Elizabeth A Duke: Foreclosure prevention efforts and market stability

Testimony of Ms Elizabeth A Duke, Member of the Board of Governors of the US Federal Reserve System, before the Committee on Banking, Housing, and Urban Affairs, US Senate, Washington DC, 23 October 2008.

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Chairman Dodd, Senator Shelby, and other members of the Committee, I appreciate this opportunity to discuss recent actions taken to stabilize financial markets and foreclosure prevention efforts.

Financial markets have been strained for more than a year, as house prices declined, economic activity slowed, and investors pulled back from risk-taking. These strains intensified in recent weeks. Lending to banks and other financial institutions beyond a few days virtually shut down. Withdrawals from money market mutual funds and prospects that net asset values would fall further severely disrupted commercial paper and other short-term funding markets. Longer-term credit also became much more costly as credit spreads for bonds jumped and interest rates rose. The problems in credit markets and increasing concerns about the state of the economy caused equity prices to swing sharply and decline notably.

Policymakers here and in other countries have taken a series of extraordinary actions in recent weeks to restore market functioning and improve investor confidence, with the aim ultimately to increase the availability of credit and the value of savings. The Federal Reserve has continued to address ongoing problems in interbank funding markets by expanding its existing lending facilities, and recently increased the quantity of term funds it auctions to banks and accommodated greater demand for funds from banks and primary dealers. We also increased our currency swap lines with foreign central banks. To alleviate pressures on money market mutual funds and commercial paper issuers, we implemented several important temporary facilities, including one to provide financing to banks to purchase high-quality asset-backed commercial paper from money funds, and another to provide a backstop to commercial paper markets by purchasing highly rated commercial paper directly from businesses at a term of three months. On Tuesday of this week, we announced another program in which we will provide senior secured financing to conduits that purchase certain highly rated commercial paper and certificates of deposit from money market mutual funds.

The financial rescue package recently enacted by Congress, the Emergency Economic Stabilization Act (EESA), provides critically important new tools to address financial market problems. EESA authorized the Troubled Asset Relief Program (TARP), which allows the Treasury to buy troubled assets, to provide guarantees, and to inject capital to strengthen the balance sheets of financial institutions. As provided in the Act, the Federal Reserve Board and its staff are consulting with the Treasury regarding the TARP. In addition, Chairman Bernanke serves as the Chairman of the oversight board for TARP that will, among other things, review the policies that are implemented and make recommendations, as appropriate, regarding the use of authorities under TARP. EESA also temporarily raised the limit on the deposit insurance coverage provided by the Federal Deposit Insurance Corporation (FDIC) from $100,000 to $250,000 per account.

Last week, the first use of TARP funds was announced. In particular, the Treasury announced a voluntary capital purchase program, and nine of the nation's largest financial institutions have agreed to participate. The program is open to financial institutions of all sizes. Under the program, the Treasury would acquire capital of financial institutions on terms that are attractive to the institutions and with features that protect the taxpayer. At the same time, the Federal Reserve Board, the FDIC, and the Secretary of the Treasury in consultation with the President, determined that there were significant risks to the stability of the financial system. With this determination, the FDIC used its authority to expand for a specified period, insurance to non-interest-bearing transactions accounts, such as payroll accounts, and a guarantee for newly issued senior unsecured debt of FDIC-insured depository institutions, including their associated holding companies.

A second, complementary, use of TARP funds will be to purchase mortgage assets, including mortgage-backed securities and whole loans. These purchases are designed to remove uncertainty from lenders' balance sheets and to restore confidence in their viability. Another objective is to improve the modification efforts of servicers on these loans to more effectively prevent avoidable foreclosures.

The Federal Reserve System is also working to develop solutions to rising foreclosures. Preventing avoidable foreclosures is good for borrowers, communities, and the economy.

A number of efforts are underway. The Federal Reserve has worked with other agencies to put in place the standards and procedures for the new Hope for Homeowners (H4H) program, and I serve on the Oversight Board. These loans can help borrowers who might otherwise face foreclosure because the new loan payments are more affordable and the homeowners get some equity in their homes. Lenders and servicers are analyzing their borrowers for good candidates for the H4H program, and the FHA and its authorized lenders are poised to process applications. We appreciate the additional flexibility provided to the program by Congress in EESA, in particular allowing up-front payments to junior lien holders that agree to release their claims.

For some time, we have called upon lenders, investors, and servicers to aggressively pursue sustainable loss mitigation activities. For example, last year the Federal Reserve and the other banking agencies issued supervisory guidance to encourage mortgage lenders and servicers to pursue prudent loan workouts. We continue to support industry-led efforts, especially those of HOPE NOW, in pursuing flexible approaches to stem the rise in foreclosures and to deal with their effects. Earlier this year, we embarked on a joint effort with NeighborWorks America on neighborhood stabilization to help communities develop strategies for addressing increases in foreclosures and vacant properties.

The Federal Reserve System is strategically utilizing its presence around the country through its regional Federal Reserve Banks and their branches to address foreclosures. Our history of working closely at the local level with communities enables us to tailor activities to the specific needs of that area. Our efforts have taken a variety of forms. We have employed economic research and analysis to target scarce resources to the communities most in need of assistance. We have provided community leaders with detailed analyses identifying neighborhoods at high risk of foreclosures. This information is helping local groups to better focus their borrower outreach and counseling efforts.

In addition, we have sponsored or supported a wide range of activities in local communities. For example, the Federal Reserve System has sponsored a series of "Recovery, Renewal, Rebuilding" forums in cities around the country in which key experts discussed the challenges related to real-estate owned inventories and vacant properties in strong and weak housing markets, and explored effective neighborhood stabilization policies. Four events were held in various parts of the country earlier this year, and the series concluded with a fifth meeting of experts this past Monday in Washington. This series is just an example of many events. All told, the Federal Reserve System has sponsored or co-sponsored more than 80 events related to foreclosures since last summer, reaching more than 6,000 attendees including lenders, counselors, community development specialists, and policymakers.

We also have supported events that bring together borrowers with counselors, lenders, and servicers. In August, the Federal Reserve Bank of Boston partnered with the HOPE NOW Alliance, NeighborWorks America, the Kraft family, and the New England Patriots Charitable Foundation, among many others, and held an event at Gillette Stadium. More than 2,100 borrowers seeking help attended. Twenty servicers and twenty non-profit counseling agencies took part, with staff at the event and on dedicated phone lines. Although we do not yet know the outcomes for these homeowners, we are monitoring the results and other Federal Reserve Banks are considering holding similar events.

In conclusion, the Federal Reserve has taken a range of actions to stabilize financial markets and to help borrowers and communities. Taken together, these measures should help rebuild confidence in the financial system, increase the liquidity of financial markets, and improve the ability of financial institutions to raise capital from private sources. Efforts to stem avoidable foreclosure and help borrowers through H4H and more aggressive modifications, as well as to develop effective strategies for dealing with foreclosed-upon properties, I believe, will also help homeowners and communities. These steps are important to help stabilize our financial institutions and the housing market, and will facilitate a return to more-normal functioning and extension of credit.