ForeclosureGate Could Force Bank Nationalization

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For two years, politicians have danced around the nationalization issue, but ForeclosureGate may be the last straw. The megabanks are too big to fail, but they aren't too big to reorganize as federal institutions serving the public interest.

In January 2009, only a week into Obama's presidency, David Sanger reported in *The New York Times* that nationalizing the banks was being discussed. Privately, the Obama economic team was conceding that more taxpayer money was going to be needed to shore up the banks. When asked whether nationalization was a good idea, House speaker Nancy Pelosi replied:

"Well, whatever you want to call it . . . . If we are strengthening them, then the American people should get some of the upside of that strengthening. Some people call that nationalization.

"I'm not talking about total ownership," she quickly cautioned — stopping herself by posing a question: "Would we have ever thought we would see the day when we'd be using that terminology? 'Nationalization of the banks?' "

Noted Matthew Rothschild in a March 2009 editorial:

[T]hat's the problem today. The word "nationalization" shuts off the debate. Never mind that Britain, facing the same crisis we are, just nationalized the Bank of Scotland. Never mind that Ronald Reagan himself considered such an option during a global banking crisis in the early 1980s.

Although nationalization sounds like socialism, it is actually what is supposed to happen under our capitalist system when a major bank goes bankrupt. The bank is put into receivership under the FDIC, which takes it over.

What fits the socialist label more, in fact, is the TARP bank bailout, sometimes called "welfare for the rich." The banks' losses and risks have been socialized but the profits have not. The bankers have been feasting on our dime without sharing the spread.

And that was before ForeclosureGate – the uncovering of massive fraud in the foreclosure process. Investors are now suing to put defective loans back on bank balance sheets. If they win, the banks will be hopelessly under water.

"The unraveling of the '***foreclosure–gate'*** could mean **banking crisis 2.0**," warned economist Dian Chu on October 21, 2010.

Banking Crisis 2.0 Means TARP II

The significance of ForeclosureGate is being downplayed in the media, but independent analysts warn that it could be the tsunami that takes the big players down.

John Lekas, senior portfolio manager of the Leader Short Term Bond Fund, said on *The Street* on November 2, 2010, that the banks will prevail in the lawsuits brought by investors. The paperwork issues, he said, are just "technical mumbo jumbo;" there is no way to unwind years of complex paperwork and securitizations.

But Yves Smith, writing in *The New York Times* on October 30, says it's not that easy:

The banks and other players in the securitization industry now seem to be looking to Congress to snap its fingers to make the whole problem go away, preferably with a law that relieves them of liability for their bad behavior. But any such legislative fiat would bulldoze regions of state laws on real estate and trusts, not to mention the Uniform Commercial Code. A challenge on constitutional grounds would be inevitable.

Asking for Congress's help would also require the banks to tacitly admit that they routinely broke their own contracts and made misrepresentations to investors in their Securities and Exchange Commission filings. Would Congress dare shield them from well-deserved litigation when the banks themselves use every minor customer deviation from incomprehensible contracts as an excuse to charge a fee?

Chris Whalen of Institutional Risk Analytics told *Fox Business News* on October 1 that the government needs to restructure the largest banks. "Restructuring" in this context means bankruptcy receivership. "You can't prevent it," said Whalen. "We've wasted two years, and haven't restructured the top banks, but for Citi. Bank of America will need to be restructured; this isn't about the documentation problem, this is because [of the high] cost of servicing the property."

Profs. William Black and Randall Wray are calling for receivership for another reason — the industry has engaged in flagrant, widespread fraud. "***There was fraud at every step in the home finance food chain," they wrote in the Huffington Post*** on October 25:

[T]he appraisers were paid to overvalue real estate; mortgage brokers were paid to induce borrowers to accept loan terms they could not possibly afford; loan applications overstated the borrowers' incomes; speculators lied when they claimed that six different homes were their principal dwelling; mortgage securitizers made false reps and warranties about the quality of the packaged loans; credit ratings agencies were overpaid to overrate the securities sold on to investors; and investment banks stuffed collateralized debt obligations with toxic securities that were handpicked by hedge fund managers to ensure they would self destruct.

Players all down the line were able to game the system, suggesting there is something radically wrong not just with the players but with the system itself. Would it be sufficient just to throw the culprits in jail? And which culprits? One reason there have been so few arrests to date is that "everyone was doing it." Virtually the whole securitized mortgage industry might have to be put behind bars.

The Need for Permanent Reform

The Kanjorski amendment to the Banking Reform Bill passed in July allows federal regulators to preemptively break up large financial institutions that pose a threat to U.S. financial or economic stability. In the financial crises of the 1930s and 1980s, the banks were purged of their toxic miscreations and delivered back to private owners, who proceeded to engage in the same sorts of chicanery all over again. It could be time to take the next logical step and nationalize not just the losses but the banks themselves, and not just temporarily but permanently.

The logic of that sort of reform was addressed by Willem Buiter, chief economist of Citigroup and formerly a member of the Bank of England's Monetary Policy Committee, in *The Financial Times* following the bailout of AIG in September 2008. He wrote:

If financial behemoths like AIG are too large and/or too interconnected to fail but not too smart to get themselves into situations where they need to be bailed out, then what is the case for letting private firms engage in such kinds of activities in the first place?

Is the reality of the modern, transactions-oriented model of financial capitalism indeed that large private firms make enormous private profits when the going is good and get bailed out and taken into temporary public ownership when the going gets bad, with the tax payer taking the risk and the losses?

If so, then why not keep these activities in permanent public ownership? *There is a long-standing argument that there is no real case for private ownership of deposit-taking banking institutions, because these cannot exist safely without a deposit guarantee and/or lender of last resort facilities, that are ultimately underwritten by the taxpayer*.

Even where private deposit insurance exists, this is only sufficient to handle bank runs on a subset of the banks in the system. Private banks collectively cannot self-insure against a generalised run on the banks. *Once the state underwrites the deposits or makes alternative funding available as lender of last resort, deposit-based banking is a license to print money*. [Emphasis added.]

Nearly all money today is created as bank credit or debt. (That includes the money created by the Federal Reserve, a bank, and lent to the federal government when it buys federal securities.) Credit or debt is simply a legal agreements to pay in the future. Legal agreements are properly overseen by the judiciary, a branch of government. Perhaps it is time to make banking a fourth branch of government.

That probably won't happen any time soon, but in the meantime we can try a few experiments in public banking, beginning with the Bank of America, predicted to be the first of the behemoths to be put into receivership.

Leo Panitch, Canada Research Chair in comparative political economy at York University, wrote in *The Globe and Mail* in December 2009 that "there has long been a strong case for turning the banks into a public utility, given that they can't exist in complex modern society without states guaranteeing their deposits and central banks constantly acting as lenders of last resort."

Nationalization Is Looking Better

David Sanger wrote in *The New York Times* in January 2009:

Mr. Obama's advisers say they are acutely aware that if the government is perceived as running the banks, the administration would come under enormous political pressure to halt foreclosures or lend money to ailing projects in cities or states with powerful constituencies, which could imperil the effort to steer the banks away from the cliff. "The nightmare scenarios are endless," one of the administration's senior officials said.

Today, that scenario is looking less like a nightmare and more like relief. Calls have been made for a national moratorium on foreclosures. If the banks were nationalized, the government could move to restructure the mortgages, perhaps at subsidized rates.

Lending money to ailing projects in cities and states is also sounding rather promising. Despite massive bailouts by the taxpayers and the Fed, the banks are still not lending to local governments, local businesses or consumers. Matthew Rothschild, writing in March 2009, quoted Robert Pollin, professor of economics at the University of Massachusetts at Amherst:

"Relative to a year ago, lending in the U.S. economy is down an astonishing 90 percent. The government needs to take over the banks now, and force them to start lending."

When the private sector fails, the public sector needs to step in. Under public ownership, wrote Nobel Prize winner Joseph Stiglitz in January 2009, "the incentives of the banks can be aligned better with those of the country. And it is in the national interest that prudent lending be restarted."

For a model, Congress can look to the nation's only state-owned bank, the Bank of North Dakota. The 91-year-old BND has served its community well. As of March 2010, North Dakota was the only state boasting a budget surplus; it had the lowest default rate in the country; it had the lowest unemployment rate in the country; and it had received a 2009 dividend from the BND of $58.1 million, quite a large sum for a sparsely populated state.

For our newly-elected Congress, the only alternative may be to start budgeting for TARP II.

Ellen Brown *is an attorney and the author of eleven books. In Web of Debt: The Shocking Truth About Our Money System and How We Can Break Free, she shows how the Federal Reserve and "the money trust" have usurped the power to create money from the people themselves, and how we the people can get it back. Her websites are webofdebt.com, ellenbrown.com, and public-banking.com.*

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