STATEMENT ON

PROPOSED ACTIONS TO AVOID FORECLOSURES ON
DELINQUENT HOME AND FARM MORTGAGES

PRESENTED TO

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION
REGULATION AND INSURANCE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES

BY

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Mr. Chairman:

We are pleased to have this opportunity to discuss proposed actions to avoid foreclosures on delinquent home and farm mortgages. As you are aware, an ever increasing number of American families are experiencing difficulty in meeting their mortgage obligations in a timely fashion, thereby threatening foreclosure and the loss of their homes. To a large extent this problem results from the high rate of unemployment that has accompanied the recession that we have experienced during the past year. The adverse effects of the recession, however, have not been limited to an increase in foreclosures. Business bankruptcy rates are also up dramatically, and in instances where business owners have pledged their homes as collateral for business loans, this has aggravated the foreclosure problem.

While foreclosure starts have risen during 1982, they apparently are below the level experienced during the recession of the mid-1970s. On the other hand, proportion of loans past due in 1982 far exceeded that experienced during the recession of 1974-75. During normal circumstances one would expect an increase in delinquencies to result in an increased rate of foreclosures. While foreclosures have increased, the weakness in the economy accompanied by the poor state of the residential housing market has made foreclosure a relatively unattractive alternative to financial institutions. A lender foreclosing on a property that it cannot sell or use to generate income is no better off than if it had exercised forbearance on the loan itself. The data suggest that many lenders are exercising forbearance. For instance, lenders faced with delinquent loans resulting from borrowers having been laid off from their jobs are better off reacting to this transitory phenomenon by either restructuring these loans or exercising forbearance in the expectation that these borrowers will be employed again in the near future.

Farmers have also suffered during the last few years. The combination of declining prices for farm commodities, accompanied by an increase in debt and the reduction in the value of farm land, has served to worsen the lot of farmers, thereby increasing delinquencies and foreclosures on farm properties. The Administration, in recognition of the problems faced by farmers, has just instituted the Payment-in-Kind program. Under this program, farmers' cash flows should be enhanced and their operating costs somewhat reduced. Consequently, the financially troubled farm sector should receive some immediate relief.

With an economic recovery seemingly underway, we believe that the problem being examined by this Committee will be lessened. However, even if economic recovery is slow and foreclosures continue to remain high, we do not believe that changes in the FDIC's policies or function should be the vehicle for addressing these significant economic problems. This is not to suggest that the FDIC is not sensitive to the problems of foreclosures. We are, and I would like to discuss the FDIC's role first as a bank supervisor and second as an insurer with regard to these problems.

As you know, we examine state nonmember banks in an effort to keep the risks to our insurance Fund within reasonable bounds and for other legislatively mandated purposes. As part of this examination, we review a bank's loan portfolio, and nonperforming loans may be classified. If an unreasonable portion of a bank's loans are classified we will call for some form of remedial action. However, contrary to the opinion of some, this does not translate into an FDIC mandate for foreclosure on the security collateralizing loans. We are acutely aware, both from our experience as examiners of banks as well as the liquidator of the assets of failed banks, that disposal of foreclosed property during bad economic times is not always a financially productive means for dealing with a delinquent loan.

One of the most important purposes of the examination process is to provide information about the true condition of an insured institution. Some problems can be remedied regardless of economic conditions and we take action to have the bank correct such deficiencies. But from a practical point of view, what can one do about an otherwise well-run bank that suddenly finds itself with a lot of delinquent mortgage and problem farm loans in the present economic environment? Unless the bank is in materially worse condition than other financial institutions in the area (suggesting that it is not "well run" and has been funding loans that should not have been made), we simply don't issue an enforcement order. We feel that we have been, and are currently, sensitive to the problems concerning you and are exercising a discretion consistent with our other responsibilities.

It would be imprudent for us to revise our examination procedures in such a way as to distort the information available to us in our assessment of the financial condition of the banks that we insure.

Additionally, it would be inappropriate for the FDIC to encourage institutions to engage in practices that distort and hide their true financial condition from their creditors and shareholders. Such practices would be harmful to the FDIC as insurer and undermine the role of the financial markets in disciplining financial institutions.

The FDIC would strenuously object to a scheme to assist mortgage interest payments with funds from our insurance Fund. The Fund has been accumulated over 50 years with the purpose of providing protection to depositors. While we believe, as we have testified on numerous occasions, that the Fund is adequate to cope with any scenario we envision of failing banks, to divert funds to alternative purposes would be irresponsible. Moreover, such an action might raise concern about its adequacy resulting in the loss of public confidence in the deposit insurance system.

The FDIC's principal responsibility is to provide deposit insurance, and in connection with this responsibility, its principal activities and expertise relate to bank supervision and the liquidation of assets of failed banks. During the past year demands on our resources have increased considerably. We simply do not have the resources or expertise to take on and administer a program to assist selected delinquent mortgage borrowers. Handling such a program, presumably, would necessitate developing standards and administering them so that assistance is provided equitably and where appropriate. There are other agencies better equipped to handle such a program than the FDIC.

As we have mentioned, the FDIC shares the concern of this Committee with the plight of homeowners and farmers faced with mortgage foreclosures.

We also are sensitive to the problems of other groups within our population, such as small businessmen, the poor, and the elderly, that have also been hurt by the economic conditions facing this country. We believe that Congress and the Administration should deal with the problems of the economy in order to alleviate its adverse effects on all our citizens rather than just focusing on one limited group.

The question of providing funding to deal with the adverse consequences of a recession on mortgage borrowers should be addressed directly in conjunction with normal budget procedures if that is what Congress chooses to do. And clearly, alternative vehicles for dealing with these problems are at hand. For example, during the 1930s the Reconstruction Finance Corporation, the Federal Farm Mortgage Corporation and the Homeowners Loan Corporation all were created to provide for the rehabilitation of loans so as to assist creditors and borrowers and serve to provide a mechanism to stave off foreclosure. A similar type of governmental body could be created today.

Since the delinquency and foreclosure problems on FHA-insured and VA-guaranteed loans are significantly greater than on conventional loans, we would suggest that the Committee might wish to urge these agencies to enlarge their programs for forbearance if you deem additional assistance necessary. Presently, to the best of our knowledge, the Veterans Administration has no formal program. With respect to FHA-insured mortgages, Congress provided for some relief to temporarily financially distressed homeowners with passage in 1980 of the Housing and Community Development Act. Unfortunately, implementation of the program has been held up by litigation.

In summary, Mr. Chairman, we do not believe it is necessary or desirable to revise present examination procedures to accommodate mortgage workout plans; we oppose any scheme in which FDIC resources would be used to maintain payments on nonperforming mortgages; and, we believe that, if Congress decides to enlarge programs to provide bridge financing for selected delinquent mortgages, that should be done through the normal budget process and administered by one of the existing housing agencies.