Chapter 2

Report from the Battlefield

Pride gets no pleasure out of having something; only out of having more of it than the next guy. . . . Pride is spiritual cancer; it eats up the very possibility of love, of contentment, or even common sense.

—C. S. Lewis (1898–1963), British novelist, essayist, and Christian apologist

It is the twilight of the first decade of the twenty-first century as I write this. The world has changed in many ways in the past 10 years; yet, in many ways, nothing has really changed at all. The age-old conflict between right and wrong still rages, but the differences between the Good Guys and the Bad Guys seem to have become less definite. I am sure that some media jackal with an agenda or some book critic on the Wall Street payroll will probably accuse me of being too simplistic, but that is because we have allowed them to frame the argument. We have allowed them to say that the concepts of right and wrong are dated and not sophisticated enough for the complexities of modern society. Don't let them blow their relativistic smoke up your pant leg. There is a growing segment of our society who does not want anyone to be able to distinguish between right and wrong because they don't want to be exposed. They have substituted "sophistication" for lack of integrity, fortitude and morality. As much as I love the work that I do, I find myself growing increasingly hostile toward the direction of the industry in general, as do many of my colleagues and business partners who have been in the financial world for over two decades now and have seen it all.

We are a nation of more than 310 million people and our national debt has grown to over $14 *trillion*. That's about $45,000 for every citizen; however, every citizen is not a taxpayer, and this debt will be borne by the taxpayers in this country. When distributed among the taxpayers, the amount equals more than $126,000! And what do I mean by distributing the national debt? This is the amount that you are responsible for paying whenever someone casually throws out a phrase like "the *government* supplies" or "the *government* provides." There is no separate autonomous entity known as "The Government." This is the pipe dream of those professional politicians who lust for power and control over other people's lives and fortunes. We, the People, are the true government, and the time has come for us to take back control of that which was initially created to serve our best interests.

Current unemployment is officially over 9 percent. Unofficially, it is generally agreed that it is at least twice that when you factor in the number of people who have fallen off the government's rolls by either exhausting their benefits or simply giving up the search for meaningful work. Forty-five million Americans now receive government assistance just to purchase food, nearly two million have filed bankruptcy, and more than a million, including close friends of mine, have lost their homes in foreclosure proceedings. As of September 2010, 23 percent of U.S. homes are worth less than the mortgage loan.[1] Homeowners across the country have lost an average of 39 percent of the value of their properties over the past three years.[2] Commercial real estate values have fallen 40 percent since their peak in 2007, according to a recent Reuters article.[3]

It is this loss of equity and value in real estate that troubles me most. It wasn't because of normal market forces like supply and demand. Many of the subprime mortgage loans should never have been made; we have become a nation incapable of living within our means. We seem incapable of accepting the reality that owning a home is not and never was intended to be a right. It is a reward for working hard and saving up enough money to not only purchase a property, but to maintain and improve it.

This crisis was the direct result of the financial blitzkrieg that has ransacked our economy over the past three years. It was an orchestrated pilfering of the wealth of this nation by private global bankers and financial institutions in league with elements within the government. There is no doubt that these people have committed a series of crimes, the least of which are abuse of their fiduciary responsibilities and compromising established business ethics; but nobody has been convicted. No one has been indicted. The greatest economy in the world has been callously brought to its knees, millions of people have seen their life's savings evaporate, and the crime is not even being investigated. How could this have happened in America?

An Inside Job

In September 2008 we witnessed one of the most brazen and daring transfers of financial assets ever to take place in recorded history. Certain large Wall Street banks pumped up the subprime mortgage bubble, made billions of dollars by securitizing the mortgage debt, and when the bubble inevitably burst, they transferred their losses to the federal government and received bailouts because they were deemed "too big to fail." This con job was pulled off, for the most part, in broad daylight and in full view of the whole world. In the space of a few days, this nation was the victim of an orchestrated theft of nearly $6 trillion. That's six million stacks of a million dollars each or $54,000 for every taxpayer.

This crime did not just happen; in fact, it didn't start out as a criminal activity at all. It had its genesis 34 years ago as a noble gesture on the part of a man who, history has shown, had more compassion than common sense. It was yet another example of the best intentions of the federal government not only exacerbating the problem, but creating even worse conditions due to the principles of unintended consequences and ignorance of basic human behavior—in this case, pride and greed.

The Community Reinvestment Act (CRA) was signed into law by President Jimmy Carter in 1977 with the lofty goal of making credit obtainable and housing affordable for those who found themselves living in lower-income neighborhoods and housing projects. There was plenty of evidence in the 1950s and 1960s that banks unfairly discriminated against poor and minority people who wanted to share in the American Dream of homeownership. Practices like "redlining" or identifying entire neighborhoods as bad risks were not endemic, but were widespread enough to cause the Congress to pass a law telling banks they had to have policies that did not discriminate against lower- and middle-income mortgage applicants. Banks were instructed to operate in a safe and sound manner, and were not required to make high-risk loans that may bring losses to the institution.

Until the early 1970s, the practice of creating mortgages from real estate had been based on the "originate and hold" business model. This meant that a bank would originate a loan of money for a buyer to purchase a home in the community, and the bank would hold a mortgage against that property, collecting principal and interest until the mortgage was paid off. The U.S. Department of Housing and Urban Development (HUD) changed that process when they created a mortgage-backed security that was sold through the Government National Mortgage Association (GNMA or Ginnie Mae) and backed by a portfolio of mortgage loans.

Through the 1970s and 1980s, banks were regulated by one of four different entities—the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, or the Federal Home Loan Bank Board—depending on their charter. These regulators graded the banks on how well they had performed in upholding a "continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered." These evaluations had increasing bearing on the bank's ability to expand through merger, acquisition, or branching and encouraged bankers to take more risks in the area of real estate financing.

This pressure to loosen credit requirements in targeted demographics, namely urban poor and minority communities, was not significant until the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) made portions of the evaluation process public. Community organizers and advocacy groups began using the data to press for increased enforcement of the CRA. The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) modified the CRA to give institutions more favorable ratings if they sponsored or set up branch offices operated by minority and women operators in disadvantaged neighborhoods. In 1992, Freddie Mac and Fannie Mae were instructed, under CRA amendments contained in the Federal Housing Enterprises Financial Safety and Soundness Act, to devote a significant percentage of their lending efforts to support affordable housing. When the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 made interstate banking possible, advocacy groups increasingly used the public comment process to protest bank applications on CRA grounds. This led many institutions to establish separate business units and subsidiary corporations to facilitate CRA-related lending and, some would say, made housing affordable and accessible to many who otherwise might have been ignored.[4]

The unintended consequence of this legislative foray into social engineering was that the consumers in these markets were not given the necessary education to properly utilize the financial resources that were now available to them. They were to become the prime target demographic for the emerging subprime mortgage originators who would prey on their naiveté and general lack of financial acumen.

In July 1993, President Clinton had urged revising the CRA to make it easier still for lenders to comply. This was at the urging of his economic policy adviser and former Goldman Sachs chairman, Robert Rubin. The then chairman of the Cato Institute, William A. Niskanen, criticized these changes in testimony before Congress, predicting that they would be costly to the economy and dangerous to the banking system.[5] He urged that the CRA be repealed. His warnings fell on deaf ears. From 1995 to 1998, subprime mortgage lending, aimed precisely at the demographic served by the CRA, reached $150 billion per year.[6] The federal government officially endorsed the subprime mortgage business in November 1997 when Freddie Mac helped Bear Stearns launch the first publicly available securitization of CRA loans. Bear Stearns, of course, then went on to issue $384.6 million of such securities, all of which carried the Freddie Mac guarantee as to timely interest and principal.

Running the Red Lights

Storm clouds were beginning to appear on the financial horizon. It cannot be said that there were no previous warnings. For years, the basic concept of risk and reward was being ignored. In May 1998, Brooksley Born, chairperson of the Commodity Futures Trading Commission (CFTC), officially raised concerns about credit default swaps. These financial instruments are traded over the counter between banks, insurance companies, or other funds or companies. Ms. Born's concern was due to the lack of transparency, and she felt they should be regulated. This brought immediate and uncharacteristically vocal opposition from Federal Reserve chairman Alan Greenspan and Treasury secretaries Robert Rubin and Lawrence Summers.[7] On May 7, 1998, former Securities and Exchange Commission (SEC) chairman Arthur Levitt joined Rubin and Greenspan in objecting to the issuance of the CFTC's concept release. Their response sought to dismiss Born's analysis. They accomplished this by focusing on an absurd hypothetical possibility—that CFTC regulation of swaps and other OTC derivative instruments could create a "legal uncertainty" regarding such financial instruments and therefore, supposedly, produce a reduction of the value of the instruments. Using their political muscle, they managed to get Congress to freeze her agency's funding, effectively forcing her out of office.

Born's concerns were validated in late September of that year when the Federal Reserve Bank of New York had to step in and rescue Long-Term Capital Management (LTCM), a hedge fund that lost more than 90 percent of its asset value over the first nine months of 1998. LTCM had been put together by mathematicians and computer geeks who were convinced that they had developed computer programs that could predict and take advantage of relative value gaps between pairs of similar securities. John Meriwether, Myron Scholes, and Robert Merton had put together what they considered to be a crack team of financial engineers, programmers, and a state-of-the-art computer system. They believed they had a formula that reduced risk to an acceptable and manageable level. They were wrong. Their formula didn't take into account the possibility of a catastrophic event such as that which occurred on August 17, 1998, when the Russian government defaulted on its sovereign debt. LTCM was leveraged at more than 100:1. This left them exposed, with no reasonable hope of recovery. Investors fled to liquidity, and $1.9 billion in LTCM assets vanished into thin air![8]

The Government Accountability Office (GAO) warned that a bailout of LTCM would just encourage firms to make risky loans on the assumption that the government would bail out "too big to fail" banks and companies.[9] Again, the Ivy League theorists scoffed at the notion that financial professionals would be anything other than prudent in the management of the nation's economic engine, and the warnings were ignored. It seemed the only consequence for the LTCM failure was a changing of leadership at one of the larger institutions. Goldman Sachs CEO Jon Corzine had been closely involved with LTCM. As a result, he was forced out in a boardroom coup led by co-chairman Henry Paulson. Corzine, thoroughly chastened for his questionable assistance to LTCM, cashed in his chips and walked away with $500 million when Goldman Sachs later went public. He then went on to become one of the U.S. senators from New Jersey.

The Joker of Gotham City

One of the main reasons that the greedy bankers were able to walk off with the wealth of this nation is that they have built up a professional image to disguise what it is that they actually do. They have also created their own language and jargon to baffle and intimidate the uninitiated. That is what you do when you are creating an illusion. Bankers and politicians are masters of illusion. They create things out of thin air and then use them to gain real wealth and real power.

When the bipartisan Gramm-Leach-Bliley Act was signed into law by President Bill Clinton in November 1999, the Glass-Steagall Act of 1933 was repealed, and commercial banks, investment banks, securities firms, and insurance companies were allowed to merge to create the "financial services" industry. The bankers loved it because they got to keep your money whether you were investing in good times or saving in bad times. The politicians loved it because they put even more clauses in that encouraged lending to underserved and minority home shoppers in support of the Community Reinvestment Act. That translated to more votes and more campaign contributions for themselves. To the subprime mortgage companies, it was like pouring lighter fluid on smoldering coals. The market caught fire and heated up rapidly.

By the year 2000, the Treasury happily reported that $467 billion in mortgage credit had flowed through CRA-approved lenders to low- and medium-income borrowers.[10] Substantial risks were being taken by the young math whizzes on Wall Street with the blessings of their elders. Average investors were being gutted by elaborate derivative schemes that were nothing more than financial shell games disguised as sophisticated computer programs and algorithms. Regulators looked the other way, and underwriters smilingly signed off on the credibility of the entire con. Truckloads of money were being raked in by Goldman, Bear Stearns, Citibank, and Lehman, while the rising real estate values across the nation began to show imperceptible signs of slowing and even flattening. It was a warning sign that was ignored.

The subprime mortgage industry's loan volume topped $330 billion by the end of 2003.[11] A year later, the subprime sharks, led by Ameriquest and funded by Lehman Brothers, were writing $529 billion in questionable mortgages per year![12] The philosophy of the greedy bankers was to let the party continue for as long as the Fed kept interest rates low and they could sell the perception that real estate was going to keep on appreciating. The more people they talked into buying, building, or refinancing homes, the better. It wasn't just the poor people who were being seduced by the easy money; the middle class and the affluent were getting into the game all across the country. It was the proverbial Golden Goose for everyone; but enough is never enough to the financial alchemists of Wall Street. Through the delusory magic of fractional reserve banking, a bank could lend $13 for every $1 held in equity. For the untutored and confused, the traditional rate ("fraction" in the fractional reserve system) of what must be held in reserve to cover losses was $1 (to be held in the bank) for every $10 lent out. The additional $3 difference, above, is a big deal.

If everyone was in a borrowing mood, why not meet the market demand and create more money to loan? More money to loan meant more money to be made in profits from mortgage-backed securities, credit derivatives, and other exotic instruments. Right?

In stepped Goldman Sachs's chairman, Henry Paulson. On April 28, 2004, this square-jawed, formerly fair-haired financial genius led a coalition of investment banks, which included Morgan Stanley, Lehman Brothers, Bear Stearns, and Merrill Lynch, in requesting that the SEC loosen the capital reserve rule and let the banks regulate themselves. To the utter astonishment of the entire financial services industry, the SEC unanimously agreed to the change after only 55 minutes of discussion. Within a few months, Bear Stearns, which was ostensibly using borrowed money to fund its mortgage-backed hedge funds, saw its leverage ratio reach 33 to 1![13] The subprime mortgage market was immediately flooded with billions of dollars in funding. This was like pouring gasoline directly onto open flames. The subprime mortgage market exploded!

Red flags began popping up everywhere as 2005 dawned. The late Edward Gramlich, appointed to serve as a Fed governor by President Clinton in 1997, had grown concerned about the appearance of predatory lending practices as early as 2000. He thought the Fed should begin a program of auditing some of the mortgage originators to ensure the integrity of resulting securities and privately broached the subject with Fed chairman Alan Greenspan. Greenspan was ideologically opposed to what he saw as unnecessary regulation, so Gramlich didn't pursue it.[14] On May 18, 2005, Gramlich tendered his resignation from the Federal Reserve Board of Governors. Gracious to the end, he only hinted at any conflict within the central bank, saying they had "met several difficult monetary challenges, and several diverse regulatory challenges."[15]

The chorus challenging Federal Reserve chairman Greenspan's reading of the subprime situation continued to grow louder. At an annual Jackson Hole retreat that was doubling as a retirement celebration for the chairman, eyebrows were raised and tempers flared when International Monetary Fund (IMF) economist Ragurham Rajan delivered a controversial paper that was critical of the financial sector and warned of pending economic collapse; Larry Summers scoffed at Rajan's concerns and called the warnings "misguided."[16]

American economist Robert Shiller repeated the theme in a *Wall Street Journal* article in August 2006 that warned of the coming "financial Apocalypse." In the meantime, *Wall Street Journal* writer Michael Siconolfi began investigating why the SEC had decided to end its investigation into the "pricing, valuation, and analysis" of mortgage-backed collateralized debt obligations by Bear Stearns, deciding not to take any action. His *WSJ* article on December 10, 2007, asked the question, "Did Authorities Miss a Chance to Ease Crunch?" and implicated then New York attorney general, Eliot Spitzer, for failing to pursue further probes into Bear Stearns's questionable dealings. In addition, Bear Stearns and other banks were known to routinely use funds from the capital accounts of publicly traded companies for prostitutes, strippers, and other immoral or even illegal services, billing them as "research" or "public relations" or "business entertainment." This has also been well documented. Although the U.S. government went after Elliot Spitzer on these kinds of issues, no one is holding the biggest investment banks responsible for this unethical and even illegal activity, which is endemic to this segment of the financial services division.[17]

On September 6, 2008, Fannie Mae and Freddie Mac were placed into conservatorship by the Federal Housing Finance Agency (FHFA) director, James B. Lockhart III, at the urging of Henry Paulson, the newly appointed U. S. Treasury secretary.[18] Federal Reserve Bank chairman Ben Bernanke voiced his approval of the move, and Mr. and Ms. U.S. Taxpayer became the *underwriters* of $5 trillion in mortgage-backed securities (MBSs) and debt owned by the Federal Reserve. This unprecedented transfer of assets to the Fed was barely mentioned by the national press. The *New York Times* painted the enslavement of the taxpayer simply as a government takeover.[19]

One week later, secret meetings were held over the weekend at the offices of the New York Federal Reserve Bank. The attendees included then New York Fed official Timothy Geithner, officials from the U.S. Treasury representing then Secretary of the Treasury Henry Paulson, regulators from the New York State Insurance Department, executives of AIG, bankers from JPMorgan, bankers from Morgan Stanley as consultants for the Treasury, and a group of Goldman Sachs bankers led by CEO Lloyd Blankfein. Everyone but Blankfein was there to head off a financial crisis that was threatening to take down AIG, Lehman Brothers, Merrill Lynch, and several other firms that had been caught up in the slice-and-dice MBS derivatives game that Goldman had been hawking. All Blankfein wanted was his money, and he seemed prepared to bring down the entire financial system to get it.[20] Following that weekend, Goldman Sachs ended up with at least $52 billion from the U.S. government via the AIG bailout, Paulson's Troubled Asset Relief Program (TARP), and Geithner's later FDIC bailout called the Temporary Liquidity Guarantee Program.

In the second quarter of 2009, Goldman Sachs posted a record profit of $3.44 billion and gave the American taxpayer the middle finger.[21] In a November 8, 2009, interview in London's *Sunday Times*, Blankfein declared, "I'm doing God's work." The state of Massachusetts disagreed and accused the delusional Prophet of Mammon of facilitating the fraud that led to the collapse of the subprime mortgage bubble. Goldman Sachs "agreed" to pay a fine of $60 million to end the investigation.[22]

Allow me to put that in perspective for the average person who doesn't toss around 9- to 12-figure numbers all day. A crackhead walks into a liquor store and takes $52,000 out of the cash register. He gets arrested but gets the district attorney to drop the charges and let him walk after he pays a fine of $60, which he pays from the stolen cash! And he gets to keep the rest of the money, too!

The extent of the criminal behavior of the greedy bankers leading up to and causing the financial meltdown that occurred in 2008 is mind-boggling when you know the facts. It includes financial fraud; self-dealing; and the pernicious synergy between compromised rating agencies, banks, and the consultants that sold marginal investments as

AAA rated, even while making money by betting against their own products, to the detriment of AIG and others.

And on the left of the political spectrum, the radicals of the 1960s who were now the heads of the community organizations and advocacy agencies created to bleed the system on behalf of the victim classes just shook their heads in disbelief. For decades they had preached about the evils of capitalism, and now these geniuses on Wall Street had done their work for them. They had been given enough proverbial rope and they had hung themselves with it. Greed and arrogance had breathed new life into the utopian dreams of the socialists.

A Crisis of Consciousness

We live in a society that is based on 30-second sound bites. We have technology that puts all of the information of humankind at our fingertips, but we have the attention span of a three-year-old at a carnival midway on the Fourth of July. We throw around a lot of words like *democracy, federal, republic, nationalist, socialist, liberal,* and *right-wing*—but do we really know what they mean?

The attractive, well-coiffed heads on television feed us the talking points of the day in small, candy-coated portions; smirking openly at the ease with which they are able to dictate popular opinion and influence policy. We dress the way a few select fashionistas dictate to the point where the color and pattern of a man's necktie signals his level of professional achievement. Our entertainment follows prescribed formats with predictable outcomes. The celebrities who pose as statesmen and politicians in our government listen to us with the same rehearsed look of concerned interest and share with us their carefully crafted "thoughts," with the strategically placed applause lines, from a teleprompter.

It is all carefully orchestrated to hide this fact: The men and women whom we have elected to represent our interests—to protect the general welfare of our nation and to defend the rights and liberties spelled out in our Constitution—in actuality have become, regardless of their political party affiliation, little more than circus monkeys doing the bidding of their unseen masters. Powerful lobbying groups actually write legislation to grant their industry favorable status, tariff protections, and tax incentives. They then shop it around Capitol Hill, pouring millions into the reelection campaigns of whichever Congressperson will sponsor the newly minted federal legislation.

Even our institutions cater to our collective attention deficit disorder, and we just accept it. Let me give you an example: According to a timeline published on the web site for the Federal Reserve Bank of St. Louis, the current economic crisis was *started* on February 27, 2007, when the Federal Home Loan Mortgage Corporation, also known as Freddie Mac, issued a press release announcing they would no longer buy the most risky subprime mortgages and mortgage-related securities.[23] That is either an indication of incredible naïveté, gross condescension, or complete insanity! I may often have the opinion that the governors of the Federal Reserve System operate in a myopic vacuum void of logic and reason, but I don't think they are naïve. And in spite of the results of their tinkering with the economy, I doubt they are in the grips of institutional insanity. That leaves only one logical conclusion. The central bank interacts with the average American citizen from a position of cold, fundamental arrogance and condescension to the point of contempt. How else would you explain such a nonchalant and flippant statement about the current economic crisis?

Since the Panic of 1819, we have had economic bubbles burst in the nauseating cycle of boom and bust that pockmarks the image of American prosperity, but *this* is different. This is a financial meltdown that has resulted in the calculated loss of billions of dollars in accumulated wealth, numerous bank failures, massive expansion of government power for which the government has no legal right, and the near extinction of the individual sovereign freedom and liberty that made this nation the most unique and successful social experiment in human history. There are many who believe that it is not over yet! This is an act of war against the American people, and it is a war that started a long time before February 27, 2007.

Notes

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