

Articles

## The Roots of the Financial Crisis: Who Is to Blame?

**BANKS THAT FINANCED SUBPRIME INDUSTRY COLLECTING BILLIONS IN BAILOUTS**

By John Dunbar, David Donald | May 06, 2009 | [ShareThis](#)

The top subprime lenders whose loans are largely blamed for triggering the global economic meltdown were owned or bankrolled by banks now collecting billions of dollars in bailout money — including several that have paid huge fines to settle predatory lending charges.

These big institutions were not only unwitting victims of an unforeseen financial collapse, as they have sometimes portrayed themselves, but enablers that bankrolled the type of lending that has threatened the financial system.

These are among the findings of a Center for Public Integrity analysis of government data on nearly 7.2 million “high-interest” or subprime loans made from 2005 through 2007, a period that marks the peak and collapse of the subprime boom. The computer-assisted analysis also reveals the top 25 originators of high-interest loans, accounting for nearly \$1 trillion, or about 72 percent of such loans made during that period.

The Center found that U.S. and European investment banks invested enormous sums in subprime lending due to unceasing demand for high-yield, high-risk bonds backed by home mortgages. The banks made huge profits while their executives collected handsome bonuses until the

**THE SUBPRIME 25**

These 25 lenders were responsible for \$997.5 billion in subprime lending from 2005 through 2007.

Countrywide #01

**SOLD**

**Countrywide Financial**

CEO: MURRAY Z...

Amount of Subp \$95.7 Billion

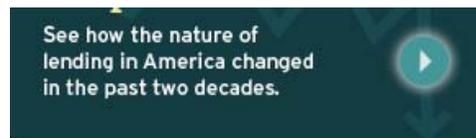
Check their stats, including bailout funds they've received.

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**Subprime Trends**

Investment banks Lehman Brothers, Merrill Lynch, JPMorgan & Co., and Citigroup Inc. both owned and financed subprime lenders. Others, like RBS Greenwich Capital Investments Corp. (part of the Royal Bank of Scotland), Swiss bank Credit Suisse First Boston, and Goldman Sachs & Co., were major financial backers of subprime lenders.



According to the Center's analysis:

At least 21 of the top 25 subprime lenders were financed by banks that received bailout money — through direct ownership, credit agreements, or huge purchases of loans for securitization. Twenty of the top 25 subprime lenders have closed, stopped lending, or been sold to avoid bankruptcy. Most were not banks and were not permitted to collect deposits. Eleven of the lenders on the list have made payments to settle claims of widespread lending abuses. Four of those have received bank bailout funds, including American International Group Inc. and Citigroup Inc.

The Center also conducted a computer analysis of more than 350 million mortgage applications reported to the federal government between 1994 and 2007, and found that the amount of money spent by homeowners on their mortgages as a percentage of their income spiked sharply during the peak of the subprime boom.

### The Subprime Universe

The Subprime 25		
<small>Securities created from subprime loans are widely blamed for the current economic meltdown. These top 25 subprime lenders were responsible for nearly \$1 trillion of the loans, according to a Center for Public Integrity computer-assisted analysis of 7.2 million "high interest" mortgage applications made between 2005 and 2007, at the peak and collapse of the subprime market.</small>		
Rank	Lender	Loan Volume
1	Countrywide Financial Corp.	\$ 97,202,850,000
2	Ameriquest Mortgage Co./ACC Capital Holdings Corp.	\$ 80,659,534,000
3	New Century Financial Corp.	\$ 75,966,191,000
4	First Franklin Corp./National City Corp./Merrill Lynch & Co.	\$ 68,009,685,000
5	Long Beach Mortgage Co./Washington Mutual	\$ 65,263,503,000
6	Option One Mortgage Corp./H&R Block Inc.	\$ 64,754,504,000
7	Fremont Investment & Loan/Fremont General Corp.	\$ 61,725,784,000
8	Wells Fargo Financial/Wells Fargo & Co.	\$ 51,887,522,000
9	HSBC Finance Corp./HSBC Holdings plc	\$ 50,368,364,000
10	WMC Mortgage Corp./General Electric Co.	\$ 49,655,812,000
11	BNC Mortgage Inc./Lehman Brothers	\$ 47,618,868,000
12	Chase Home Finance/JPMorgan Chase & Co.	\$ 30,027,847,000
13	Accredited Home Lenders Inc./Lone Star Funds V	\$ 29,000,898,000
14	Indymac Bancorp Inc.	\$ 26,475,227,000
15	CitiFinancial/Citigroup Inc.	\$ 26,327,651,000
16	Equifirst Corp./Regions Financial Corp./Bardays Bank plc	\$ 24,464,765,000
17	Encore Credit Corp./ECC Capital Corp./Bear Stearns Cos. Inc.	\$ 22,379,670,000
18	American General Finance Inc./American International Group (AIG)	\$ 21,852,938,000
19	Wachovia Corp.	\$ 17,605,460,000
20	GMAC LLC/Cerberus Capital Management	\$ 17,228,006,000
21	NovaStar Financial Inc.	\$ 16,017,194,000
22	American Home Mortgage Investment Corp.	\$ 15,367,310,000
23	GreenPoint Mortgage Funding Inc./Capital One Financial Corp.	\$ 13,143,409,000
24	ResMae Mortgage Corp./Clairol Investment Group	\$ 13,016,239,000
25	Aegis Mortgage Corp./Cerberus Capital Management	\$ 11,538,877,000
<b>TOP 25 TOTAL</b>		<b>\$ 997,538,108,000</b>
<b>ALL HIGH-INTEREST LENDERS</b>		<b>\$1,379,831,861,000</b>
<small>Source: Home Mortgage Disclosure Act data and Center for Public Integrity research.</small>		

[Click here for expanded list](#) Subprime does not mean

“lower than prime.” In fact, it’s just the opposite. Subprime lenders charge rates that are higher than prime, the rate offered to a bank’s most creditworthy customers — sometimes much higher. Subprime borrowers are generally people with poor credit who may have a recent bankruptcy or foreclosure on their record, according to the Federal Reserve.

Each year, under the Home Mortgage Disclosure Act, the federal government collects reams of data from lenders in an effort to determine whether they are adequately serving their communities and whether there is discrimination against minority borrowers. Some smaller lenders and some that do business in rural areas are not required to report. The government estimates the data account for about 80 percent of all home mortgages. In 2004, the Federal Reserve began requiring lenders to indicate when borrowers were being charged three percentage points or more above the rate of interest earned on U.S. Treasury bonds of a similar maturity.

The objective was to gather data encompassing “substantially all of the subprime mortgage market while generally avoiding coverage of prime loans,” according to the Federal Reserve.

The Center analyzed these loans from 2005 through the end of 2007 to come up with its top 25 list of

and crashed in 2007. The top 25 subprime lenders represent nearly 5 million loans.

There are multiple definitions of what constitutes a subprime loan. For the Center's criteria and to learn how the list was created, please see our methodology page.

Most of the top subprime lenders were high-volume, "non-bank" retail lenders that advertised heavily, generated huge profits, and flamed out when Wall Street benefactors yanked their funding. Nine of the top 10 lenders were based in California — seven were located in either Los Angeles or Orange counties. At least eight of the top 10 were backed at least in part by banks that have received bank bailout money.



Countrywide Financial Corp., which made at least \$97.2 billion worth of loans from 2005 through the end of 2007, ranked No. 1 among subprime lenders nationally. The company was purchased by Bank of America last year. No. 1 was Calabasas, California-based Countrywide Financial Corp., with at least \$97.2 billion worth of loans from 2005 through the end of 2007. Countrywide was bought by Bank of America last year, saving it from probable bankruptcy. Second was Ameriquest Mortgage Co. of Orange, California, now defunct, which originated at least \$80.6 billion worth of loans. Third was now-bankrupt New Century Financial Corp. of Irvine, California, with more than \$75.9 billion in loans.

### Non-Bank Lenders Dominate

Independent mortgage companies like Ameriquest and New Century were among the most prolific subprime lenders. Since they were not banks, they could not accept deposits, which limited their access to funds. At least 169 independent mortgage companies that reported lending data in 2006 ceased operations in 2007, according to the Federal Reserve.

Some of the nation's largest banks have subprime lending units, including Wells Fargo & Co., which ranked No. 8, JPMorgan Chase & Co. at No. 12, and Citigroup Inc. at No. 15. The big banks' mortgage business was less reliant on subprime lending than that of the non-bank lenders. But most of the big investment banks also purchased subprime loans made by other lenders and sold them as securities.

Several other lenders among the Top 25 were subsidiaries of Wall Street banks or hedge funds. Encore Credit Corp. (No. 17), for example, was a subsidiary of Bear Stearns, and BNC Mortgage Inc. was part of Lehman Brothers (No. 11).

The lending totals in the survey include subsidiaries owned by the parent companies. British bank HSBC Holdings plc (No. 9) owned American subsidiary HSBC Finance Corp., which in turn owned subprime lender Decision One and also operated under the names Beneficial and HLC.

Two of the top subprime lenders were seized by the government. IndyMac Bank (No. 14) and Washington Mutual (owner of Long Beach Mortgage Co., No. 5) were each taken over by federal banking regulators after big losses on their portfolios of subprime loans.

American International Group (AIG), better known for insurance and complex trades in financial derivatives, made the list at No. 18, thanks to subsidiaries like American General Finance Inc., MorEquity, and Wilmington Finance Inc.

The five banks on the list that are still lending are Wells Fargo, JPMorgan Chase, GMAC LLC, Citigroup, and AIG. All have received billions from the government's bank bailout programs.

### Bailout Recipients



President George W. Bush signs the Emergency Economic Stabilization Act of 2008 in the Oval Office. (*White House/Eric Draper*) On Oct. 3, 2008, former President Bush signed the \$700 billion Emergency Economic Stabilization Act of 2008 into law. The legislation created the “Troubled Asset Relief Program” — or TARP, as it is known — to buy up mortgage-backed securities and hold them, ideally, until they recovered some of their value and could be auctioned. By removing the so-called “toxic” assets from the banks’ balance sheets, it was hoped they would begin lending again. The administration later changed direction and opted instead to buy shares of stock from the banks.

In addition to the \$700 billion bailout, the Federal Reserve began committing hundreds of billions of dollars to guarantee against losses on failing mortgage assets of AIG, Citigroup, and Bank of America.

Among the lenders on the Center top 25 list, seven have received government assistance. Citigroup has collected \$25 billion through the TARP program, \$20 billion through the Treasury Department’s “targeted investment program,” and a \$5 billion Treasury backstop on asset losses. It has also been guaranteed protection from losses on \$306 billion in assets. Wells Fargo has collected \$25 billion in TARP funds, and Bank of America, which bought Countrywide and Merrill Lynch before their imminent collapse, received another \$45 billion in TARP money. Also on the list: JPMorgan Chase (owner of Chase Home Mortgage), Regions Financial Corp. (former owner of EquiFirst), GMAC/Cerberus Capital Management, and Capital One Financial Corp. (former owner of GreenPoint Mortgage). And the bailout of insurance giant AIG may go as high as \$187 billion and includes a combination of loans, direct investment by the government, and purchases of shaky assets.

Center researchers attempted to reach every CEO and corporate owner on its list of the top 25 lenders with mixed success.

A call and e-mail to Bank of America were not returned. A Wells Fargo spokesman said the bank carefully reviews a borrower’s ability to pay. “That’s why 93 out of every 100 of our mortgage customers were current on their payments at the end of 2008,” the bank’s Kevin Waetke wrote in an e-mail.

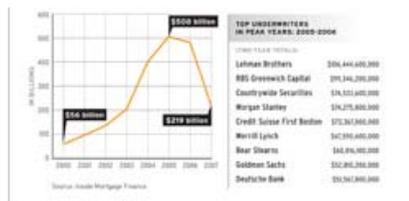
Capital One spokeswoman Tatiana Stead responded that GreenPoint’s loans were considered Alt-A, which generally do not require documentation of income but whose borrowers have good credit. Such loans are not considered subprime, she said, and added that the bank closed GreenPoint shortly after it was acquired.

Since the confusion and panic of 2008 has receded, angry taxpayers have been looking for someone to blame for the mess. Subprime lenders that originated loans they knew were likely to fail are widely cited as a good place to start. But the subprime lenders could never have done so much damage were it not for their underwriters — those giant investment banks in the U.S., Germany, Switzerland, and England.

### Wall Street Cash Pours In

During the boom years, investment banks provided a staggering amount of cash to subprime lenders so they could make loans.

Between 2000 and 2007, backers of subprime mortgage-backed securities — primarily Wall Street and European investment banks — underwrote \$2.1 trillion worth of business, according to data from trade



[Click here for expanded view](#) publication *Inside Mortgage*

*Finance*. The top underwriters in the peak years of 2005 and 2006 were Lehman Brothers at \$106 billion; RBS Greenwich Capital Investments Corp., at \$99 billion; and Countrywide Securities Corp., a subsidiary of the lender, at \$74.5 billion. Also among the top underwriters: Morgan Stanley, Merrill Lynch, Bear Stearns, and Goldman Sachs.

When New Century filed for bankruptcy, it listed Goldman Sachs Mortgage Co. as one of the 50 largest unsecured creditors. Other New Century creditors include Bank of America, Morgan Stanley, Citigroup, Barclays, and Swiss bank UBS.

New Century earlier reported to its shareholders that it had lines of credit totaling \$14.1 billion from those five banks, plus Bear Stearns, Credit Suisse First Boston, Deutsche Bank, and IXIS Real Estate Capital, a French banking firm (since taken over by a company called Natixis) that frequently worked with Morgan Stanley.

An investigative report prepared for the U.S. Trustee overseeing the bankruptcy case described a “brazen obsession with increasing loan originations, without due regard to the risks associated with that business strategy” at New Century. It said the company made loans “in an aggressive manner that elevated the risks to dangerous and ultimately fatal levels.”

In December 2006, Citigroup pooled \$492 million-worth of mortgages to sell to investors as securities, one of several major offerings the bank had packaged for Wall Street. Sixty-three percent of the mortgages were originated by New Century, according to the lengthy prospectus. Eighty-one percent of the loans were adjustable rate mortgages.

Despite their massive investment in subprime loans, some of the nation’s most powerful bankers continue to deflect responsibility.

“Demonizing the bankers as if they and they alone created the financial meltdown is both inaccurate and short-sighted,” Citigroup chairman Richard Parsons told reporters recently. “Everybody participated in pumping up this balloon and now that the balloon has deflated, everybody in reality has some part in the blame.”

A lawyer for former New Century CEO Robert K. Cole said he would have no comment.

Attorney Bert H. Deixler, who represents another former New Century CEO, Brad Morrice, was reached by e-mail. He was asked to comment on New Century’s ranking as well as the contention that subprime loans originated by banks like New Century led to the collapse of the financial industry. Deixler described the Center’s conclusions as “ludicrous.” Several calls and e-mails asking him to elaborate were not returned.

Amerquest, according to Center research of prospectuses, had relationships with virtually every major Wall Street investment bank. The lender sold billions of dollars in loans to Lehman Brothers, Bear Stearns, Goldman Sachs, Citigroup and Merrill Lynch. Some of its other financial supporters included Morgan Stanley, JPMorgan Chase, Deutsche Bank, UBS Securities, RBS Greenwich Capital, Credit Suisse First Boston, and Bank of America.

Countrywide, in addition to capital from shareholders, also had credit agreements with Bank of America, JP Morgan Chase, Citicorp USA (part of Citigroup), Royal Bank of Canada, Barclays, and Deutsche Bank.

Some investment banks owned subprime lenders. Merrill Lynch bought First Franklin Corp. (No. 4 on the Center list) in late December 2006 for \$1.3 billion — just before the bottom fell out of the market. Bear

The British banking giant HSBC got into the U.S. mortgage business in a big way when it bought Household International in 2003. It also purchased Arizona-based DecisionOne Mortgage, and operated under the Beneficial and HLC brands. An HSBC spokeswoman said HSBC Finance was primarily a portfolio lender, meaning it did not sell mortgages to third parties. HSBC, however, did package loans from its subprime subsidiaries into securities, according to SEC filings.

Lehman Brothers, now bankrupt, ranked No. 11 on the subprime list. The bank was a pioneer of sorts in investing in subprime lending. It owned several subprime lenders, including BNC Mortgage, Finance America, and Aurora Loan Services LLC.

Even banks that managed to dodge much of the carnage created by the subprime meltdown — like Goldman Sachs — were invested in the subprime mortgage business. Goldman in May 2005 submitted a prospectus so that it could sell more than \$425 million in securities known as “mortgage pass-through certificates.”

Those securities were sold from an underlying pool of 9,388 second-lien loans that Goldman Sachs bought from Long Beach Mortgage Co., a company that ranks No. 5 on the Center's list of the top 25 subprime lenders. Long Beach was a subsidiary of Washington Mutual, which collapsed in 2008 thanks largely to losses in the subprime mortgage market. It was the biggest bank failure in U.S. history.

Included in the prospectus for those Goldman Sachs securities was a boiler-plate warning to investors considering buying subprime mortgages. It says the borrowers, “for one reason or another, are not able, or do not wish, to obtain financing from traditional sources” and that the loans “may be considered to be of a riskier nature than mortgage loans made by traditional sources of financing.” Goldman eventually received \$10 billion from the government TARP program, a sum the bank says it would like to pay back as soon as possible.

Goldman has been more conciliatory than some banks as far as accepting responsibility for the economic collapse. “Much of the past year has been deeply humbling for our industry,” bank spokesman Michael DuVally wrote the Center. “As an industry, we collectively neglected to raise enough questions about whether some of the trends and practices that became commonplace really served the public's long-term interest.”

Morgan Stanley owned a subprime mortgage company, but its volume wasn't high enough to make the Center's top 25. The investment bank, which has also received a \$10 billion TARP investment, was far more active as an underwriter. It backed \$74.3 billion of subprime loans during the peak years of 2005 and 2006, according to *Inside Mortgage Finance*, ranking it fourth for that period.

In 2006, Morgan and French banking firm IXXIS Real Estate Capital Inc. (now part of Natixis) hoped to sell \$1.3 billion in subprime mortgage-backed securities to investors, according to a prospectus. It included 6,755 loans originated by 20 different lenders, including First NLC Financial Services LLC, Accredited Home Lenders and Countrywide.



[Click here to find out where the companies made their loans.](#) In addition to Wall Street, the Federal National Mortgage Corporation (Fannie Mae) and the Federal Home Mortgage Corporation (Freddie Mac) also fed the subprime monster. Fannie and Freddie were created by the government to promote home ownership by buying mortgages from lenders and selling them to investors, thus freeing up cash for banks to make more loans.

With investment banks buying more and more loans themselves each year, Freddie and Fannie began buying a huge volume of mortgage-backed securities from Wall Street as a means to foster affordable

As of the end of February 2009, Fannie and Freddie held a combined \$292.1 billion in private mortgage-backed securities in their portfolios, according to monthly statements from both companies. On September 7, 2008, the government took control of the two entities.

## Abusive Lending

The subprime lending business has had its share of public relations problems. Subprime lenders say they serve an important function — offering credit to people who have been snubbed by traditional mortgage lenders. But regulators and consumer advocates say some are “predatory” lenders who take advantage of people with little knowledge of how the financial system works and few options when it comes to borrowing.

Indeed, subprime lenders have paid billions to settle charges of abusive lending practices. At least 11 of the lenders on the Center’s list have paid significant sums to settle allegations of abusive or predatory lending practices.

Two of the largest settlements ever reached for lending problems were with AIG and Citigroup, two financial institutions that have received billions in federal aid. Citigroup has a history of subprime lending, dating back to its purchase of Associates First Capital Corp. in 2000. Citigroup at the time was building a global banking empire thanks to its success in convincing the government to deregulate the financial services industry the year before.

Associates had been criticized by some as a predatory lender, and in 2002, Citigroup paid a price for it. The bank agreed to pay \$215 million to resolve Federal Trade Commission charges that Associates had engaged in “systematic and widespread deceptive and abusive lending practices.”

In 2004, the bank was hit again, this time by the Federal Reserve. The Fed levied a \$70 million civil penalty against CitiFinancial, Citigroup’s subprime lending unit, for abuses during 2000 through 2002.

A Citigroup spokesman said the bank does not sell or securitize its loans. It does a small portion of adjustable rate mortgages, but does not offer “teaser rates” that so often get borrowers in trouble. Citigroup has caught heat from other big banks for supporting a bill, backed by consumer advocates, that would give judges more leeway in reworking mortgage loans of people in bankruptcy. The bill died in the Senate on April 30.



[Click here for expanded view](#) AIG settled claims of abusive

lending practices in 2007. AIG subsidiary Wilmington Finance Inc. agreed to pay approximately \$128 million in restitution after the Office of Thrift Supervision found the lender had failed to consider the creditworthiness of borrowers and charged large broker and lender fees. AIG also agreed to donate \$15 million to “financial literacy and credit counseling.”

The company did not respond to a Center request for comment.

customers in all 50 states for unfair and deceptive lending practices.

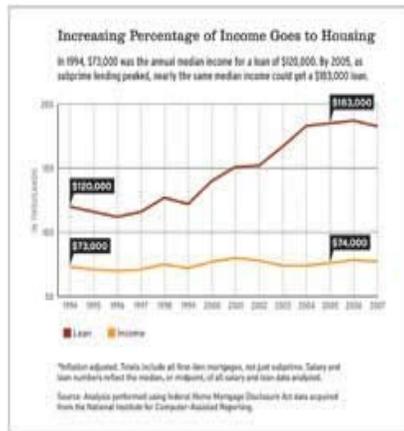
Ameriquest was the subject of at least four settlements involving predatory lending since 1996, including charges of excessive fees and misleading poor and minority borrowers. In 2006, Ameriquest and its holding company, ACC Capital Holdings Corp., agreed to a \$325 million settlement with the District of Columbia and 49 states over allegations that the company misled borrowers, falsified documents, and pressured appraisers to inflate home values.

Countrywide, No. 1 on the Center's list, signed off in 2008 on the mother of all predatory lending settlements. After being sued by 11 states, the company agreed to provide more than \$8.6 billion of home loan and foreclosure relief.

The Center contacted an attorney for former Countrywide CEO Angelo Mozilo, but did not receive a response.

## Deeper and Deeper in Debt

There's no question it has become easier over the last few decades to buy a home. Keeping it, however, is a different matter. One of the key measures of whether borrowers can afford a home or not is to compare their income to their loan amount. In its analysis of the lending industry, the Center tracked the loan-to-income ratio of borrowers between 1994 and 2007. The Center did a computer analysis of more than 350 million mortgage applications reported to the federal government during this time.



[Click here for expanded view.](#) In 1994, the median loan after adjusting for inflation was \$120,000 — meaning half of loans approved were greater than that amount and half were less. The median income of borrowers was \$73,000. That's a loan-to-income ratio of 1.65. So borrowers were taking out loans that amounted to 165 percent of their salary.

The ratio remained relatively steady through the rest of the 1990s, but by 2000, it began to shoot upward. By 2005, the peak of the subprime lending boom, the median loan grew to \$183,000 while borrowers' median income remained roughly the same. That amounts to a loan-to-income ratio of 2.46. That meant the typical loan amounted to 246 percent of annual income.

Borrowers, in other words, were spending a much higher percentage of their income on housing during the subprime lending boom. Many of the lenders coaxed them along by lowering lending standards, failing to require documentation of income on loans, and providing adjustable rate loans with low two-year teaser rates that reset to much higher levels. Ultimately, that fed a wave of foreclosures, leading to trouble for borrowers, lenders, and eventually taxpayers — lots of it. And digging out will be no easy task.