



Commentary

A 'Bankrupt' Financial System

A. Jay Cristol 03.07.09, 12:01 AM ET

Last week the House of Representatives postponed a vote on HR 200, "Helping Families Save Their Homes in Bankruptcy Act of 2009." If enacted, this legislation would allow as many as 1,200,000 homeowners to avoid foreclosure and save their homes.

But the financial crisis continues.

The genesis of the crisis is that the greed and stupidity of the banking and credit card industry ran wild without proper regulations. Nationalizing the banks has been suggested as a solution, but the negative aspects of a national banking bureaucracy weigh against this solution and render it a last resort.

Savings and loan associations, established in 1932, provided the means for more Americans to own their own homes than at any previous time in our history. Deposits were insured under federal law. Then congressional enactments and deregulation beginning in 1980 dismembered the associations and swept their business into the hands of greedy banks.

Re-establishment of these institutions would provide a means for home ownership through conventional 20-year fixed-rate mortgages. The savings and loan industry did have a problem, though, with depositors' right to withdraw their savings at any time. But using the associations as a vehicle for depositing 401(k) and IRA accounts--which are long-term deposits--would cure the short-term deposit problem. And it would provide individual retirement funds a safe depository and a satisfactory rate of return, while at the same time helping the housing industry and home buyers.

In days of yore, the 3-6-3 banker was one of the wealthiest individuals in town. He lived in a fine home, drove an expensive car, paid you 3% interest on your savings, charged you 6% interest on your loans and was on the golf course at his country club each afternoon at 3 p.m.

Old time 3-6-3 bankers underwrote loans. They evaluated the ability of the borrower to repay and essentially made loans that were repaid, assuring their profits, their good lifestyle and the success of their borrowers.

Sadly, the banking and credit card industry was permitted to create a new class of indentured servants out of our working class. With the government looking the other way, loan sharking became institutionalized in the U.S. On the fraudulent representation that they are democratizing credit, banks are charging interest rates vastly beyond the recognized 2% time value of money.

And credit card companies, owned by the banks, are charging 29% and 33% interest. While the banks claim they must do this because of increased risk, the higher rates become a self-fulfilling prophecy of failure. Borrowers cannot bear the weight, and loans that might have been repaid at a lower rate go into default.

Imagine: An 18-year-old purchases an iPod and accessories on a credit card for \$360. The buyer, who then pays the minimum payment of \$10 on time every month at 33% interest until he or she is 65 years old, will at that point have paid \$5,640 in interest--and will still owe the original \$360.

Federal Deposit Insurance Corp. Chair Sheila Bair has put forth some excellent ideas, but they aren't yet being implemented by banks and loan servicers.

They would be implemented, however, if Congress will enact them as law rather than hope these institutions will adopt them voluntarily. For it is Congress that should legislate limits on home mortgage loans and business loans. Congress should codify usury and limit interest rates to about 6% for individuals and 15% for business and commercial loans.

Further, there should be a law prohibiting the unsolicited offers of pre-approved credit via mass mailings to persons of unknown financial ability, including my deceased father-in-law, my two-year-old granddaughter and my friend's dog. It would only benefit an industry that has become more concerned with market share and stock prices on Wall Street than with the business in which they are engaged and the services they render.

The U.S. has led the world when it comes to reorganizing ailing businesses under Chapter 11 bankruptcy law. Until a few months ago, General Electric Capital provided more than half the lending nationwide for post-petition and exit financing in Chapter 11 cases.

Abruptly, though, GE stopped lending. The result? Many businesses capable of reorganization are being sold or liquidated rather than reorganized, with attendant loss of jobs and goods and services for the economy.

But the government is now making student loans directly to students, bypassing the banks. The same should be done for the businesses in Chapter 11 bankruptcy cases. This type of lending obtains primary or super-priority status over assets and need not be made without reasonable expectation of repayment in full. If made from stimulus funds, taxpayers could get back all their money plus a modest profit, and thousands of businesses and hundreds of thousands of jobs could be saved.

This is the time for Congress to put aside partisanship and act together to ameliorate the financial crisis.

A. Jay Cristol, an adjunct professor at the [University of Miami School of Law](#), is chief judge emeritus of the U.S. Bankruptcy Court in Miami.