Investment firms, New York Fed demand Bank of America buy back mortgages

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Some of the most powerful Wall Street investment firms, together with the New York Federal Reserve Bank, on Tuesday took the initial step toward launching legal proceedings aimed at forcing Bank of America to buy back as much as $47 billion in mortgage-backed securities.

The investors, who together control 25 percent of the voting rights for the securities, say that Countrywide Financial, now owed by Bank of America, misrepresented the quality of the securities when it sold them. They further claim that Countrywide has not made good on its obligations to the debt holders by taking too long to foreclose on properties and failing to keep proper records.

The investors' group includes the bond giant Pimco and the investment management firm BlackRock.

Documents for many of the mortgages, which were being churned out in assembly-line fashion at the height of the real estate frenzy, are either missing or never existed in the first place.

Analysts expect banks to take even further losses from repurchasing toxic mortgage-backed securities. The US banking industry may lose between $55 and $120 billion, according to a study issued October 15 by JP Morgan Chase.

The New York Federal Reserve Bank holds $16 billion of mortgage-backed securities acquired in its 2008 bailout of the investment bank Bear Stearns and the insurance giant American International Group (AIG).

Over the past month, numerous investigations have revealed that the largest banks and finance companies disregarded legal requirements in processing foreclosures and moving to evict homeowners and seize their houses.

The announcement of the firms' letter, together with Bank of America's disclosure of a third-quarter loss of $7.4 billion, contributed to a sharp stock sell-off Tuesday, with Bank of America shares falling 4 percent.

Bank of America acquired Countrywide Financial, the largest US issuer of home mortgages, at the height of the financial crisis, when the latter was on the verge of collapse. Countrywide was among the leading issuers of subprime loans and was among the first of the major financial firms to be shattered by the financial crisis.

The law firm for the investment companies and the New York Fed, Gibbs & Bruns LLP, sent the Bank of America a "notice of nonperformance" concerning $47 billion in residential mortgage-backed securities issued by Countrywide prior to the mortgage meltdown. The issuing of the letter gives Bank of America 60 days to redress the group's grievances before the group presses on with a lawsuit. The letter "begins the clock ticking" on legal action, according to Kathy Patrick, a partner at the law firm.

Patrick told CNBC, "There were representations made to my bond holders when they purchased these securities. They are contractual representations about the credit quality of these mortgages... and my clients are concerned... that the mortgages in question did not, at the time they were securitized, conform to those representations."

As the law firm's press release puts it, "[The letter] urges the Trustee [New York Mellon Bank] to enforce Countrywide Servicing's obligations to service loans prudently by maintaining accurate loan records, demanding the repurchase of loans that were originated in violation of underwriting guidelines, and compelling the sellers of ineligible or predatory mortgages to bear the costs of modifying them for homeowners or repurchasing them from the Trusts' collateral pools."

Bank of America rejected the charges Tuesday morning, saying, "We're not responsible for the poor performance of loans as a result of a bad economy. We don't believe we've breached our obligations as servicer." The company said that it will "vigorously defend" itself against the allegations.

The issue boils down to a dispute between the issuers of mortgage-backed securities—who made huge amounts of money by re-selling dubious mortgages as securities—and the financial companies that bought the bonds. At the height of the real estate bubble, companies like Pimco were as happy to buy subprime mortgage-backed debt as companies like Countrywide were to issue it.

But now that real estate values have collapsed, foreclosures continue to mount and mortgage-backed securities have lost most of their value, the companies are fighting among themselves over who is going to absorb the losses.

As the *Financial Times* put it: "We are now dealing with the tail-end of the subprime crisis—or the rash of pre-credit crisis greed that led many to sloppily securitise, or hastened them towards paperwork shortcuts, or to buy into 'blemished' loans in the first place… So expect continued rising tension between different players in mortgage securitizations—servicers, trustees, investors, etc."

The financial press has for weeks been writing about rising tensions between the various firms involved in subprime mortgages. But the recent revelations of widespread fraud in the processing of foreclosures has provided debt holders an opportune occasion to press their case for further compensation. "I'm sure the law firm issued the letter now because the issue of foreclosures is in the current news cycle," said Kevin Heine, a spokesman for New York Mellon, the trustee for the $47 billion in bonds that are in dispute.

Whatever the result of the present negotiations, the episode underscores the fraudulent nature of the subprime lending that fueled the real estate bubble. Lenders' lack of proper documentation is inseparable from the lack of lending standards and the frenzied speculation and parasitism by means of which Wall Street made huge profits in the pre-crash period.

None of the major financial players, whose greed and recklessness played a major role in crashing the financial system and sparking the deepest slump since the Great Depression, are being held accountable. Earlier this week, the Securities and Exchange Commission announced a deal with former Countrywide CEO Angelo Mozilo to settle fraud and insider trading charges and avoid a civil trial. In sidestepping a trial, the Obama administration acted to block embarrassing and possibly incriminating information about the machinations of Wall Street from reaching the general public.

Mozilo, who made over $460 million as Countrywide CEO during the housing bubble, was fined $67.5 million, two thirds of which will be paid by Bank of America.