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Skimming Profits Off Bad Loans: Bankers And Their Dirty Tricks

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Global Research, September 29, 2012
Counterpunch

Region: USA
Theme: Global Economy

Didn't Ben Bernanke promise that another round of bond purchases would lower unemployment and boost economic growth?

We think he did, which is why we're wondering why all the benefits from QE3 appear to be going to the banks. According to Bloomberg News:

> "The Federal Reserve's latest mortgage bond purchases so far are helping profit margins at lenders including Wells Fargo & Co. (WFC) and JPMorgan Chase & Co. (JPM) more than homebuyers and property owners looking to refinance…Since the Fed's Sept. 13 announcement that it would buy $40 billion more securities per month, the rates offered for new 30- year loans have fallen by just 0.11 percentage point, compared with a drop of more than 0.6 percentage point for yields on the bonds into which the loans get packaged." ("Fed Helps Lenders' Profit More Than Homebuyers:Mortgages", Bloomberg)

Well, how do you like that? That means that Mr. Bernanke's trickle down monetary theories aren't really working at all. Instead of the savings being passed along to homeowners in the form of lower rates, the banks are juicing profits by taking a bigger share for themselves. Who could have known?

Keep in mind, that Bernanke is not some madcap scientist who doesn't fully grasp how QE works. That's not it at all, in fact, he's considered one of the world's foremost authorities on the topic and has written extensively on Japan's deflationary woes and their "broken channels of monetary transmission", which is shorthand for saying that loading the banks with trillions of dollars in reserves won't do a blasted thing except pump a little ether into stock prices. (which it has done in the last 2 rounds of easing) So, Bernanke's been down this road before. He knows what QE will do and what it won't do, which is why he instructed members from the Bank of Japan (BOJ) to implement fiscal-monetary policies that would have a chance of succeeding. His advice was: "BOJ purchases of government debt could support spending programs, to facilitate industrial restructuring."

Now there's an idea. Have the Fed buy the bonds that pay for the programs that put people back to work. Brilliant! Once the new workers get their weekly paycheck, it's off to the grocery store, the gas station, the mall etc. Spending increases, state revenues soar, and the economy clicks back into high-gear. Simple, right? So, why are we still fiddling with this crackpot QE-circlejerk that does nothing but line the pockets of crooked bankers? That's the question.

In theory, quantitative easing is supposed to lower interest rates and spur investment. That boosts activity and reduces joblessness. But according to a survey conducted by Duke University, the CFO's of 887 large companies found that lower interest rates wouldn't really effect their decisions. Here's a summary:

According to the Duke University analysts:

> "CFOs believe that … monetary action would not be particularly effective. Ninety-one percent of firms say they would not change their investment plans even if interest rates dropped by 1 percent, and 84 percent said they would not change investment plans if interest rates dropped by 2 percent.("Currency war warnings follow US Fed's "quantitative easing", Nick Beams, World Socialist Web Site)

Of course it won't change their investment plans, because what businessmen care about is demand. Who's going to buy their bloody widgets, that's what matters to them, not interest rates. Right now, there's no demand for more widgets because unemployment is high, wages are flatlining, and policymakers have turned off the fiscal stimulus-spigot in an effort to shrink the economy so they can pursue their lunatic idea of dismantling public services and social programs. (mainly Medicare, Medicaid, and Social Security, the "real targets.")

The point is, spending has to increase to get the economy off the canvas, and the only party that has money to spend is the government. So, Obama should be spending like crazy. The Central Bank cannot fix this problem with its wacko printing spree.

So, what else are the banks up to besides keeping rates elevated so they can make a bigger killing on refis?

Well, for one thing, they're using their high-powered attorneys and lobbyists to twist arms at the Federal Housing Finance Agency (FHFA) to make it easier for them to make bad loans without suffering any consequences.

How can that be, after all, wasn't it bad loans that got us into this mess to begin with?

Yes, it was. Even so, the banks are back at it again, up to their same old tricks. Here's the story from Reuters:

> "Just four years after toxic U.S. mortgages brought the global financial system to its knees and triggered the deepest recession since the Great Depression, a U.S. housing regulator may be making it easier for banks to make bad loans without suffering losses.The Federal Housing Finance Agency released a little-noticed rule last week that makes it harder for Fannie Mae (FNMA.OB) and Freddie Mac (FMCC.OB) – the government-owned companies that guarantee home loans made by banks – to hold lenders accountable when mortgages go bad.Some experts said the new rules show that lessons of the housing crisis are already being forgotten, and could set up taxpayers for tens of billions of dollars of losses if the lending bubble re-inflates later in the credit cycle.At issue is when Fannie Mae and Freddie Mac can press banks to make them whole when mortgages go bad." ("Housing regulators loosen rules, but at what cost?", Reuters)

Can you believe it? The FHFA is actually accepting responsibility for mortgages where the underwriting was either shoddy or fraudulent. This is the kind of power the banks have. The agency is also assuring that the banks will create more of these garbage loans now that they know that Uncle Sam will be picking up the tab. That's what you call "bad incentives"! Up to now, the FHFA had been able to force the banks to repurchase the loans that showed "substantive underwriting and documentation deficiencies". But that's not going to happen anymore. The looser rules mean that the banks will return to their old ways and that future losses to taxpayers will tally in the hundreds of billions of dollars. According to Joseph Mason, a professor at Louisiana State University's business school, "Fannie Mae and Freddie Mac could lose even more than they did this time around." (Fannie and Freddie have already cost taxpayers $188 billion)

To repeat, the banks had changed their behavior because they were afraid of having to repurchase the dodgy loans they originated. (These returned mortgages are called "put-backs") Now the rules are being tweaked so the banks can shrug off the bad loans for which they are alone responsible. Here's more from the National Association of Realtors:

> "The federal government is taking steps to ease a problem lenders have been complaining about for several years, and that's the buy-back risk they face if they underwrite a federally backed loan that goes bad and the guarantor of the loan—whether FHA, Fannie Mae or Freddie Mac—determines that the loan was never underwritten in compliance with their "representation and warranty" requirements…….lenders remain concerned about the risk they face, and in fact earlier this year, in February, Bank of America announced it would stop selling loans to Fannie Mae because of its concerns over the company's buy-back policies. ("FHFA Gives Banks Reason to Revisit Overlays", National Association of Realtors)

So B of A is threatening to "stop selling loans to Fannie Mae"? Hurt me some more.

What's more important, is that the regulators had fixed this problem by imposing penalties on the lenders, but now they've backtracked and undone their progress. Now it's business as usual where the taxpayer-pinata get's clobbered with more toxic loans. Oh good.

And that's not all the banks are up to. They're also fighting "risk retention" rules because they don't want to pony-up the small amount of capital (5 percent of the loan's value) on high-risk mortgages that go into securitizations. It's like an insurance company refusing to keep money on hand to pay off claims. If you think that's fair, then you should probably be a banker. Now get a load of this excerpt from a "Letter to Bernanke on QE3″ from Moe Veissi, president of the National Association of Realtors:

> "Reducing mortgage interest rates in general through MBS purchases will have diminished impact if three important rules counter the availability of mortgage credit. As you have noted, mortgage credit is already tight. A recent survey of NAR members indicates that 53 percent of loans in August went to borrowers with credit scores over 740. To put this in perspective, only 41 percent of loans backed by Fannie Mae in 2001 had scores above 740. If the forthcoming Ability to Repay/Qualified Mortgage (QM), Risk Retention/Qualified Residential Mortgage (QRM), and Basel III rules only serve to further tighten credit, the impact of QE3 is likely to be diminished and only felt among those of substantial wealth and pristine credit. In short, those who need access to affordable credit the least.While the Federal Reserve (The Fed) is no longer the purveyor of the QM rule, we believe there is still time for the Fed to weigh in with the Consumer Financial Protection Bureau (CFPB) and ensure that this rule

> does not serve to further tighten credit." ("NAR Submits Letter to Bernanke on QE3″, Mortgage Professional)

How do you like that, eh? So according to Moe Veissi, making the system safer is too expensive. We just can't afford it. We need to make credit available to people who wouldn't normally qualify for a loan.

Sure, Moe, what could go wrong? It's not like we're going to blow up the financial system by lending too much money to people who can't repay their debts, right?

Oh wait….

In any event, the banks and the special interest groups are trying to unwind the "Ability to Repay" and "Risk Retention" portions of the new regulations, even these are the essential firewalls that protect the general public from another disaster like the Crash of '08?

If we heap these recent developments together (FHFA changes on "put-backs", opposition to "risk retention" and "ability to repay"), then we see that we're fairly close to where we were in 2007 before the two Bears Stearns hedge funds defaulted sparking the downward spiral that ended with the obliteration of Lehman Brothers on September 15, 2008 and the beginning of the Great Depression 2.

The banks are again in a position where they can skim profits off bad loans to every Tom, Dick and Harry that can sit upright and sign on the dotted line. They don't have to worry about holding capital against their dodgy assets or whether Uncle Sam is going to get fleeced on the bogus $400,000 loan they issued to that unemployed landscaper living on food stamps. No worries. They've covered all the bases.

Now if Bernanke can just get that bubble-thing going, they'll be back in the clover.

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