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Wall Street's Soiled Hands

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The capital unscrupulously pumped from poor neighborhoods by way of predatory loans whizzes along a high-speed financial pipeline to Wall Street to be used for investment. "It's about creating debt that can be turned into bonds that can be sold to customers on Wall Street," explains Irv Ackelsberg, an attorney with Community Legal Services in Philadelphia who has been defending clients against foreclosure and working to restructure onerous loans for twenty-five years.

Household-name companies like Lehman Brothers, Prudential and First Union are involved in managing the process of bundling loans--including subprime and predatory--into mortgage-backed securities. They often provide the initial cash to make the loans, find banks to act as trustees, pull together the layers of financial and insurance institutions, and create the "special vehicles"--shades of Enron--that shield investors from risk.
Four securities-rating agencies--Moody's, Standard & Poor's, Duff & Phelps and Fitch--provide bond ratings for all of Wall Street; before assigning the acceptable rating that will draw investors, they assess the risk firewalls constructed by the securitizing company. It becomes a complex matrix of financial operations designed to generate capital and minimize risk for Wall Street with the unwitting help of borrowers. "This whole business is about providing triple-A bonds to funds that you or I would invest in," says Ackelsberg. "The poor are being used to produce this debt--what you have is a glorified money-laundering scheme."

Ackelsberg and his colleagues frequently find themselves struggling through a tangle of companies to find a party legally liable for remedy when a client is in foreclosure due to a bad loan. Often the company that originated the loan doesn't actually own it but, rather, is acting as a servicing agent--assuring the cash flow to a securitization trust. Frequently shifting ownership also complicates attempts to create accountability: In one case, United Companies Lending, once hired as a trust by Lehman Brothers, went bankrupt; EMC Mortgage Corporation, a wholly owned subsidiary of Bear Stearns, placed the highest bid for the right to service the outstanding loans and collect the servicing fees.

Sheila Canavan, a Berkeley-based attorney who recently won a settlement that will pay out some $60 million to the plaintiffs in a fraud lawsuit against First Alliance Mortgage, says, "The industry and lawyers make it as complicated and arcane as they can so people don't understand." They also, she adds, want to distance themselves from the frontline predators who hawk the loans.

Government-sponsored mortgage lenders Fannie Mae (FNMA) and Ginnie Mae (GNMA) have long bundled conventional loans--in the 8-percent range--to create mortgage-backed securities. During the mergers and acquisitions boom in the mid-1990s, when banks began absorbing subprime lenders, Wall Street caught on to the potential of bunching subprime mortgages, including predatory loans. "The banks realized that this was a moneymaker," says Shirley Peoples, a social research analyst for the Calvert Group, an investment fund specializing in socially responsible lending. "They put a legitimacy on it, but it still is what it is."

"Wall Street, since it got into securitization, needs product, needs mortgage loans to pull together," says Canavan. The securities are then aggressively marketed, she says. "The Wall Streeters go around the country, pools of loans are sold to institutional investors, pension plans, universities."

And while it looks as if the lenders themselves set up the difficult loan terms, Canavan says that Wall Street encourages the gouging practices. The big financial institutions fronting cash for predatory loans have information on the loans' interest rates and know very well what it takes to trap borrowers into those rates. They also build in incentives for dubious practices: "The loan originators are compensated with late fees," Canavan says, by way of example. "They're going to make sure payments don't get there on time, that they get lost or, as the industry says, 'drawered.'"

It's tough for a mutual fund investor to know whether investment dollars are going toward supporting a predatory loan scheme. The investor who knows the names of the biggest offenders may be able to detect them in a prospectus, but many times the information is not included or the names of the companies change. Socially responsible funds such as Calvert and organizations like the Interfaith Center on Corporate Responsibility have been meeting face to face with banking interests to probe their policies and positions on bundling the predatory loans. And many in the industry argue that a rash of bankruptcies and financial failures has pressured the industry to reform.

But not all consumer advocates buy that.

"These companies come and go," says Ackelsberg, "but the residue of their abusive activity remains because the mortgage loans are still out there."

About Bobbi Murray

Bobbi Murray lives in Los Angeles and writes frequently on economic justice issues. **more...**