

# NY Bank Investigation Challenges Bailouts

by Paul Gallagher

May 27—As the momentum of the national Glass-Steagall mobilization is reflected in the House of Representatives, the Wall Street banks that a new Glass-Steagall Act would break up and cut loose from bailout protection, are coming under growing pressure from state attorneys general, including potential criminal prosecutions, even if two years overdue.

The central target is those banks' issuance—led by Goldman Sachs, Bank of America, and a group of the biggest Euro-based banks—of mortgage-backed securities (MBS) and synthetic debt derivatives based on them, in 2005-09. The former totalled about \$7 trillion; the latter were in the tens of trillions; and the desperate government bailouts when they blew up in 2007-09, have collapsed the credit of all trans-Atlantic governments since then.

These investigations are a break from the Obama White House, which, ever since the banks' "foreclosuregate" last Summer, has been trying to limit the damage to procedural changes by the banks, and "get the foreclosures rolling again." No bank executive or trader has yet been prosecuted for history's most devastating debt-securitization fraud, which triggered the global financial crash beginning July 2007, and worldwide mass unemployment. By contrast, 800 savings-and-loan bankers were imprisoned in the mid-1980s real estate bubble bust, a minor problem compared to this global crash.

Journalist Matt Taibbi in *Rolling Stone* magazine recently emphasized that the investigation by New York Attorney General Eric Schneiderman, in particular, challenges Obama: "A desire to get some kind of deal done and sweep the mortgage mess under the rug once and for all seems almost universal among high-ranking politicians, and particularly in the Obama administra-

tion, which has acted throughout like it wants more than anything to simply get all of this over with and put in the past. Schneiderman's investigation throws a monkey wrench into all of this."

The major Wall Street, London, and Eurozone banks are now coming under potential criminal probes for exactly what got them all bailed out: their super-leveraged "assets," debt securities whose collapsing values the bailout policy has desperately tried to hold up for three years now. These included most massively the toxic MBS and over-the-counter credit derivatives.

Most importantly, the spotlight on the bankers' criminality should fuel the drive for Glass-Steagall, without which no solution to the bankruptcy crisis can be found.

## Derivatives in the Dock

As of early May, Federal Reserve Chairman Ben Bernanke and Treasury Secretary Tim Geithner appeared to have the 50 state attorneys general's probes of the mortgage bubble and "foreclosuregate" zipped up, ready to agree with the Wall Street on a trivial \$5 billion collective fine and a promise of nicer foreclosure procedures in the future. During May, while the policy turn associated with the fate of IMF director Dominique Strauss-Kahn has occurred, a half-dozen state attorneys general have abruptly broken out of White House control and gone after the banks and their MBS frauds.

The keystone investigation is that of the state where "DSK" was snagged. New York Attorney General Schneiderman has an expanding, potentially criminal investigation of the issuance of fraudulent mortgage products and fraudulent securities, by all the biggest MBS-issuing and -trading banks: first Goldman Sachs, Morgan Stanley, and Bank of America; then UBS, Royal Bank of Scotland, JPMorgan Chase, and Deutsche Bank Morgan Grenfell were added.

Schneiderman's subpoenas make clear he is investigating not just MBSs, but the over-the-counter (OTC) debt- and credit-derivatives markets built on top of them. He is taking evidence and documents by subpoena from four of the "monoline insurers" that became notorious for their credit derivatives "insurance" to col-



Office of Jerry Nadler  
New York Attorney General Eric Schneiderman

lapsing MBSs and collateralized debt obligations in 2008. This indicates that the Attorney General is investigating the OTC credit derivatives markets. One of the insurers, MBIA, was in bankruptcy and is being sued by these same banks because of non-payment to them; a New York Federal court just threw this suit out. MBIA is, in turn, suing the banks for fraudulent representations on their MBS and underlying mortgages.

New York State's 1921 Martin Act allows criminal prosecution of securities crimes—exactly the giant mortgage-backed securitization (MBS) fraud Schneiderman will be investigating—without having to prove criminal intent, just criminal activity. That Goldman in particular, and Wall Street banks in general, were engaged in criminal fraud on a mass scale, has already been documented by Sens. Carl Levin's (D-Mich.) and Tom Coburn's (R-Okla.) hearings and report, and by the Angelides Commission.

The New York areas of investigation are multiple, overlapping frauds: Not only did the investment banks securitize mortgages they knew to be fraudulently underwritten and issued, and suborn ratings agencies to cover this up; they also provided the large loans to Countrywide Financial, et al., to make those fraudulent mortgage products possible in the first place. And they misled their investors and the government, as Senator Levin stressed.

Levin is leveraging the New York investigation to place great pressure on Attorney General Eric Holder to start a criminal investigation of Goldman Sachs at the Federal level. He has gotten Holder to state publicly that the DoJ is studying the Levin-Coburn report for evidence against Goldman and its top executives.

If the banks end up being found liable for all of these offenses, they could face truly crippling fines and penalties.

### **Other AGs Break Out**

In California, Attorney General Kemala Harris on May 23 announced a task force to investigate “the origination of mortgage loans, the marketing of mortgage-backed securities, and false or fraudulent claims made to the state with respect to sub-prime mortgages”—exactly what Schneiderman is investigating. She said she was targeting “fraud and crime at every step of the mortgage process.” On May 25, Harris started issuing subpoenas to the biggest “foreclosure fraud mills” in the country, including Lender Processing Services, Inc. (LPS). Illinois Attorney General Lisa Madigan an-

nounced an investigation May 26 and subpoenaed the same companies.

Also on May 25, Utah Attorney General Mark Shurtleff started a criminal fraud probe against Bank of America (“ReconTrust, Inc.” in Utah), based on an early-2010 Utah court decision that Shurtleff could have picked up on at any time in the past year—he did so now. On May 26, Connecticut AG George Jepsen threatened Bank of America with prosecution.

### **Secret \$80 Billion Bailout Exposed**

Thus, the significance of the May 26 revelation by Bloomberg News, that the New York Federal Reserve Bank, in March 2008 when its president was Timothy Geithner, quickly threw out an \$80 billion “pure subsidy” credit line to these same banks, taking their suddenly worthless MBS as “collateral” for the first time.

This is a bailout whose existence has been kept secret by the Fed until now. Bloomberg gained access to the Fed's records of it through a legal suit, which Bernanke's Fed fought for two years, ultimately losing in the Supreme Court. Though Sen. Bernie Sanders' (I-Vt.) legislatively forced the Fed to disclose many of its huge discount window bailout operations, no one in Congress was aware of this one. That included the supposedly super-informed Rep. “Bailout Barney” Frank (D-Mass.), who acknowledged he had never learned of this bailout while serving as House Financial Services Committee chairman.

This bailout line, which went out six months *before* the failure of Lehman Brothers, expanded what the Fed had just done for JPMorgan Chase—lending \$30 billion against Bear Stearns' exploding MBS and derivatives, so that Morgan could take over the failing investment bank. This bailout then grew: Crédit Suisse got \$45 billion; Goldman \$30 billion; Deutsche Bank, UBS, and RBS \$15 billion each. It was the first time such toxic, speculative securities had become collateral for a Federal Reserve bailout—at a 0.01% interest rate, when the Fed's discount rate was 0.5%. And it then led, in 2009, to the Fed's outright purchase of nearly \$1.5 trillion in these toxic MBSs from the banks; followed by its \$900 billion purchase, at rising prices, of their Treasury securities; and the continuing money-printing program known as “QEII.”

That the bulk of these bailed-out trillions in MBSs and derivatives was fraudulently issued in the first place, as the attorneys general are going to show and prosecute, further fuels the fire for Glass-Steagall.