

“The Largest Financial Swindle in World History”. “Counterfeit” Mortgages “Laundered” by the Banks

By [Washington's Blog](#)

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A “false front” building from the Old West. Towns built false fronts to make the town look more substantial and prosperous than it really was.

The tidal wave of evidence showing that the giant banks have engaged in fraudulent foreclosure practices is so large that the attorneys general of [up to 40 states](#) are launching investigations.

People’s homes are being taken when they [didn’t even hold a mortgage](#), and the big banks have been using “[robo signers](#)” to forge mortgage related documents. Indeed, even president Obama has been hit by robo signers (see [this](#) and [this](#)).

Its so blatant that foreclosure mills have published [price lists](#) for forging documents, including such gems as:

“Create Missing Intervening Assignment” \$35

“Cure Defective Assignment” \$12.95

“Recreate Entire Collateral File” \$95

In response, the big banks are saying that these are simply “procedural defects” which don’t affect their ability to foreclose. See [this](#), [this](#) and [this](#).

But let’s take a step back. Only with some context will the actions of the banks with regards to these “defects” make any sense.

As I [pointed out](#) last year:

Simon Johnson confirmed what William K. Black has said about fraud by the financial sector, booms and busts.

As I previously [wrote](#):

Black explained that fraud by a financial company usually involves the company:

1) Growing like crazy

2) Making loans to people who are uncreditworthy, because they’ll agree to pay you more, and that’s how you grow rapidly. You can grow really fast if you loan to people who can’t you pay you back

and

3) Using extreme leverage.

This combination guarantees stratospheric initial profits during the expansion phase of the bubble.

But it guarantees a catastrophic subsequent failure when the bubble loses steam.

And collectively – if a lot of companies are playing this game – it produces extraordinary losses (more than all other forms of property crime combined), and a crash.

In other words, the companies intentionally make loans to people who will not be able to repay them, because – during an expanding bubble phase – they’ll make huge sums of money. The top executives of these companies will make massive salaries and bonuses during the bubble (enough to live like kings even even if the companies go belly up after the bubble phase).

Johnson confirmed that a high housing default rate was part of the banks’ models. The financial giants knew they would make huge sums during the boom, and then transfer their losses to the American people during the bust.

As William Black [noted](#) last October:

Everyone involved knew that the CDOs which packaged subprime loans were not AAA credit-worthy (which means that they are completely risk-free). He also said that the exotic instruments (CDOs, CDS, etc.) which spun the mortgages into more and more abstract investments were intentionally created to defraud investors

In November 2007, one rating agency – Fitch’s – dared to take a look at some loan files. Fitch concluded that there was the appearance of fraud in nearly every file reviewed

As I [wrote](#) in April:

University of Texas economics professor James K. Galbraith previously [said](#) that fraud caused the financial crisis:

You had fraud in the origination of the mortgages, fraud in the underwriting, fraud in the ratings agencies.

Senator Kaufman [said](#) last month:

Fraud and potential criminal conduct were at the heart of the financial crisis.

Congresswoman Marcy Kaptur says that there was rampant fraud leading up to the crash (see [this](#) and [this](#)).

According to economist [Max Wolff](#):

The securitization process worked by “packag(ing), sell(ing), repack(aging) and resell(ing) mortgages making what was a small housing bubble, a gigantic (one) and making what

became an American financial problem very much a global” one by selling mortgage bundles worldwide “without full disclosure of the lack of underlying assets or risks.”

Buyers accepted them on good faith, failed in their due diligence, and rating agencies were negligent, even criminal, in overvaluing and endorsing junk assets that they knew were high-risk or toxic. “The whole process was corrupt at its core.”

Indeed, Galbraith just gave a must-watch half hour speech where he [points out](#):

“At the root of the crisis we find the largest financial swindle in world history.”

The fraud originated in the mortgage market of the United States.

The houses were over-appraised, and the banks only hired appraisers who were willing to do that. Galbraith rhetorically asks: “For what conceivable reason would a lender accept an inflated appraisal for a house against which it was going to make a loan?”

The language used in the mortgage industry is very telling: “liar’s loans”, “ninja loans” (where the borrowers had no assets and no income), “neutron loans” (where it would destroy the people but leave the buildings), and “toxic waste”

The mortgages in the millions were counterfeits, not mortgages. They were “laundered” ... the dirty paper was converted into clean paper. Securitization was used to convert the worthless paper from triple D minus junk to triple A. The commercial banks were the “fences”, they took the laundered paper and sold it on to the legitimate market. The “marks” were the pension funds, or any investing entity which trusted triple A rating or investment banks.

The police left the beat.

If the counterfeit is big enough, the whole system collapses, because you can’t tell what’s real from what’s counterfeit and so confidence collapses.

The failure to face the problem of fraud constitutes a huge barrier in the path of economic recovery. The banking system can’t be restored until it is taken apart, cleaned up and rebuilt in a transparent and honest manner.

We should make the Department of Justice uncomfortable to ignore these frauds. Because if we don’t have fair and honest and functioning financial system, we won’t get out of this crisis.

Indeed, there was fraud at every step of the mortgage process. The big banks intentionally signed up borrowers with insufficient income and assets, threw out the documentation because it would prove fraud, racked up loan fees and received short-term payments before all of the new borrowers ran out of money, and then laundered the bad loans into securitized instruments to sell to the suckers.

The banks created an intermediary called “MERS” to hold all of the documentation, in an attempt to shield the banks legally. But courts have held that this scheme doesn’t fly, and that MERS doesn’t have title to foreclose on houses. See [this](#) and [this](#)(and as Tyler

Durden [points out](#), MERS might have infected the commercial real estate market as well.)

Then there's the whole foreclosure scandal, where banks have forged and backdated documentation to try to prove they are entitled to foreclose. This is the part that is in the news right now. But because fraud was committed every step of the way - from mortgage origination and loan applications, to securitization, to MERS to foreclosures - it shows a fraudulent scheme, and not just sloppy paperwork.

As Yves Smith [writes](#):

[The banks' statement that is a minor paperwork problem] is an effort to divert attention from the real issue, the mess the securitization industry has made of the housing market at pretty much every step of the process, from ginning up bad "spready" loans on purpose to feed demand for CDOs, to deciding to ignore the carefully-devised procedures to make sure the securitization trust complied with all the requirements needed for it to have ownership of the mortgages

Karl Denninger [writes](#):

Everyone talking about this in the mainstream media - with a handful of exceptions ... is trying to play this down as a mere technicality.

It's not.

It's a coverup that is now coming unraveled.

In another essay, Denninger [points out](#):

The issue is not "robo-signed" documents. The issue is that the robo-signed documents are an attempt to cover up for previous failures in the securitization process which have left investors worldwide holding an empty bag, and homeowners with seriously-damaged chains of title.

As Ellen Brown [writes](#):

By most reports, it would appear that the voluntary suspension of foreclosures is underway to review simple, careless procedural errors. Errors which the conscientious banks are hastening to correct. Even Gretchen Morgenson in the New York Times characterizes the problem as "flawed paperwork."

But those errors go far deeper than mere sloppiness. They are concealing a massive fraud.

They cannot be corrected with legitimate paperwork, and that was the reason the servicers had to hire "foreclosure mills" to fabricate the documents.

These errors involve perjury and forgery — fabricating documents that never existed and swearing to the accuracy of facts not known.

These problems cannot be swept under the rug as mere technicalities. They go to the heart of the securitization process itself. The snowball has just started to roll.

How do you recreate the original note if you don't have it? And all for a flat fee, regardless of the particular facts or the supposed difficulty of digging them up.

All of the mortgages in question were "securitized" – turned into Mortgage Backed Securities (MBS) and sold off to investors. MBS are typically pooled through a type of "special purpose vehicle" called a Real Estate Mortgage Investment Conduit or "REMIC", which has strict requirements defined under the U.S. Internal Revenue Code (the Tax Reform Act of 1986).

That was not done; and there is no legitimate way to create those conveyances now, because the time limit allowed under the Tax Code has passed.

The question is, why weren't they done properly in the first place? Was it just haste and sloppiness as alleged? Or was there some reason that these mortgages could NOT be assigned when the MBS were formed?

Denninger argues that it would not have been difficult to do it right from the beginning. His theory is that documents were "lost" to avoid an audit, which would have revealed to investors that they had been sold a bill of goods — a package of toxic subprime loans very prone to default.

The government, of course, did nothing to prevent mortgage fraud. See [this](#), [this](#), [this](#), [this](#), and [this](#).

Indeed, the government is [closing ranks with the banks](#). And instead of fixing the underlying problem, the government is [still trying to prop up](#) the whole rotten, falling down mess:

(Its not working very well.)

So what can we do, if anything?

Karl Denninger has a [great suggestion](#). And we must [break up the giant banks](#).

But these solutions will only be followed if the government decides to [start following the rule of law](#) again.

As the Wall Street Journal [notes](#), some congress members and states attorney general have set their sites a little lower, focusing on short-term help for homeowners:

"I think the mortgage-servicing firms need to understand that they face real exposure now, and they would be well advised to take this very seriously, to clean this up by doing loan workouts to keep people in their homes, which up till now they've just paid lip-service to," said Ohio Attorney General Richard Cordray.

Some in Congress have called for a moratorium on all foreclosures until the documentation issue is resolved, though senior Administration officials Monday again declined to endorse that idea.

The attorneys' general immediate aim is to determine the scale of the document problems and correct them. But several of them have said that the investigation could force the lenders and servicers to agree to mass loan modifications or principal forgiveness schemes. Other possibilities include financial penalties or changes in mortgage servicing practices.

Former New Jersey attorney general Peter Harvey, now a trial lawyer in New York, said that a settlement with state attorneys general would likely "to give the banks some cover" to make changes that might otherwise result in lawsuits by investors in mortgage-backed securities.

Iowa attorney general Thomas Miller, who is leading the effort, said his office might take cues from an investigation brought by Massachusetts attorney general Martha Coakley. She successfully pressured Bank of America Corp. in March to reduce mortgage-loan balances by as much as 30% for thousands of borrowers, using the threat of a lawsuit to get a settlement, though documentation problems were not at issue then.

The primary weapon the states could wield would be their respective laws against unfair and deceptive acts and practices, said Prentiss Cox, a professor of law at the University of Minnesota and former Assistant Attorney General in Minnesota.

Those laws are easier to apply, however, when a lender misleads a borrower than in pursuing problems with foreclosures related to documentation, he said. Individual attorneys general could also bring actions under states' various foreclosure laws.

Illinois Attorney General Lisa Madigan said she was preparing to introduce legislation meant to tighten foreclosure laws and prevent document errors in the future. She also is pushing federal representatives to resurrect a bill that would allow bankruptcy judges to "cram down," or cut, a troubled homeowner's mortgage debt.

"The immediate goal is to stop fraudulent foreclosure and to require that the lenders and servicers are following the law. But that's the bare minimum. That's what they have to do to follow the law," she said.

Nearly a dozen attorneys general nationwide, including Ms. Coakley and Mr. Miller, have called on lenders and servicers to suspend foreclosures until document irregularities are studied and corrected.

Top lawyers from multiple states have gone after mortgage lenders before. In 2008, Bank of America Corp. settled charges brought by 15 attorneys related to accusations of predatory lending in its Countrywide Financial Corp. unit, granting loan modifications worth \$8.4 billion to thousands of homeowners.

Mr. Cordray, of Ohio, last week became the first attorney general to sue a mortgage servicer, when he filed suit against GMAC Mortgage LLC. The suit also named as a defendant GMAC employee Jeffrey Stephan, an alleged "robo-signer," who said that he signed off on thousands of court documents related to foreclosures without reading them first.

GMAC announced that it was suspending foreclosures in the 23 U.S. states where judges are

required to sign off on them after news of Mr. Stephan's activities surfaced. J.P. Morgan Chase & Co.'s Chase Home Mortgage unit suspended judicial foreclosures soon after, and Bank of America followed suit. On Friday, Bank of America widened its foreclosure freeze to all 50 states.

Some attorney generals would like to look beyond the narrow issues raised by the robo-signing. The issue "I'm most engaged in right now is the big servicers who are initiating foreclosures while the borrower is in the modification process," said Arizona Attorney General Terry Goddard.

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