Regulator says banks lied about assets sold to Fannie Mae and Freddie Mac

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The federal agency overseeing Fannie Mae and Freddie Mac, the government-sponsored mortgage companies, filed a lawsuit Friday against 17 of the world's largest banks, alleging that they lied about the quality of mortgage-backed securities they sold to Fannie and Freddie.

The lawsuit, which was filed on both the federal and state levels, is the most sweeping case to date against the major perpetrators of the mortgage-backed securities fraud that triggered the financial meltdown of 2008 and subsequent recession.

The Federal Housing Finance Agency (FHFA) claims that losses incurred by Fannie Mae and Freddie Mac during the crisis were partly due to misrepresentations by the banks about the real value of the mortgage-backed securities they sold to Fannie and Freddie.

The agency said that the banks violated "federal securities laws and common law in the sale of residential private-label mortgage-backed securities" to Fannie Mae and Freddie Mac. Complaints against some of the firms also allege "state securities law violations" and "common law fraud."

The accused banks include Bank of America, Citigroup, Goldman Sachs and JPMorgan Chase, as well as European banks such as Société Générale and Deutsche Bank.

The agency's claim stated that "the loans had different and more risky characteristics than the descriptions contained in the marketing and sales materials provided" to Fannie and Freddie by the banks.

It adds that the banks "falsely represented that the underlying mortgage loans complied with certain underwriting guidelines and standards, including representations that significantly overstated the ability of the borrowers to repay their mortgage loans."

The court documents claim that the total value of mortgage-backed securities sold to Fannie and Freddie by these companies was $200 billion, of which Bank of America and the companies it acquired sold $57 billion, JPMorgan Chase sold $33 billion, Goldman Sachs sold $11 billion and Morgan Stanley sold $10 billion.

The regulator announced the lawsuit after stock trading ended Friday, but rumors of an impending government action sent bank shares down. Bank of America fell by 8.3 percent, and Goldman Sachs and JPMorgan Chase each dropped over four percent.

While the total damages sought by the agency have not yet been announced, commentators estimated that the claim would be in the range of $40 billion.

The rescue of Fannie Mae and Freddie Mac required $153 billion in taxpayer funds, and the ultimate cost could be double that, according to government estimates.

While the banks have largely paid back the money given to them through the so-called "Troubled Asset Relief Program," TARP was only one element of the vast Treasury bailout of Wall Street. The rescue of Fannie and Freddie has been one of the dozens of ways that taxpayers were left to foot the bill for the banks' fraudulent activities.

Many of the securities in question were based on subprime mortgages that Fannie and Freddie were not permitted to buy directly. They did, however, purchase highly rated mortgage-backed securities from the banks, nominally under the assumption that their high credit rating made them financially safe. In reality, the mortgages on which the securities were based were issued to borrowers who would never be able to pay them.

Fannie and Freddie were placed under the conservatorship of the FHFA on September 6, 2008.

Under the law authorizing the move, the FHFA was given a three-year statute of limitations, which expires Wednesday, to file any civil lawsuits in relationship to the mortgage crisis.

The filing echoes the claims made by the Senate Permanent Subcommittee on Investigations report issued in April. The Senate committee report claimed that banks systematically lied to investors about the real value of mortgage-backed securities that they bundled and resold.

The FHFA filing comes amid discussion over a settlement over the so-called "robo-signing" of mortgages. After the collapse of 2008, the major banks falsified mortgage documents to speed up foreclosures. The major banks are currently working out a settlement with state attorneys general, valued at around $20 billion.

The Obama Administration intervened to back the settlement, which New York Attorney General Eric T. Schneiderman has claimed grossly undervalues the damage done to homeowners. (See here)

The Senate Permanent Subcommittee report chronicles dozens of other smaller-scale, though equally egregious, crimes on the part of the banks. Most prominently, in 2007, Goldman Sachs had hedge fund manager John Paulson pick the contents of mortgage-backed securities sold to investors, which he then proceeded to bet against, making a billion dollars as a result. In 2010, Goldman Sachs agreed to pay $550 million to settle a civil indictment by the Securities and Exchange Commission in relation to the transaction.

The compensation being sought by the FHFA and Attorneys General totals to at most a few tens of billions of dollars, of which only a fraction is likely to be paid.

But even the figure of $40 billion is tiny compared to the trillions of dollars in public losses and economic damaged caused by the crisis, and a minuscule portion of the hundreds of billions in profits and executive pay generated by the major banks every year.

Whatever is agreed to between the banks and the government agencies, the settlement payments will amount to "hush money." The proposed mortgage document fraud settlement entails clauses that prevent future lawsuits on the issue, and similar provisions will no doubt be worked into any settlement between the FHFA and the banks.

In fact, the most likely outcome of the Fannie and Freddie case, judging from previous suits filed against former Countrywide Financial CEO Angelo Mozilo and Goldman Sachs, is an out-of-court settlement that avoids a public trial. The ultimate aim—expressed most clearly by the Obama Administration in its support of the "robo-signing" settlement—is to block any avenue for criminal prosecution of bank executives.

This demonstrates the state of class relations in American society. The banks are immune to prosecution for their crimes because their executives and millionaire shareholders control political life. The trial is a formality, giving the banks a financial slap on the wrist for crimes resulting in the impoverishment and suffering of millions of people.