Federal Government Turns on the Banks It Bailed Out

After spending hundreds of billions to bail them out, the federal government is now turning on the big banks it once protected. Earlier this month, the Federal Housing Finance Agency launched a broad legal assault on 17 major banks, claiming the banks misled Fannie Mae and Freddie Mac in misrepresenting the quality of mortgage-backed securities. The FHFA?s lawsuit is a new attempt on the part of the federal government to recoup from big banks some of the taxpayer money lost during the financial crisis. Banks named in the action include Bank of America, J.P. Morgan Chase, Goldman Sachs, Morgan Stanley, Citigroup, and Deutsche Bank.

In a separate action, the feds went on a second offensive against Goldman Sachs, with the Federal Reserve newly empowered as a financial regulatory and enforcement body, besides being a central bank initiating legal action against the investment bank, claiming Goldman had exhibited a pattern of misconduct and negligence in its issuing of mortgage-backed loans.

As the *Washington Post* wryly observed:

> The federal action underscored the often contradictory relationship between the government and financial firms in the wake of the crisis. At times, government officials have come to the rescue of banks and counted on them to help accelerate the nations lagging economic recovery. But often, officials have derided the practices that fueled the financial meltdown and sought to keep banks in check, either through new regulations or negotiated settlements or, as on Friday, potentially costly litigation.

There does appear to be considerable merit to some of the FHFAs claims. It is alleged, for example, that banks sold the shoddy loans even after a third-party analysis company informed the banks that billions of dollars worth of mortgages did not meet the specifications that the banks made in legal filings and in statements to Fannie and Freddie, which are still owned by U.S. taxpayers, the *Huffington Post* reported.

For their part, several of the big banks targeted are hitting back, claiming that Fannie Mae and Freddie Mac ought to shoulder some of the blame. Wrote the Bank of America:

> Fannie Mae and Freddie Mac were among the most sophisticated, powerful and heavily regulated financial institutions in the U.S. mortgage finance system. They claimed to understand the risks inherent in investing in subprime securities and, in fact, continued to invest heavily in those securities even after their regulator told them they did not have the risk management capabilities to do so.

The FHFA alleges that Fannie Mae and Freddie Mac were systematically deceived, and that they would not have purchased the mortgage-backed securities if they had been given honest information. A firm that analyzed mortgages for all of the banks named in the lawsuit, Clayton Holdings, has already revealed that it found problems with many of the mortgages it scrutinized, and that it informed the banks in no uncertain terms of the risks they were taking but that the banks went ahead and sold the mortgages anyway.

Observers note that the really significant point, however, is that banks cared little for the risks they were taking, because they knew that other peoples U.S. taxpayers money would be made available to cover any losses. In other words, while big banks are certainly to be held accountable for their reprehensible conduct, it should be borne in mind that moral hazard created by government regulations and collusion with banking interests *encouraged* rather than discouraged such behavior. Many have pointed out that is more than a little ironic that the government is trying to seize the moral high ground now that the banks and their executives have been protected from the full consequences of their reckless behavior.

No matter the outcome of these latest actions, the U.S. taxpayer will lose. For one thing, the damage has already been done; no amount of legal action will suffice to recover the enormous sums of taxpayer dollars gifted to banking and investment behemoths at home and abroad. For another, the grievous precedent has already been set with the Bush and Obama bailouts, not to mention independent actions taken by the Federal Reserve to keep ailing American and European banks solvent. While the government may extract its pound of flesh this time around, the banks know that, should another crisis flare up tomorrow, they will be shielded from the consequences of their follies by the same government that today holds their feet to the fire.