# The Affordable Mortgage Depression

Government policies were designed to increase homeownership. Affordable Mortgages, created to realize this goal, were responsible for the Housing Bubble and distorted the economy. The unwinding of these distortions will result in a Global Depression.

## Origins of the Housing Bubble: The Riegle-Neal Act of 1994

### The Housing Bubble's Inception

The Riegle-Neal Interstate Banking and Branching Efficiency Act can arguably be identified as the origin of the Housing Bubble. I am not implying that Riegle-Neal was singularly responsible for the distortion, nor am I devaluing the impact of events that followed through 2005 which certainly contributed to the Bubble. This Act was only one component in a flurry of legislative activity which distorted the housing market for more than a decade, but this bill has the dubious distinction of being first.

Effective September 29, 1994, the Riegle-Neal Act was an overt and effective mechanism for forcing the U.S. banking system into providing credit to borrowers who did not merit it and would not have had access to it otherwise. The innocuous sounding stated purpose of the Act was:

***To amend the Bank Holding Company Act of 1956, the Revised Statutes of the United States, and the Federal Deposit Insurance Act to provide for interstate banking and branching.***

The relevant and distorting component of the Act was included within Section 109. (The amendment's text may be skipped or skimmed for the purpose of this article. Important excerpts are highlighted in red.)

**Sec. 109. PROHIBITION AGAINST DEPOSIT PRODUCTION OFFICES.**

(a) REGULATIONS
The appropriate Federal banking agencies shall prescribe uniform regulations effective June 1, 1997, which prohibit any out-of-State bank from using any authority to engage in interstate branching pursuant to this title, or any amendment made by this title to any other provision of law, primarily for the purpose of deposit production.

(b) GUIDELINES FOR MEETING CREDIT NEEDS
Regulations issued under subsection (a) shall include guidelines to ensure that interstate branches operated by an out-of-State bank in a host State are reasonably helping to meet the credit needs of the communities which the branches serve.

(c) LIMITATIONS ON OUT-OF-STATE LOANS
(1) LIMITATIONS -- Regulations issued under subsection (a) shall require that, beginning no earlier than 1 year after establishment or acquisition of an interstate branch or branches in a host State by an out-of-State bank, if the appropriate Federal banking agency for the out-of-State bank determines that… the bank's level of lending in the host State relative to the deposits from the host State (as reasonably determinable from available information including the agency's sampling of the bank's loan files during an examination or such data as is otherwise available) is less than half the average of total loans in the host State relative to total deposits from the host State (as determinable from relevant sources) for all banks the home State of which is such State--

A. the appropriate Federal banking agency for the out-of-State bank shall review the loan portfolio of the bank and determine whether the bank is reasonably helping to meet the credit needs of the communities served by the bank in the host State; and

B. if the agency determines that the out-of-State bank is not reasonably helping to meet those needs-

(i) the agency may order that an interstate branch or branches of such bank in the host State be closed unless the bank provides reasonable assurances to the satisfaction of the appropriate Federal banking agency that the bank has an acceptable plan that will reasonably help to meet the credit needs of the communities served by the bank in the host State, and {{8-31-00 p.7493}}

(ii) the out-of-State bank may not open a new interstate branch in the host State unless the bank

provides reasonable assurances to the satisfaction of the appropriate Federal banking agency that the bank will reasonably help to meet the credit needs of the community that the new branch will serve.
(2) CONSIDERATIONS -- In making a determination under paragraph (A), the appropriate Federal banking agency shall consider--

A. whether the interstate branch or branches of the out-of-State bank were formerly part of a failed or failing depository institution;

B. whether the interstate branch was acquired under circumstances where there was a low loan-to-deposit ratio because of the nature of the acquired institution's business or loan portfolio;

C. whether the interstate branch or branches of the out-of-State bank have a higher concentration of commercial or credit card lending, trust services, or other specialized activities;

D. the ratings received by the out-of-State bank under the Community Reinvestment Act of 1977;

### The Implications of the Riegel-Neal Act

What this Act accomplished was to force compliance with the Government's arbitrary requirement that the banking industry "help to meet the credit needs of the community". Any bank that existed, attempted to expand, aspired to acquire another bank or wanted to open a new branch outside of its home state had to comply with these regulations to the satisfaction of banking regulators. Community Reinvestment Act ratings received by out-of-state banks were used to determine whether to permit such interstate branches.

Helping to meet the credit needs of the community may sound like a noble plan but the implications of the Act were profound.

### A Fundamental Change in the Banking Regulatory Function

There is a good reason why the banking industry is tightly controlled and highly regulated. The disastrous bank panics of the Great Depression and the economic devastation which they wrought demonstrated the importance of a stable, sound and solvent banking system. To this end, the Federal Government insures consumer banking deposits through the FDIC. In exchange for the benefit of the Government's explicit guarantee of consumer deposits, the banking industry must comply with capital requirements, operating restrictions and curbs on growth to reduce and manage risk. For 60 years it was the responsibility of banking regulators to implement and monitor these important risk management mechanisms.

As of The Riegel-Neal Act of 1994 Congress changed the arrangement. Instead of acting to ensure the banking system's safety and solvency, Congress inappropriately used its influence over banks in an attempt to achieve the social agenda of increased homeownership. The responsibilities of banking regulators were amended to include the subjective goal of "helping to meet the credit needs of the community". It mattered not that these objectives were in direct opposition to one another.

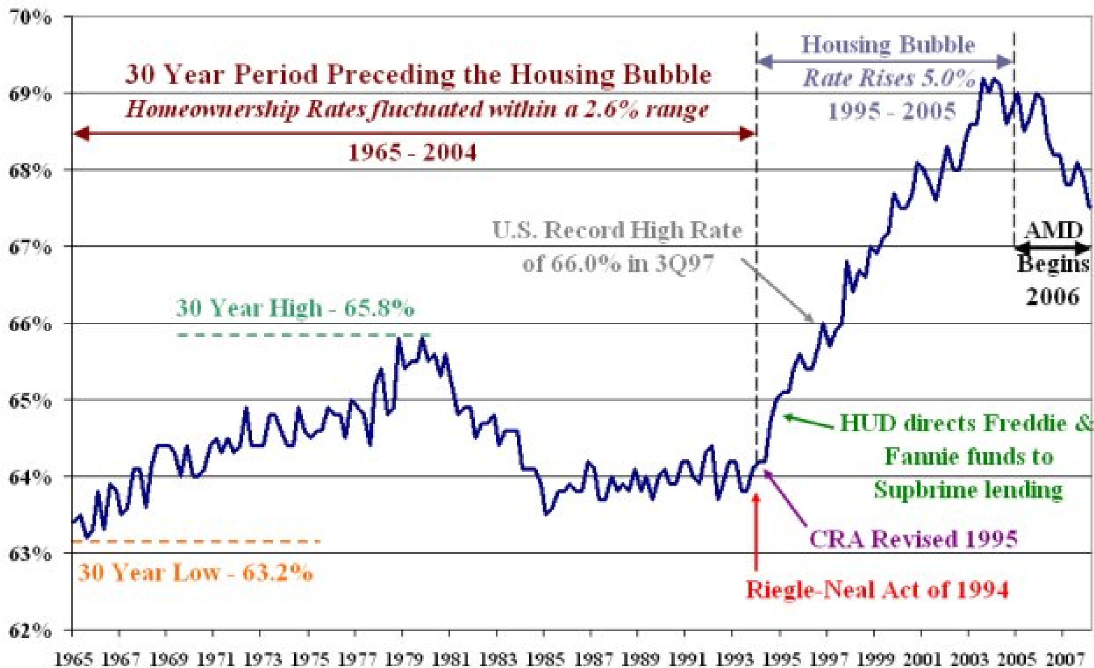
In order for a bank to exist or grow beyond its home state the institution was required to engage in the unsound, unwise and risky business of lending to people without adequate credit, capital, cash flow and collateral to qualify for such loans based on merit. Bank of America could operate based on sound banking practices in North Carolina, but if it wanted to operate in any other state it had to comply with Government directed community lending standards. And the regulators, previously responsible for the safety of the banking system, were used as the tool to force compliance.

### Origin of the Housing Bubble

It was not appropriate for the Federal Government to force banks to "meet the credit needs of the community", nor to define either what those needs were, or what fulfilling those needs would require. These are functions that have always been and should only be performed by the private sector.

At the direction of Congress, making risky loans to unqualified borrowers became a cost of doing business for the banking industry. The requirement for banks to operate in more than one state was compliance with politicians who had a social agenda in mind, not the safety and security of our banking system.

The Riegel-Neal Act was paired with other initiatives including legislation that revised the Community Reinvestment Act and HUD directives which forced Fannie Mae and Freddie Mac to allocate massive funding to Subprime loans. The distortionary impact of these Government initiatives, paired with historical data which clearly demonstrates homeownership rates responding dramatically to the altered mortgage environment, provides a clear understanding of the forces which originated the Housing Bubble.

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