RUTH BADER GINSBURG AMERICAN INN OF COURT

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The Financial Crisis of 2008

Written Materials

I. How did the financial crisis start? (Skit)

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   a. Recipe for Disaster
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Disclaimer

The opinions provided in this presentation are not those of MidFirst Bank.

The imprudent lending practices described in this presentation were not representative of the entire banking industry. Many local and regional financial institutions did not participate in the subprime or nontraditional lending practices at the heart of the foreclosure crisis.

Notwithstanding, the entire banking industry has experienced the consequences of the 2008 financial crisis, including a heightened regulatory environment in today's world.

SETTING THE STAGE:

THE RECIPE FOR DISASTER

RECIPE FOR DISASTER:
THE FINANCIAL CRISIS OF 2008

Ingredients:

- Mass **Unrealistic Expectations**
  - Nationwide housing industry and public that believed home prices would continue to rise and rates would stay low
  - … thus creating higher and higher demand for more and more housing and mortgage loans, which in turn fueled higher and higher housing prices (the housing bubble).
- Millions of **Bad Loans**
  - Subprime (low FICO score) loans with no downpayment requirements, high LTV and nontraditional terms that included a low, fixed "teaser" rate followed by stepped up, variable rate and payment increases
  - Borrowers who obtained these loans were not required to save a downpayment, to demonstrate that they could pay for the loan when the payment reached its maximum amount, and these loans left borrowers with no equity in their homes on day one
  - No verification of borrower income allowed for high levels of fraud by borrowers, mortgage brokers and originators, and other related parties who would benefit from the loan origination and would not be responsible when it defaulted
- Millions of **Bad Investments in the Bad Loans**
  - Mortgage Backed Securities (MBS) were the bedrock of many investment portfolios, retirement plans and pension funds because of the perceived enduring stability and safety of the US housing market (reference above)
  - Investors included city and local government and educator pension funds, small and large business retirement funds, money market funds, banks, and even foreign governments.

RECIPE FOR DISASTER:
THE FINANCIAL CRISIS OF 2008

Instructions:

- Combine Ingredients
  - Millions of bad loans originated over a period of years were packaged into investments and sold to investors who believed the US housing market was a safe and stable investment.
  - The booming housing industry funded millions of small businesses and employed millions of people - people who in turn would spend more money buying houses and using credit to purchase auto loans and other consumer goods
  - Many more businesses grew out of the booming economy fueled in part by the booming housing market
- Turn up the heat
  - Interest rates started to rise in 2005, which triggered monthly payment increases in many ARM loans that were originated with low monthly payments
  - Teaser rates then began to expire, with significant increases in monthly payments for millions of borrowers
  - By early 2007, delinquencies and defaults rose to record highs
- Then Broil
  - The housing bubble burst – home prices began to fall nationwide in 2007, and borrowers who could no longer afford their increased payments could not sell their loans or refinance

THE DISASTER : THE FINANCIAL CRISIS OF 2008

- **Millions of foreclosures across the nation**
  - As the housing bubble burst, housing prices fell 17.8 percent from 2006 to 2009 (adjusted for inflation), accelerating subprime mortgage defaults and, in turn, the number of foreclosure filings. In 2008, roughly one of every 54 households received a foreclosure notice. In that year alone, 861,664 households lost their properties due to foreclosure.1
  - Arizona, Florida, California and Nevada were the hardest hit states; however, an increase number of homes were left vacant in thousands of cities and towns across the US.2
- **Millions of closed businesses and lost jobs**
  - Businesses and jobs that depended on the booming housing and mortgage industry, such as construction firms and their employees, real estate agents, mortgage lenders.
  - Investment firms closed and laid off employees
  - Many other businesses failed or cut staff because consumer spending sharply curtailed – examples included retailers and auto manufacturers
- **Millions people who lost pensions, retirement and savings**
  - City and local government pension funds, teacher pension funds, individuals and companies that invested in MBS that lost their value Stock market values dropped as a result of the crisis, so even investors that did not heavily invest in MBS lost principle and income.
  - The financial crisis wiped out about a quarter of U.S. household net worth, affecting most severely people who were between ages 55-64 in 2007-2008.3

Sources:

1 Just the Facts: A Look Back at the Role of Federal Courts in the Foreclosure Crisis, U.S. Courts (October 24, 2019), located at https://www.uscourts.gov/news/2019/10/24/just-facts-look-back-role-federal-courts-foreclosure-crisis.

2 Report to Congress on the Root Causes of the Foreclosure Crisis, U.S. Department of Housing and Urban Development, Office of Policy Development and Research (January 2010), located at https://www.huduser.gov/portal/publications/Foreclosure_09.pdf.

3 Retirement Security and the Financial and Economic Crisis: An Overview, published by the Pension Research Council, The Wharton School, September 2011, located at https://pensionresearchcouncil.wharton.upenn.edu/wp-content/uploads/2015/09/PRC-WP2011-06.pdf.

Immediate Government Response

The Concern: By Fall, 2008, economists and government officials were concerned that the recession would spiral further downward into a depression without intervention. One key concern was the potential collapse of institutions deemed critical to the economy ("too big to fail").

The Tool: Emergency Economic Stabilization Act of 2008

- Public Law 110-343, proposed by Treasury Secretary Henry Paulson, passed by 100th Congress and Signed into law October 3, 2008 by George W. Bush
- Stated purpose was to "provide authority for the Federal Government to purchase and insure certain types of troubled assets for the purposes of providing stability to and preventing disruption in the economy and financial system and protecting taxpayers …."
- Created the Troubled Asset Relief Program (TARP) to purchase distressed assets of companies critical to the U.S. economy.

The Result: Government Bailouts and Public Outcry

- Government bought $700 billion in MBS that were in danger of defaulting. Giants such as AIG, Chase, Wells Fargo and Bank of America received bailout funds to keep them afloat.
- Although the bailouts stabilized the economy, many in Congress and the public were enraged at the government bailouts, particularly of those involved in the origination of the bad loans at the heart of the MBS crisis.

Subsequent Congressional Actions

Wall Street Reform and Consumer Protection Act of 2010 (Dodd Frank Act)

- Public Law 111-203, amending Title 12 and Title 15 of the USC; passed by the 111th Congress and signed into law by President Obama July 21, 2010.
- Stated purpose was "to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail," to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes."
- Amended numerous existing laws, including but not limited to the Consumer Credit Protection Act, the Federal Deposit Insurance Act, the Federal Reserve Act, Protecting Tenants at Foreclosure Act, the SEC Act of 134, and the Truth In Lending Act.
- Among the key provisions:
  - Required banking regulators to develop and implement requirements for certain large banks to conduct regular periodic "stress testing" to determine if the institutions have the ability to withstand adverse economic conditions.
  - Required "systemically important" institutions to have a plan to provide for an orderly shut down in the event of bankruptcy.
  - The Volcker Rule prohibited banks from making certain investments with their own accounts (with exceptions)
  - Created a new, independent federal consumer protection agency, the Consumer Financial Protection Bureau to supervise financial institutions with assets exceeding $10 billion and all non-bank lenders, to enforce consumer protection laws, and to develop new regulations to protect consumers.

Other Important Related Laws

- Credit Card Accountability and Responsibility Act (CARD Act) of 2009
- Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act) of 2009

Government Enforcement Actions

In years 2009-2016:

- SEC charged numerous investment firms with misleading investors, failing to properly disclose about exposure to subprime mortgages, and in some cases securities fraud. Actions included players such as Fannie Mae, Freddie Mac, Bank of America, Citigroup, Deutche Bank, Goldman Sachs and many others.

  See, for example, Press Release, U.S. Sec. & Exch. Comm'n, Litigation Release No. 21377, SEC Charges Bank of America for Failing to Disclose Extraordinary Losses at Merrill Lynch Prior to Merger (Jan 12, 2010), available at http://www.sec.gov/litigation/litreleases/2010/lr21377.htm; SEC v Bank of Am., No. 10 Civ. 0215 (JSR), 2010 U.S. Dist. LEXIS 54171, at *3-6 (S.D.N.Y. Apr. 6, 2010) (order approving proposal for disbursement of the $150 million settlement).

- The Department of Justice pursued the largest banks on charges of misleading investors and obtained substantial settlements.

  See, for example, Press Release, U.S. Dep't of Justice, No. 14-884, Bank of America to pay $16.65 Billion in Historic Justice Settlement for Financial Fraud Leading Up to and During the Financial Crisis (Aug. 21, 2014), available at http://www.justice.gov/opa/pr/201/August/14-ag-884.html; Press Release, U.S. Dep't of Justice, No. 14-733, Justice Department, Federal and State Partners Secure Record $7 Billion Global Settlement with Citigroup for Misleading Investors about Securities Containing Toxic Mortgages (July 14, 2014), available at http://www.justice.gov/opa/pr/2014/July/14-ag-733.html.

Government Enforcement Actions

- **Foreclosure Processing** became a key focus of enforcement and litigation in light of the sharp rise in the volume of nationwide foreclosures beginning in 2008. Regulators identified concerns with practices such as:
  - Foreclosure governance
  - Inadequate staffing to address increased volumes
  - Issues with affidavit and notarization practices
  - Issues with accuracy of documentation
  - Issues with oversight of third party vendors (foreclosure firms)
- Beginning in April 2011, federal banking regulators initiated a review of foreclosure practices of 15 of the nation's largest mortgage servicers and entered into consent orders with the servicers, subject to the hiring by each of independent firms to conduct comprehensive reviews of the firms' foreclosure activities in 2009-10. This process ultimately resulted in $3.9 billion in payments to homeowners and over $6 billion in loss mitigation and foreclosure prevention.
- In February 2012, 49 state Attorneys General, the District of Columbia, and the Department of Justice announced a joint state-federal settlement with the country's 5 largest mortgage servicers, later called the "National Mortgage Settlement"
  - $25 billion agreement in relief to distressed borrowers and direct payments to signing states (Oklahoma did not participate)
  - The agreements established minimum servicing standards for signing banks
  - Additional settlements followed thereafter with other nationwide mortgage servicers

Sources:

Information about the settlements is available on Department of Justice website (www.justice.gov/ust/national-mortgage-settlements) and National Mortgage Settlement website (www.nationalmortgagesettlement.com).

Information about the Independent Foreclosure Review and subsequent consent orders is available on the OCC website: See *Interagency Review of Foreclosure Policies and Practices* (www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47a.pdf) and *Foreclosure Related Consent Orders Status Report: Observations, Payments, and Foreclosure Prevention Assistance* (www.occ.gov/news-issuances/news-releases/2014/nr-occ-2014-65a.pdf)

New Regulatory Environment

Consumer Financial Protection Bureau (“CFPB” or “the Bureau”) now supervises approximately 250 depository financial institutions and depository institution affiliates, along with nonbank lenders nationwide.

- The Bureau has published 77 Final Rules.
- The bureau also has brought at least 236 enforcement actions since its inception in 2012, with some of the highest fines in history. The CFPB reports that it has provided over $12.4 billion dollars in fines and remediation to American consumers.
- Although the Bureau’s activity in some aspects has slowed down, 27 enforcement actions were brought in 2019 and 2020 YTD.
- Summaries of several key consumer protection rules published by the CFPB follow.

Source: CFPB website www.cfpb.gov

Loan Originator Compensation Rule 12 CFR 1025.36

- Amended Regulation Z (implementing the Truth in Lending Act).
- Imposes requirements and restrictions for crediting of payments as of the date received, for application of partial payments, and for providing payoff statements within a reasonable time
- Prohibits pyramiding of late fees
- Prohibits payments to loan originators (broadly defined and includes bank loan officers and mortgage brokers) that are tied to any term of the transaction, or any proxy thereof
- Also prohibits dual compensation to mortgage originators and imposes qualification requirements for mortgage originators
- Prohibits a mortgage originator from steering a consumer to a loan based the mortgage originator’s compensation for that product

Ability to Repay Rule
12 CFR 1026.43

- Amended Regulation Z (implementing the Truth in Lending Act).
- For certain loans secured by a dwelling, imposed requirements to determine and document the borrower’s ability to repay the loan.
- Included
- “Qualified Mortgage” safe harbor for government loans, loans qualifying for sale to Fannie Mae or Freddie Mac, and loans that meet certain defined standards.

Mortgage Servicing Rules
12 CFR 1024.30-1024.41 (Subpart C)

- Amended Regulation X (implementing the Real Estate Settlement Procedures Act).
- Required new disclosures, implementation of a process and procedures to respond to a borrower Notices of Error and Requests for Information within designated timeframes, imposed certain restrictions related to forced place insurance, and imposed new requirements for outreach with delinquent borrowers, and new requirements for communications and borrower assistance where a request for loss mitigation is made, including delay in foreclosure for a designated time period.

Enhanced Mortgage Data Collection and Reporting 12 CFR Part 1003

- Amended Regulation C (implementing the Home Mortgage Disclosure Act)
- Greatly expanded the reporting requirements and the number of data fields to be collected and reported by lenders to the government for monitoring.
- This data is made publicly available.