

As watchdog warns of bailout fraud

Obama meets with bank, credit card executives

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President Barack Obama met Thursday at the White House with executives of major banks and credit card companies amidst growing public anger over sudden increases in interest rates and fees, in many cases by companies that have received billions of dollars in taxpayer bailout money.

Obama, who pledged during his presidential campaign to curb abuses by credit card firms, was silent on the issue until last week, when media reports emerged detailing how firms were doubling and tripling their charges to customers, including those with good credit who had remained current on their payments.

These reports coincide with others showing that banks that have received cash, cheap loans and debt guarantees from the \$700 billion Troubled Asset Relief Program (TARP) and other government programs are ramping up home foreclosures while continuing to reduce lending. First the Bush and now the Obama administration have defended the transfer of public funds to Wall Street as the only means of ending the credit crunch and resulting recession.

Trillions have been pumped into the banks, but the recession has deepened, unemployment has soared and millions of people have been thrown into poverty and homelessness. The banks have used the bailout money to bolster their balance sheets and generate profits by speculating on turbulent financial markets and by finding ways to cash in on the collapse in home prices. They have intensified their assault on the working class, slashing hundreds of thousands of jobs, driving people out of their homes and raising the cost of credit upon which most Americans depend to pay their bills.

They adamantly oppose even the most modest restrictions on their activities, including certain limits on executive compensation, enhanced power of bankruptcy courts to alter mortgage terms for distressed homeowners, and laws that would restrict their ability to arbitrarily increase charges on credit card holders.

Obama's White House meeting was typical of his public relations efforts to placate public opposition while taking no serious measures to rein in the banks. Participants, besides Obama and his top economic aides, included executives from Bank of America, JPMorgan Chase, Citigroup, Wells Fargo, US Bancorp, Visa, Mastercard, Capitol One Financial, American Express, Discover Financial Services and several other firms. Also present was the president of the American Bankers Association, which is lobbying against congressional bills that would curb abuses by credit card issuers.

Following the closed-door meeting, Obama told reporters, "We're confident we can arrive at something that is commonsensical."

Seeking to reassure the bankers, he added, "We want to preserve the credit card market but we also want to do so in a way that eliminates some of the abuses and some of the problems that a lot of people are familiar with." He did not say which abuses would be allowed to continue.

One indication of the seriousness of the administration's effort was provided by Lawrence Summers, the director of the White House's National Economic Council. According to reporters, he dozed off during Obama's brief remarks to the press.

Executives leaving the meeting said it was "constructive." They are confident that they will succeed in blocking passage of a bill, dubbed the "Credit Cardholders' Bill of Rights," that is moving through Congress. On Wednesday the bill was approved by the House Financial Services Committee, but a Senate version is opposed by Republicans on a party-line basis and by some Democrats, all but insuring its defeat.

The banks and credit card companies maintain that legislation is not necessary since the Federal Reserve has already announced restrictions on interest charges and fees. However, those regulations are not slated to take effect until July of 2010, giving the banks ample time to ramp up charges in advance of the new rules.

Earlier on Thursday, the special inspector general appointed to monitor the TARP program testified before the Joint Economic Committee of Congress and indicated that the bailout program is rife with conflicts of interest and fraud.

Neil Barofsky, a former prosecutor, told the panel that he had already initiated 20 criminal investigations into securities fraud, insider trading, collusion, price-fixing, money laundering and other illegal activities in relation to the government bailout. He suggested that there would be many more probes.

On Monday, Barofsky released a 250-page report to Congress on the TARP program in which he decried the refusal of the Treasury Department, despite his repeated urgings, to require firms that receive taxpayer handouts to report on how they are using the government money. He noted that the Obama administration has signed off on another \$30 billion for the insurance giant American International Group (AIG), which had already received some \$150 billion, without any requirement that the company explain what it has done with its bailout money.

The TARP program, he wrote, which began as a \$700 billion plan to purchase toxic assets from the banks, has morphed into twelve separate programs involving more than \$3 trillion in government cash, loans and loan guarantees—an amount roughly equal to the annual

federal budget.

In his report and in his congressional testimony, Barofsky focused on the new bailout program detailed on March 24 by Treasury Secretary Timothy Geithner. He warned that the “Public-Private Investment Program” (PPIP), under which Wall Street investment firms will be given low-cost government loans and guarantees against losses to purchase toxic assets from the banks at inflated prices, was “inherently vulnerable to fraud, waste and abuse.”

He said that the program, which is to be run by the private firms, with between two-thirds and 92.5 percent of the funding provided by the government, had “significant issues relating to conflicts of interest facing fund managers, collusion between participants, and vulnerabilities to money laundering.” He urged that the program not go forward without the addition of serious safeguards against fraud.

In his testimony before the Joint Economic Committee, Barofsky said that the program was designed so as to allow the private fund managers to set the price for the securities purchased from the banks. “This is a lot of economic power given to a small number of fund managers,” he said. He pointed out that fund managers would likely be buying the same mortgage-backed securities they had in other accounts, giving them an incentive to pay inflated prices and thereby increase the value of their previous investments, which they could subsequently unload at a huge profit.

“The banks will also make a huge profit,” he said. “And when the securities go back to their real market price, the taxpayer will pay the loss.”

He also warned that the incorporation of the Federal Reserve’s Term Asset-Backed Securities Loan Facility (TALF) into the Public-Private Investment Program added another level of potential fraud. Investment firms running Public-Private funds would be able to borrow additional money under the TALF program.

That program, using \$80 billion in TARP funds to leverage \$1 trillion in Fed loans, was initially designed to subsidize the issuing of new securities backed by consumer loans. Now it is to be used to subsidize the purchase of existing toxic asset-backed securities on the banks’ books.

He decried the fact that the Federal Reserve was relying on credit rating agencies to rate the toxic assets to be purchased under TALF and the PPIP, noting that the same agencies had contributed to the financial collapse by giving dubious mortgage-backed securities their highest rating.

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In effect, he suggested, the program would enable the banks to offload the worst of their bad debts, generating massive profits for Wall Street and huge taxpayer losses.

Asked at the hearing whether there were any provisions in the TARP bill passed last October that required banks to report on their use of bailout money, he said, “No.” Without fundamental changes in the structure and management of the bailout programs, he said, there would be “potentially catastrophic taxpayer losses.”

Barofsky was asked about a report published that morning by the *Wall Street Journal* citing testimony by Bank of America CEO Kenneth Lewis that Federal Reserve Chairman Ben Bernanke and then-Treasury Secretary Henry Paulson pressured him to conceal the dire financial position of Merrill Lynch last September, when the Bush administration engineered the takeover of the investment bank by Bank of America. Merrill Lynch lost more than \$15 billion in the fourth quarter of 2008, liabilities that led to a government bailout of

Bank of America last December.

Barofsky said that his office was investigating the Bank of America takeover of Merrill. He listed six audits he was conducting, including, besides the Bank of America deal, the use of bailout funds, compliance with executive compensation limits, external influences, AIG executive bonuses, and AIG counterparty payments.

The latter concerns the fact that AIG has used its government bailout funds to pay off banks and other firms that had entered into credit default swaps with the insurance giant at 100 percent of the face value of the deals, rather than forcing its counterparties to accept reduced payments.

One such deal that is ripe for criminal investigation involves Goldman Sachs, former Treasury Secretary Paulson and the current CEO of AIG, Edward Liddy. It has emerged that Paulson, who was CEO of Goldman before becoming treasury secretary under Bush, designed the AIG rescue so as to allow AIG to funnel \$13 billion in bailout money to his former bank. He picked Liddy, a former board member of Goldman, to become the new CEO of AIG. Liddy, meanwhile, retains an investment of more than \$3 million in Goldman Sachs.

Obama’s treasury secretary, Geithner, was president of the Federal Reserve Bank of New York at the time and played a critical role in designing and implementing the TARP program and the bailout of AIG. That neither he, nor Obama, nor the Democratic-controlled Congress has any intention of implementing the changes proposed by Barofsky was underscored by Geithner’s testimony Tuesday before the Congressional Oversight Committee for TARP.

Although Geithner’s appearance occurred the day after Barofsky released his report to Congress and the day it was released to the public, none of the committee members raised it. Geithner, for his part, announced that the “vast majority” of banks were more than adequately capitalized, stressed that banks shown to need more capital by government “stress tests” would have many options for raising money, in addition to government purchases of their stock, and warned Congress against placing new requirements on bailed out firms.

His testimony was taken as a pledge that the Obama administration would continue to run interference for Wall Street and shield the wealth of the financial elite. It sparked a 127.8 point rise in the Dow, with bank stocks recording double-digit gains for the day.



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