives to staying in the home and to lessen the impact of the loss of the home by helping them to find and move into an affordable home that allows the kids to stay in school, all depending upon the circumstances. Experienced real estate agents would normally be qualified to do or help with this work.

b. A portion of the funds should be used to review past foreclosures to ensure that they were just and that applicable laws and regulations were followed including in particular that mortgage creditors had proved that they owned the loans. If proof was not provided or if there are irregularities in the foreclosure process appropriate action should be taken

Resolving the Derivative Crises

18. Resolve each derivative in about the same way that mortgage backed securities and individual mortgages were resolved. Actions include:

a. Require that financial institutions owning/holding any derivatives break down each derivative into the individual "**instruments (s)**", e.g. promissary note(s) or contract(s), from which the derivative derived its value and determine the "**real property(s)**" associated with the instruments(s), maintain proof that they are indeed the owners of the instrument and maintain records of all of the owners, originators, packagers, regulators, transactions and prices for each individual derivative and the related instruments when they changed hands.

b. Resolve any fraud involved in the origination and trading of each instrument and the related derivative. Refer irregularities or fraud that can't be resolved to the appropriate authorities.

c. Determine the amount owed on each instrument based on new interest rates and late fees, the approximate market value of the real property and taxes and fees if the real property were to be sold.

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d. Owners of the instruments and real property and the servicer conduct arms length negotiations. Evaluate each instrument and real property with various approaches including lowering interest rates, stretching out the term, dividing the real property, selling off parts, lease to buy plans, lease only plans and/or leasehold type contracts. It is to the advantage of both parties to keep the real property in use. If an agreement cannot be reached, the real property could be put on the market and the owner pay a reasonable market lease rate to continue to use the property while finding a replacement and the real property is sold. The owner of the real property should have the right of first refusal of the best offer minus fees if he can afford the property and can and will make payments.

e. In any case choose the best option(s) for the owner of the property and the owner of the mortgage⁴.

Resolve the Banking Crisis:

19. Require that banks prepare accurate balance sheets which reflect actual values of all liabilities and assets including troubled assets and risky investments. Determine which banks are solvent or insolvent and by how much and the reasons for the insolvencies.

20. Government seize insolvent banks and other insolvent financial institutions and keep them in operation as federal government owned, contractor operated (GOCO) entities so that they continue to function and the work force stays employed. Replace senior management.

a. Separate out investment activities Sell off those parts of the banks that have nothing to do with banking.

b. Ultimately break the larger bank into community, city and no larger than state size banks/firms.

21. As soon as practicable turn over branches within a states and allow states to operate them as publicly-owned banks that issue low-interest credit similar to the Bank of North Dakota (BND)

B. ACTIONS TO REFORM, REGULATE AND REVITALIZE FINANCIAL SYSTEMS

1. Return all investment activities to the **true purposes of capitalism which are to:**

a. **provide a source of capital for worthwhile businesses** and

b. **provide investment opportunities**

2. *Stop the corruption of members of the Congress and the Administration by the financial, insurance, real estate and other industries through campaign contributions and lobbying.*

3. *Reject the theory that financial institution and markets self regulate and replace it with serious financial regulatory reform with realistic financial market theories*

4. Extend regulations and oversight to the "shadow banking system,"

5. *Reform/establish new regulatory institutions empowered by law to control financial markets and force them to act in the public interest and populate them with well trained officials who believe in serious regulation.*

⁴ In ending foreclosures and resolving the home mortgage the following should be kept in mind:

a. The factors involved with each mortgage including irregularities or fraud involved in its origination and sale, the financial condition, debts, health and ability of the owner(s) to pay, state and local homestead and other laws, land records, foreclosure procedures, job availability, zoning regulations, school districts, neighborhood association rules, health of the owners and property taxes, vary by home and location and can best be adjudicated locally rather than from Washington.

b. In many areas housing prices are decreasing rapidly and more mortgages are upside down (the mortgage balance is more than the market value of the home) and getting further upside down.

c. At least two federal judges have dismissed foreclosure cases because mortgage creditors had not proved that they own the loans. Such proof gives a creditor standing to foreclose against a borrower and is required by law.

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James Crotty and Gerald Epstein, in their article **Proposals for Effectively Regulating the U.S. Financial System** to Avoid Yet Another Meltdown⁵, also outline a *Nine Point Program for Financial Regulation*

1. *Move all risky investments back on bank balance sheets and require adequate capital to support them.*
2. *Require due diligence by creators of complex structured financial products.*
3. *Prohibit the sale of financial securities that are too complex to be sold on exchanges.*
4. *Transform financial firm incentive structures that induce excessive risk-taking. i) Implement a financial pre-cautionary principle. Crotty and Epstein suggested: careful consideration of the "anything not specifically permitted is prohibited" principle.*
5. *Restrict the growth of financial assets through counter-cyclical capital requirements.*
6. *Implement lender-of-last-resort actions with a sting. Institutions might be too big to fail, but no CEO should be. The CEOs of the seven largest investment banks received a total of \$3.6 billion from 2004-07, yet the market capitalization of their firms declined by \$364 billion from their peak values, an average fall of 49 percent. As long as there is financial capitalism, there will be a need for some lender of last resort bailouts, even if all of these proposed policies are implemented. But a key distinction must be made between the financial institution itself and the agents who made the decisions to take risks and benefitted from these decisions – top management, key traders and other richly rewarded operators. These rainmakers must be made to pay significantly when their firms are bailed out.*
7. *Create a bailout fund financed by Wall Street.*

Enact legislation that:

1. **Prohibits trading of mortgage backed securities and all other derivatives** including, credit default swaps, structured investment vehicles, collateralized debt obligations, repo (repossession) agreements, and other toxic paper.
2. **Prohibits commercial and retail banks engaging in investment activities, speculative trading and mergers** or collaborating with brokerage firms as was required by the **Glass-Steagall Act**.
3. **Prohibits:**
 - a. **"Shadowy" banks, private equity accounts and hedge funds.**
 - b. **Adjustable rate mortgages.**
 - c. **Stock options.**
 - d. **Off-balance sheet accountings and more than one set of books.**
4. **Restores and strengthens:**
 - a. **Uptick rules** that require short sale transactions be entered at a price that is higher than the price of the previous trade. This rule prevents short sellers from adding to the downward momentum when the price of an asset is already experiencing sharp declines.
 - b. **Position limits and margin requirements**
5. Provides **real oversight** over the SEC, regulatory authorities and the Federal Reserve System.

⁵ **Proposals for Effectively Regulating the U.S. Financial System** to Avoid Yet Another Meltdown by James Crotty and Gerald Epstein, Department of Economics and Political Economy Research Institute (PERI), University of Massachusetts, Amherst, October 7, 2008.
http://www.peri.umass.edu/fileadmin/pdf/working_papers/working_papers_151-200/WP181.pdf

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6. Causes the rule of law to be enforced.

Crotty and Epstein concluded: *that we will not be able to enact adequate reforms until two fundamental changes take place. First, the mainstream theory of efficient financial markets that is the foundation of support for the NFA must be replaced by the realistic financial market theories associated with John Maynard Keynes and Hyman Minsky. Recent events should convince any rational economist that the theory of efficient capital markets should be rejected once and for all, though it is far from clear that this ideologically grounded vision will in fact disappear. Second, there must be a broad political mandate in support of serious financial regulatory reform. For too long the Lords of Finance have corrupted the political process. Congress and the President have acted in recent decades as if they were paid employees of financial market interests, which many of them were. Perhaps anger over the \$700 billion dollars and the likely recession can galvanize the needed political support for change. The key is to channel the anger into pressure for a new "New Deal" in government regulation of financial markets.*

Until we have regulatory institutions empowered by law to control financial markets and force them to act in the public interest and we populate them with well trained officials who believe in serious regulation, we will continue down the disastrous path we have been following for the past three decades.

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Endnotes

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Mark Pittman and Bob Ivry. This article reports that from about December 2007 until March 31,
2009, the Federal Reserve the Treasury Department and the Federal Deposit Insurance
Corporation (FDIC) had lent or committed \$12.8 trillion to selective banks and other financial
institutions. Neil Barofsky, the Special Inspector General over the Troubled Asset Relief

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Program (TARP) in his July 2009 report to Congress reported that “*Since the onset of the financial crisis in 2007 [through June 30 2009], the Federal Government, through many agencies, has implemented dozens of programs that are broadly designed to support the economy and financial system. ... the total potential Federal Government support could reach up to \$23.7 trillion.*”

2. Doctorhousingbubble.com **Public-Private Investment Program for Dummies**, <http://www.doctorhousingbubble.com/public-private-investment-program-for-dummies-how-does-the-new-treasury-plan-impact-housing-and-the-market-poorly-planned-investment-program-ppi>
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3. Ellen Brown, **Yes Magazine** article, A Radical Plan for Funding a New Deal, suggests several way to fund recovery efforts including the government setting up its *own federally-owned lending facility* and states chartering State Banks. The article also provides excellent insights into banking and the Federal Reserve System.