2006 on Global Financial Crisis: Corporate Crime?

U.S. government bailout of between $7-$13 trillion to private financial institutions

Banks and Mortgage companies gave home loans to anyone.

Lenders would not ask for any verification about job, credit, assets

Lenders would not ask for a down payment

Lenders would try to put borrowers in most expensive homes at highest interest rate (more fees, higher interest)

Lenders would try to put borrowers in subprime mortgages even though they qualified for a better mortgage (committed fraud to do so).

Lenders would try to put borrowers in ARM and “option ARMs”

People gambled that the price of the house would increase and they could sell it before they were confronted with the consequences of the risk

Speculators entered the market, prices went up.

Housing prices skyrocketed as demand went up, money was cheap for banks and

brokers

Result:

A huge “bubble” was created, houses inflated, borrowers with risky mortgages,

huge fees and commissions but market flooded with bad debt.

Question: why would banks and mortgage companies engage in the practice of lending loans to people they knew wouldn’t or couldn’t pay?

Answer:

banks did not keep the mortgages

investment banks came up with the idea of putting mortgages in pools and turning them into securities,

bundled residential home mortgages, and sold them as investments (like stocks and bonds) to union funds, retirement funds, insurance companies, investment banks, commercial banks, hedge funds all over the world.

Next step: break up these pools into “tranches” and sell to outside investors. Tiering the mortgages into higher and lower rated securities. These are what are called derivatives.

They were able to sell them because the ratings agencies like Moody’s and Standard and Poors gave them the highest rating AAA and many funds, banks and insurance companies need a portfolio of AAA investments to protect depositors (apparently only regulation).

Example: GSAMP Trust 2006-S3: 8,274 mortgages (99% of mortgages, no down payment, and no equity, 58% “no-doc” or “low-doc.”) 2/3 given AAA rating

Even more, a third party, say a hedge fund, private investment pool, could buy insurance on the transaction even though they were not involved in the sales of the derivatives and even though they were not involved, and if the derivatives failed, they would collect on their insurance policy. (It is like if someone has terminal cancer and a third part found out and was able to buy life insurance on the person and collect when the person died.) This is called a naked credit default swap.

Question: How did they get away with this?

In 1999 legislation was passed, Gramm, Leach, Bliley that repealed Glass-Steagull, Depression-era legislation that outlawed the merger of commercial banks, investment banks, and insurance companies. Two reasons: keep from creating huge corporations that are too big to fail and avoiding conflicts of interest, especially between commercial banks and investment banks.

In 2000 the Commodities Futures Modernization Act was passed which deregulated derivatives, credit default swaps and foreign currency swaps.

(prior to the passage of the law, a 20 page paper submitted by the Chair of the Commodities Futures Board predicted everything that has happened and she was fired). Also prevented states from regulating.

Federal Reserve creating the belief that it would come to the rescue no matter what by printing more money and making it available at lower and lower interest rates.

Consequences:

Financial Corporations are bigger (used bailout money to buy smaller banks that failed because of the above, fired workers)

CEOs and high level managers are richer (used bailout money to pay bonuses, one of the architects of AIG Financial Products Division was getting one million a week)

Financial Corporations used money to successfully lobby against regulatory legislation like Dodd-Frank

Hedge Funds made billions through credit default swaps.

Between $7 trillion and $13 trillion (paying off every single subprime mortgage would have only cost $1.4 trillion).

Nothing created out of this, no new jobs, no new energy grid, no new mass transit, no new schools.

Millions lost their homes through continued fraud: “robo signing” and “high speed” courts.

Latest agreement between states and banks is another bailout to banks.

Who benefits? Who governs? Who wins?