Racial Coding and the Financial Market Crisis

andré douglas pond cummings

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by

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I. Introduction

The financial market crisis of 2008 continues to plague the United States and countries around the world.\(^1\) The underlying causes of the 2008 collapse are numerous, intricate and complex. Academic scholars, investigative reporters and leading economists are now deconstructing the multiplicity of failures that enabled the breathtaking meltdown that nearly collapsed the global economy.\(^2\) As this thoughtful deconstruction emerges, a

\(^{\ast}\) Visiting Professor of Law, University of Iowa College of Law; Professor of Law, West Virginia University College of Law. I am grateful to Professors Aya Gruber, Steven Ramirez, Peggie Smith, Timothy Canova, Deirdre Bowen and Kristin Johnson for excellent comments to early drafts of this article. For fantastic research support, I am grateful to Sarah Tofflemire, University of Iowa College of Law, class of 2011. I am further appreciative to Kimberly Murphy, West Virginia University College of Law, class of 2009, and Kyle Schmidt, University of Iowa College of Law, class of 2011, for terrific research assistance. For excellent feedback on this piece in its nascent stages I am grateful to the Mid-Atlantic People of Color Conference, held at the University of Virginia in January 2010, particularly Deborah Post, Henry Richardson, William Rhee and Atiba Ellis and the Midwestern People of Color Conference, held at Loyola University Chicago in April 2010. Of course, as usual, the politics and errata of this article belong exclusively to me.


disturbing trend has forcefully surfaced, wherein dozens of writers, scholars and thinkers, motivated by politics, limelight and self-indulgence, attempt to fix a singular or foundational cause as “the” reason for the market crisis of 2008. In a current political environment that favors simplicity and scapegoating a certain toxic danger exists when singular blame is fixed to deeply complex failures in order to pander to those in an electorate that live for sound bites and embrace minimalist explanations. Attempting to find singular or primary causation by assigning simple blame for the enormous institutional and personal failures that precipitated the financial market crisis is reckless and ultimately counterproductive.³

The magnitude of the collapse and its devastating consequences,⁴ many of which continue unrequited,⁵ requires a careful and systematic review of causes, impacts, failures

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³ See The Financial Crisis and the Role of Federal Regulators: Hearing Before the House Committee on Oversight and Government Reform, 110th Cong. 6-35 (2008) (statement of Alan Greenspan, former Chairman of the Federal Reserve) (“It was the failure to properly price such risk assets [subprime securities] that precipitated the crisis.”); see also Peter J. Wallison, Barney Frank, Predatory Lender, WALLS J., Oct. 16, 2009, at A19 (blaming Democrats, Fannie Mae and Freddie Mac for the market crisis).

⁴ See Edmund L. Andrews, Economic Activity Is Slowing Across Many Areas, Fed Chairman Says, NY TIMES, Sept. 25, 2008, at C13. (“Mr. Bernanke said Main Street was already beginning to reel from the crisis on Wall Street. . . . Consumer spending, adjusted for inflation, declined in both June and July and probably in August as well. The country lost 100,000 jobs in August and has lost 770,000 since November. . . . “This is the most significant financial crisis of the postwar period,” Mr. Bernanke said . . . ‘I see the financial markets as already quite fragile. The credit markets aren’t working. Corporations aren’t able to finance themselves through commercial paper.’”); see also Carl Hulse and David Herszenhorn, Behind Closed Doors, Warnings of Calamity, NY TIMES, Sept. 20, 2008, at C5. (“Gathered in the conference room just off House Speaker Nancy Pelosi’s personal suite on the second floor of the Capitol, the Congressional leadership had just received the sobering news Thursday night that America’s economy remained in peril despite a series of sudden interventions by the Federal Reserve. . . . In telephone briefings with lawmakers, Mr. Paulson and the Fed chairman, Ben S. Bernanke, sought to make it clear that the price of doing nothing could be calamitous. ‘If we don’t get this, it will be nothing short of a disaster for our markets,’ Mr. Bernanke told House Republicans in a conference call Friday.”); Sudeep Reddy, The Financial Crisis: The Outlook: Fed Could Suffer if New Role Clashes with Policy-Setting, WALL ST. J., Sept. 22, 2008, at A8; Michael R. Crittenden and Patrick Yoest, The Financial Crisis: AIG at Risk: Resolution Trust Plan is Floated, WALL ST. J., Sept. 17, 2008 at A12. (“Staring down the worst financial crisis in decades, U.S. lawmakers are strongly considering whether they need to dust of a 1980s-era plan to help save the banking industry and stabilize the economy more broadly.”).

⁵ See Peter S. Goodman, Despite Signs of Recovery, Chronic Joblessness Rises, NY TIMES, Feb. 21, 2010 at A1. (“Even as the American economy shows tentative signs of a rebound, the human toll of the recession continues to mount, with millions of Americans remaining out of work, out of savings and nearing the end of their unemployment benefits.”); see also Economic News Release, U.S. Bureau of Labor Statistics, http://www.bls.gov/news.release/empsit.nr0.htm (last visited Mar. 21, 2010) (Unemployment for January 2010 is at 9.7% nationally with an estimated 14.8 million people unemployed.); Failed Bank List FDIC,
and economic breakdowns. The foundational causes of the meltdown are numerous. Despite evidence that literally dozens of failures precipitated what some have now dubbed the “Great Recession,” many on the right and on the left continue to strive to point to individual and singular causes for the economic crisis that serve to forward a political purpose or win for them political points in their current positioning. Still, thoughtful and honest analysis of the meltdown defies easy blame categorization or simple causation bottoming. A sincere commentator, academic or politician will


6 See Elliot Spitzer, Frank Partnoy, and William Black, Show Us the E-Mail, NY TIMES, Dec. 20, 2009, at WK9. (“The three of us, as experienced investigators and prosecutors of financial fraud, cannot answer those questions now. But we know where the answers are. They are in the trove of e-mail messages still backed up on A.I.G. servers, as well as in the key internal accounting documents and financial models generated by A.I.G. during the past decade. Before releasing its regulatory clutches, the government should insist that the company immediately make these materials public. By putting the evidence online, the government could establish a new form of “open source: investigation.”); see also Brady Dennis, The AIG E-Mail Trail; Behind the Public Declarations of Optimism in 2007, Months of Internal Discord and Doubt, NY TIMES, Dec. 30, 2009, at A01. (“While the e-mails offer the most revealing look yet at AIG’s inner struggles, they also underscore the main obstacle to federal prosecutors assessing individual culpability for the financial crisis. In a Wall Street culture defined by salesmanship and secrecy, divining the difference between optimism and deceit can be a legal morass – especially when it comes to convincing a jury that the line has been crossed. ... The e-mails, many consumed with technical details of the firm’s deals, reflect an ongoing internal debate about how best to characterize the company’s subprime exposure.”); Sewell Chan, A First Step on Fannie and Freddie, NY TIMES, Mar. 23, 2010, available at http://dealbook.blogs.nytimes.com/2010/03/24/a-first-step-on-fannie-and-freddie/ (“Amid growing pressure from Congress, the Obama administration is taking a tentative first step in developing a plan to reshape Fannie Mae and Freddie Mac. ... Timothy F. Geithner, said the administration would ‘take a fresh, cold hard look at the core problems’ in housing finance.”); Benjamin M. Friedman, The Failure of The Economy and the Economists 56 NEW YORK REVIEW OF BOOKS 9 (2009).

7 See infra Parts II.A, II.B., II.C.


9 See Peter J. Wallison, Barney Frank, Predatory Lender, WALL STREET JOURNAL, Oct. 16, 2009, at A19; see also Stephen Gandel, Did Foreigners Cause America’s Financial Crisis? TIME, Jan. 15, 2010, available at http://www.time.com/time/business/article/0,8599,1954240,00.html (“‘There is no doubt that the pressure on the U.S. financial system [that led to the financial crisis] came from abroad,’ says Caballero, who is head of MIT’s economics department. ‘Foreign investors created a demand for assets that was difficult for the U.S. financial sector to produce. All they wanted were safe assets, and [their ensuing purchases] made the U.S. unsafe.’”).
acknowledge the depth of the failures, the breadth of the negligence and ignorance, and the audacity of the greed and avarice that nearly collapsed the global marketplace. Still, many commentators continue to “expose” the simple reason that the economy collapsed.

The recklessness of pinning simple blame is manifest. First, it obscures a genuine interrogation of causation and hampers the ability to remedy mistakes and past failures. Second, it allows for misdirection and manipulation of events in a way that confuses and distorts. Third, it camouflages policies and provides cover for policy makers that promoted positions and legislation that enabled the failure. Finally, assigning singular, simplistic blame for political purposes undermines thoughtful and careful introspection that must necessarily be measured when debating and promoting new policy direction and legislation aimed toward prevention of future financial crises.

This article is among the first to reject the general, reckless trend toward simple blame causation which swiftly emerged as interested parties initiated attempts to quantify the financial market crisis as an avoidable event, but for a particular reason, decision, or legislative enactment. This piece will challenge specifically one of the most nefarious “the market collapsed because of ‘this’” explanations that emerged with surprising force just moments into the frenzied days of September 2008. Rejecting the simplicity of this approach to causation, this article carefully examines a laundry list of quantifiable failures that enabled the economy to slip to the very edge of the financial abyss just twenty two months ago. Challenging the most nefarious of the causation explanations for the meltdown, this piece will explore post-racialism in the United States and will confront the dirty little myth that emerged immediately upon notice that the economy faced certain collapse.

In the early rush by commentators to evaluate the financial market crisis, several startling explanations emerged, primarily from those seeking to assign simple extrapolations. Perhaps the most startling “cause” of the near global meltdown is the “minority borrower” myth that emerged in the very first moments of the September 2008 frenzy that accompanied the Troubled Asset Relief Program (“TARP”) debates. During the tensest moments surrounding the mortgage crisis in September and October 2008, as TARP was furiously debated on Capital Hill, and as doomsday messages were being delivered daily, many pundits on the right named “minorities” and lending to “poor minorities” as a foundation cause for the market collapse. This “dirty little myth” played on loop at Fox News and on the Rush Limbaugh radio program for weeks and months resonating with those Americans that receive their politics and views from such sources.

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11 See supra Part III.A.

12 See infra notes 342-355 and accompanying text.
In an ultimate irony, at precisely the same moment that minority borrowers were being saddled with the responsibility for crashing a global economy, the United States citizenry was preparing to send a minority politician to the White House to take the most powerful seat in the world. During the September 2008 firestorm where financial Armageddon was threatened as certain, the United States was simultaneously engaged deeply in a historic election cycle. As then Senator Barack Obama and Senator John McCain battled for the votes of this country, the campaign was blindsided by the economic crisis. In the weeks leading up to the November 2008 election, the financial market crisis played a critical role in the campaigns as both Obama and McCain worked hard to convince the voting public that each was the man best qualified to lead the country forward. Most agree that Barack Obama was more convincing in that role and Professor Derrick Bell posits that absent the market crisis, Obama would not have secured the presidency.

With the financial market crisis as backdrop, President Obama overwhelmingly won the election. Dozens of commentators and millions of Americans then argued that, with the election of Barack Obama as president, the United States officially entered a post-racial era. Post-racialism, in averring that the election of an African American president formally moves the nation past its racial problems, essentially maintains that honest and open interrogation of racism and discrimination in the United States is no longer necessary. According to post-racialists, America has truly arrived at our colorblind ideal. Racism is a relic of a checked past that has been affirmatively overcome.

Notwithstanding the attractiveness of the post-racial ideology, these arguments were being made at the very same time that a simmering racist myth was being floated and

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14 See Derrick Bell, On Celebrating an Election as Racial Progress, 36 HUMAN RIGHTS 4 (2009) (“Barack Obama’s election was a dramatic example of Interest Convergence. . . . Facing lost jobs and foreclosed homes, they [voters] had to ask themselves if they wanted a really smart young black guy, or a stodgy old white guy from the same crowd who put them in this hole.”); see also John Heilemann and Mark Halperin, Game Change: Obama and the Clintons, McCain and Palin, and the Race of a Lifetime ___ (2010).


16 See infra Part IV.

17 See Schorr, supra note 15.
adopted by many of the very same citizens that were hailing a new post-racial America. While markets were roiling in September and October 2008, with financial Armageddon at the nation’s doorstep and two Presidential candidates debating the possible effects and solutions, a simple message emerged from the right and was peddled to the consuming American public as the primary reason that the global markets were collapsing: Minorities. African American and Latino borrowers were provided as the scapegoat to explain why the global economy was failing. The dirty little myth maintains that because of Governmental intrusion into the home lending industry, through the Community Reinvestment Act of 1977, lenders were forced to provide loans to extremely risky minority borrowers, who themselves were overreaching by trying to purchase homes that they had no business buying. Because lenders had no choice but to provide loans to risky minority borrowers, subprime loans became the avenue of choice.

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for lenders to overreaching minority borrowers and it was the current failure of black and brown homeowners to pay their mortgages that the subprime mortgage industry collapsed. Thus, as the myth purports, the financial market crisis is ultimately traceable to minority Americans and governmental social welfare.\(^{23}\)

With precious little evidence to support this scapegoating, many U.S. citizens have embraced the dirty little myth hook, line and sinker.\(^{24}\) And, this percolating resonance continues to survive as myth proponents today include economists,\(^{25}\) conservative think tank employees,\(^{26}\) Wall Street insiders,\(^{27}\) mutual fund presidents,\(^{28}\) pundits\(^{29}\) and average

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\(^{23}\) See supra notes 21-22 and accompanying text.

\(^{24}\) See Jeff Davis, Minority Subprime Mortgages Have Caused the Financial Crisis, ALTERMEDIA.INFO, Sept. 23, 2008, available at http://us.altermedia.info/news-of-interest-to-white-people/minority-mortgages-brought-financial-market-to-its-knees_3693.html (“I think everyone can see the desire to give more mortgages to minorities loosened standards and caused the subprime crisis. Banks and mortgage companies were giving home loans to every Tyrone, Jose and Roberto in order to get a commission and generate worthless paper for the lender to use as collateral on loans from the bigger fish.”); see also Larry Keller, Minority Meltdown: Immigrants Blamed for Mortgage Crisis, SOUTHERN POVERTY LAW CENTER, Spring 2009, available at http://www.splcenter.org/get-informed/intelligence-report/browse-all-issues/2009/spring/minority-meltdown (describing the massive viral spreading and popularity of the immigrant/minority trope for causing the mortgage crisis). According to the SPLC “The CRA falsehood easily jumped from the far-right fringe to more mainstream, presumably more credible conservative media outlets, illustrating how sloppy fact-checking or no fact-checking at all have become increasingly common in the midst of fierce competition among speed-obsessed media.” Id.


citizens. That the dirty little myth would spring up at the onset of this generation’s greatest economic ordeal is disappointing. That the dirty little myth would be embraced by so many with so little to support it, with scant questioning or thought is demoralizing. The myth is particularly mystifying in an era where many post-racialist Americans are determined to believe that with the election of an African American President Obama that our nation has crossed over into a colorblind era. Critical Race Theory, however, provides insight into how a 21st century dirty little myth can still find traction in the United States.

The powerful continuing dynamism of entrenched traditional American racism persists in our newly acclaimed “post-racial” United States. This static feature, relentless U.S. racial discrimination, simply evolves, and as the laws change to outlaw various manifestations of overt racism, it merely mutates into new and sophisticated, complex manifestations of race hatred. This mutation involves racist embrace of any available avenues including Youtube.

(Describing board meeting wherein Mutual Fund representatives blamed the Community Reinvestment Act for the financial market crisis).


30 Examples of average Americans that blame minorities for the financial market crisis abound on Web 2.0 avenues including Youtube. See generally http://www.youtube.com/watch?v=bb-wwZwpn8U; http://www.youtube.com/watch?v=TxgSubmiGt8; http://www.youtube.com/watch?v=ZKHpaCIPOFY; http://www.youtube.com/watch?v=UVVVzEKauzY.


33 See supra note 32; see also Charles R. Lawrence III, The Id, the Ego, and Equal Protection: Reckoning with Unconscious Racism, 39 STAN L. REV. 317, 335-336 (1987) (“But how is the unconscious involved when racial prejudice is less apparent—when racial bias is hidden from the prejudiced individual as well as
mechanism or adjacent expression to subordinate the interests of minorities in the United States and oft-times seeks to attach liability in careless ways to any available minority scapegoat.\textsuperscript{34}

The dynamism and continuing intensity of American racism is clearly evident in the financial market crisis of 2008. The market collapse was caused by intense and complex economic forces and failures, not by minority borrowers.\textsuperscript{35}

To explore the true underlying causes of the financial market crisis in order to challenge the simplicity trend and to examine the emergence of the dirty little myth in light of a new post-racial America, this article will proceed as follows: Part II will carefully analyze the genuine underlying causes of the financial market crisis as identified by economists, scholars and academics. This section serves to dissuade pundits and commentators from attempting to hijack the market crisis debate for political purposes and aims to provide clear and concise guidance to those that thoughtfully engage in reform efforts targeted toward avoiding future crises. Part III will explore the dirty little myth which was introduced as the most central of the primary causes floated by individuals/parties anxious to pin blame for political purposes rather than interrogate the true failures that precipitated the meltdown. Part IV will examine post-racialism and query whether in a nation that accepts minority scapegoating with little objection, it can truly be situated as post-racial. Part V concludes with forward looking thoughts.

II. Financial Market Crisis Reality

Despite attempts to pin the market collapse on a simple cause, respected voices now argue in light of the breadth and depth of the crisis that the underlying foundational economic theories that support American capitalism are suspect or discredited, if not outright broken.\textsuperscript{36} The neoclassical law and economics theories that drive so much of

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\textsuperscript{35} See **infra** Part II.

\textsuperscript{36} See **SIMON JOHNSON & JAMES KWAK**, *13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN* 6-13 (2010); **ROBERT SKIDELSKY**, *KEYNES: THE RETURN OF THE MASTER* 3-28 (2009); see also **Timothy A. Canova**, *Financial Market Failure as a Crisis in the Rule of Law: From Market Fundamentalism to a New Keynesian Regulatory Model*, 3 *HARV. L. & POL’Y REV.* 369, 370 (2009) (“The economic model underlying today’s failing regulatory regime is a neoclassical equilibrium model that is highly abstract and mathematical, often based on unrealistic assumptions and ignorant of historical
United States economic policy and legal philosophizing are now being critically interrogated both from long time critics and surprising new sources. This examination

contexts and the many complex dynamics and interdependencies of human behavior and market psychology. Largely uncontrolled and uncoordinated, the current regulatory approach does not serve the interests of the public, but rather the far narrower interests of the regulated institutions that have captured the agencies of government and the policy-making process.

T: Timothy A. Canova, The Failing Bubble Economy: American Exceptionalism and the Crisis in Legitimacy, 102 AM. SOC’Y INT’L L. PROC. 237, 237 (2008) (“Lawyers and legal scholars have tended not to question the economic assumptions of orthodox economic models and policies of central banks and international financial institutions. As the crisis reached a peak and the U.S. Congress passed a bailout plan along the lines of the original plan proposed by U.S. Secretary of the Treasury Henry Paulson, economic assumptions began to shift in profound ways. “Regulation,” which had been a dirty word for the past three decades, was suddenly the prescription for the failures of “deregulation.””); Timothy A. Canova, Legacy of the Clinton Bubble, 41 Dissent ## (2008) (“The Federal Reserve became increasingly independent of elected branches and more captive of private financial interests. This was seen as “sound economics” and necessary to keep inflation low. Yet the Federal Reserve’s autonomy left it a captive of a financial constituency it could no longer control or regulate.”); STEVEN RAMIREZ, TOWARD A MORE PERFECT CAPITALISM (NYU Press forthcoming 2010) (manuscript on file with author) (describing the economic framework that did predict the current crisis, with powerful explanatory power, is Hyman Minsky’s Inherent Instability Hypothesis which directly contradicts the Efficient Market Hypothesis).

37 See id.; see also Douglas M. Branson, Corporate Governance Reform and the ‘New’ Corporate Responsibility, 61 U. PR. LAW. 605, 619 (2009) (“Every book and journal article in the corporate law field had to take an economics of law perspective if they were to succeed in the marketplace of ideas. In its more extreme forms, law and economics solutions to problems of human behavior were paraded as “science” (not as social science but as “science”), the findings of which were unassailable. Those who questioned were made to appear ignorant or foolish . . . .What prevented managers from ‘ripping off’ the owners, by misuse or embezzlement of corporate funds or property or by other forms of purposeful venality? The answer law and economics gave was not ‘more regulation’ or ‘public interest directors,’ or ‘intervention by the federal government,’ but ‘market forces.’”); Lawrence E. Mitchell, The Morals of the Marketplace: A Cautionary Essay for Our Time, 20 STAN. L. & POL’Y REV. 171 (2009) (“The law that imposes no corporate obligation on shareholders or creditors historically was based on the assumption that the financial incentives of investors would rationally direct them to act in their own self interest, which would align with their perceptions of the entity’s best interests, and the same may be said of financing productive activity more broadly.”) Professor Mitchell continues:

The productive entity would be well-run, or at least for the purpose of achieving the success of its business, because it was in the interest of its financiers to ensure that it was. The more attenuated the security from the productive activity, the less is this true. . . . If financing productive activity is a major justification for the existence of capital markets, that justification is increasingly untenable. Taming the capital markets to take responsibility, or at least to act as if they were responsible, for economic production in the real economy is the solution. . . . The problem, and it is a very real and very substantial one, is that the growth of risk management has not been accompanied by the growth of what might be called ‘responsibility management.’ Rather, the goal of risk management, at least in the capital markets, has been to parcel out pieces of risk normally associated with a given type of investment so that no single investor holds the entire risk. The substantial achievement of this goal in certain areas has meant that no single investor takes any responsibility for the acceptability of the underlying investment, nor for the productive enterprise underlying it, either, and that the issuer of the securities that parcels out the risk similarly is untroubled by it.

leads many critics to freshly conclude that the astonishing rise to prominence of law and economic theory in this country has now proven folly as neoclassical economics is intellectually and morally bankrupt. This scrutiny leads other critics to claim that capitalism and the rush to deregulate the U.S. economy in the past two decades have proved a failed exercise.

Two surprising commentators are leading this new questioning of capitalism and neoclassical economics and are acknowledging the depths of the failures and the breadth of the negligence. Famed law and economics champion Judge Richard Posner recently

38 See Richard Posner, A Failure of Capitalism: The Crisis of ’08 and the Descent into Depression xii (Harvard University Press) (2009) (“We are learning from it [the crisis] that we need a more active and intelligent government to keep our model of a capitalist economy from running off the rails.”). Judge Posner continues in admitting failures in his “law and economics” modeling “So the market can be blamed for recessions, which without government intervention would often turn into depressions, as they often did before the government learned (we thought!) in the after-math of the Great Depression how to prevent that from happening.” Id. at 270. “But there might not have been a depression had it not been for the Bush Administration’s mismanagement of the economy.” Id. at 271. “There were three big prevention failures this time: excessive deregulation, neglect of warning signs, and insouciance about the decline in the rate of personal savings and the safety of such savings.” Id. at 289.

Former Federal Reserve Bank Chairperson Alan Greenspan joins Judge Posner in his “conversion” away from laissez-faire free markets. The Financial Crisis and the Role of Federal Regulators: Hearing Before the House Committee on Oversight and Government Reform, 110th Cong. 6-35 (2008) (statement of Alan Greenspan, former Chairman of the Federal Reserve) (“We are in the midst of a once-in-a-century credit tsunami. . . . . Those of us who have looked to the self-interest of lending institutions to protect shareholders’ equity – myself, especially – are in a state of shocked disbelief. . . . I made a mistake in presuming that the self-interest of organizations, specifically banks and others, were such that they were best capable of protecting their own shareholders and their equity in firms. . . . . I still do not fully understand why it happened. And obviously, to the extent that I figure out where it happened and why, I will change my views.”);

39 See supra note 36; see also Steven Ramirez, Toward a More Perfect Capitalism (NYU Press forthcoming 2010) (manuscript on file with author) (“The emergence of yet another bubble followed by a debt crisis highlights the intellectual bankruptcy of the neoclassical paradigm, as it lacks any ability to predict such a crisis, explain such a crisis or remedy such a crisis.”); Simon Johnson & James Kwak, 13 Bankers: The Wall Street Takeover and the Next Financial Meltdown 3-13 (2010); Robert Skidelsky, Keynes: The Return of the Master 3-28 (2009).

40 See supra notes 36, 38; see also Richard Posner, A Failure of Capitalism: The Crisis of ’08 and the Descent into Depression 75 (Harvard University Press 2009) (“Digging a little deeper, we find [the underlying causes of the depression] . . . the withering of the regulation of financial services, which removed checks on risky lending.”). Judge Posner continues “The housing bubble and the risky lending practices could have been prevented by more aggressive regulation and the elimination of tax benefits for homeowners. But the absence of these or other preventative measures was the result not of too much government but of too little.” Id. at 113; André Douglas Pond Cummings, “Ain’t No Glory in Pain”: How the 1994 Republican Revolution and the Private Securities Litigation Reform Act Collapsed the U.S. Capital Markets, 83 Neb. L. Rev. 979 (2005) (describing the “deregulation hysteria” that gripped the “Contract With America” Congress in 1994) [hereinafter Cummings, Ain’t No Glory in Pain]; André Douglas Pond Cummings, Still “Ain’t No Glory in Pain”: How the Telecommunications Act of 1996 and Other 1990s Deregulation Facilitated the Market Crash of 2002, 12 Fordham J. Corp. & Fin. L. 467 (2007) (describing the deregulatory enactments of the 1990s and early 2000s that lead to great market instability) [hereinafter Cummings, Still Ain’t No Glory in Pain].
penned *A Failure of Capitalism: The Crisis of ‘08 and the Descent into Depression* wherein he admitted, astonishingly to some, that “[t]he [2008 financial market crisis] is a failure of capitalism, or more precisely of a certain kind of capitalism (‘laissez-faire’ in a loose sense . . .), and of capitalism’s biggest boosters.”41 Throughout Posner’s *A Failure of Capitalism* and his surprising rejection of many law and economics principles, he is extremely critical of his conservative compatriots and plainly discusses the failures of capitalism and neoclassical economics that allowed the financial markets to bubble, balloon and implode.42

Joining Posner in retrospection and contrition is former Federal Reserve Chair Alan Greenspan, perhaps the fiercest proponent of deregulated free markets. Under 2008 Congressional questioning, Greenspan admitted grave error in aggressively advocating that the U.S. derivatives markets should be freed from governmental oversight, staking the gravity of his reputation on the fact that large financial institution leaders would never leverage their companies to the point of collapse in pursuit of reckless profit.43 In this, Greenspan was confounded, as he later recognized. “Those of us who have looked to the self-interest of lending institutions to protect shareholders’ equity, myself included, are in a state of shocked disbelief,” said Greenspan during Congressional hearings into the 2008 collapse.44 Further, Greenspan admitted that he relied too much on the “self-correcting power of free markets”45 and that careful oversight and regulation could have prevented the “self-destructive power of wanton mortgage lending.”46 Greenspan further admitted that the Fed and the government allowed the growth of highly risky mortgages and out of control derivatives trading without recognizing the “self-destructive power” of those instruments.47

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41 RICHARD POSNER, *A FAILURE OF CAPITALISM: THE CRISIS OF ‘08 AND THE DESCENT INTO DEPRESSION* 260 (Harvard University Press 2009). Judge Posner wrote “The way was open for a doctrinaire free-market, pro-business, anti-regulatory ideology to dominate the Bush Administration’s economic thinking and regulatory enforcement (or nonenforcement) until the depression was upon us, whereupon ideology took a back seat.” *Id.* at 274.

42 See generally *id*.


47 See Robert Skidelsky, *The Remedist*, N.Y.TIMES, Dec. 14, 2008, available at http://www.nytimes.com/2008/12/14/magazine/14wwln-ledet.html (“Among the most astonishing statements to be made by any policymaker in recent years was Alan Greenspan’s admission this autumn that the regime of deregulation he oversaw as chairman of the Federal Reserve was based on a ‘flaw’: he
That Richard Posner and Alan Greenspan concede significant failure in their foundational economic theories and beliefs should signal to economists, academics, political leaders and the broader community a striking need to reevaluate the core underpinnings of our current and continuing economic policies. Still, when given the opportunity to truly interrogate capitalism, the way we “do” corporate law, and the pervading neoclassical economic theories in the United States, we as a nation are largely failing that invitation.

While the 111th Congress tepidly fritters around the fringes of the massive failures that brought the global economy to its knees, the forces that view Posner’s and Greenspan’s admissions of error as weak kneed, those that would perpetuate status quo economic theories and capitalism’s virtues without examination, including the banking lobby, marshal their forces and organize against any formal movement toward new regulation or correction. This marshaling of opposition to new and fresh regulation of the financial institutions most embroiled in the market collapse has been truly impressive.

overestimated the ability of a free market to self-correct and had missed the self-destructive power of deregulated mortgage lending. The ‘whole intellectual edifice,’ he said, ‘collapsed in the summer of last year.’”). That said, Greenspan has retooled his message and recently amended his outlook suggesting that no person could have foreseen or prevented the financial market crisis and that his judgments were correct, in retrospect, 70% of the time. See Ben Rooney, Greenspan: I Was Right 70% of the Time, CNNMONEY.COM, Apr. 7, 2010, available at http://money.cnn.com/2010/04/07/news/economy/Greenspan_financial_crisis_commission/index.htm?hpt=T1; see also Frank Rich, No One Is to Blame for Anything, N.Y. TIMES, Apr. 11, 2010, available at http://www.nytimes.com/2010/04/11/opinion/11rich.html (“[Greenspan] was eager to portray himself as an innocent bystander to forces beyond his control. In his rewriting of history, his clout in Washington was so slight that he was ineffectual at ‘influencing the Congress.’”).


See Christopher Swann, Time to Stand Up to the Banking Lobby, REUTERS, Jul. 15, 2009, available at http://blogs.reuters.com/great-debate/2009/07/15/time-to-stand-up-to-the-banking-lobby/ (“Banks might have less money to throw around. But they do not appear to be skimping on lobbying. Political action committees run by the Independent Community Bankers of America have already raised 40 percent more funds than last year. Overall the finance, insurance and real estate sectors spent $110.7 billion on lobbying in the first three months of the year – second only to healthcare providers.”).


paralyzed by reelection fear, Congress has so significantly diluted meaningful regulatory reform that it appears that it will not address the changes so achingly obvious in the heated aftermath of Government bailouts and Wall Street chaos. Still, much is now being written about the causes of the financial market crisis of 2008. Amidst all of the reporting and rhetoric, several crisis truths now appear beyond dispute. First, a deregulatory movement gripped Congress and the Federal Reserve Bank through the 1980s, 1990s and early 2000s and several federal legislative enactments during that period created a Wall Street atmosphere that invited the recklessness that caused nearly every single financial industry titan to face certain collapse in 2008. Second, a housing market bubble inflated in the early part of the past decade, enabled by lax lender regulation, predatory lending, predatory borrowing and governmental cover. When the housing bubble burst and the market corrected, the entire house of cards collapsed. Third, mortgage loan securitization seized the imaginations of institutional investors and securities speculators in unprecedented fashion, leading to the bundling of home mortgages (most critically subprime mortgages) into derivative investment vehicles that were bought and sold with unregulated abandon, all of which was enabled, protected and hedged by collateralized debt obligations, credit rating agencies, reckless executive

where Harvard Law Professor Warren described the bank lobby as appearing in the offices of sitting Congresspersons “two and three and four times a day,” unlike anything she “has ever seen” before; see also Real Time with Bill Maher (HBO television broadcast Feb. 19, 2010) (interview with Elizabeth Warren).


leadership, credit default swaps and balance sheet fraud.\textsuperscript{56} Greed and avarice overwhelmed Wall Street. Risk assessment and quant modeling broke down in a truly unprecedented fashion. An honest exploration of the crisis reveals that each of the factors outlined above and examined below contributed its critical part to the global meltdown. Critically, not one of the causes outlined below implicate race or social engineering that the dirty little myth posits caused the global meltdown.

A. Deregulation

“We cannot control ourselves. You have to step in and control the Street”
—John J. Mack, CEO, Morgan Stanley\textsuperscript{57}

A clear deregulatory trend has driven Congress and regulators for the past two to three decades wherein proponents of \textit{laissez faire} economics have successfully persuaded leaders and legislatures to adopt positions that hamper oversight and restrict thoughtful regulation of capital markets. Four such examples, which are clearly linked to enabling the market collapse, include deregulatory policies initiated by the Federal Reserve Bank, the Gramm-Leach-Bliley Act, the Commodities Futures Modernization Act and the Private Securities Litigation Reform Act, amongst a host of other deregulatory legislative and agency enactments.

1. The Federal Reserve Bank

The Board of Governors of the Federal Reserve System (“Federal Reserve”) played an integral role in the financial market crisis of 2008. Dating back to the 1970s, the Federal Reserve has been captured by investment banking interests engaging largely in a strategy of deregulation that has proved disastrous for all parties concerned aside from the largest bailed out Wall Street financial institutions and their executives.\textsuperscript{58} The Fed began more than twenty-five years ago to relax lending standards for mortgage providers, loosen interest rates and slacken capital requirements for large commercial and investment


According to Professor Timothy Canova, in the ultimate “capture” the Fed affirmatively adopted the investment banker’s agenda as far back as the 1980s and since then, the Fed has used that agenda to set policy for commercial and investment banking in the United States. By adopting the corporate agenda, the Fed has engaged in a systematic “dereliction of duty” by promoting standards that increased the profitability of banks at the expense of protecting consumers from lending abuse.

The deregulation trending embraced by the Fed and its wholesale cooptation of the banking lobby agenda led in large part to the financial market crisis. The relaxation of lending standards, the continuing reduction of interest rates, the campaign to free over-the-counter derivatives trading from any oversight, the campaign for repeal of the Glass-Steagall Act and the catering to the interests of Wall Street investment banks all fell into the deregulatory pattern and agenda that consumed Washington D.C. during the 1990s and early part of 2000s. And, as has been well documented, the Fed’s immediate response to the financial market crisis was to provide an incredible, unprecedented and unfettered infusion of bailout capital into the very Wall Street banks whose recklessness brought the economy to its knees.

Reacting to the crisis, the Federal Reserve slashed interest rates on loans and obligations offered to member banks, in order to keep the economy afloat. Staring into a potential


63 See JOHNSON & KWAK, supra note 2, at ___.

64 See Christian Johnson, Exigent and Unusual Circumstances: The Federal Reserve and the U.S. Financial Crisis, European Business Organization Law Review (forthcoming 2010); see also supra notes ___-___ and accompanying text.

financial abyss, the Fed hastened to open up new lines of credit to Wall Street investment firms, “creating financial arrangements not unlike deposit insurance, but chillingly devoid of traditional deposit insurance regulatory oversight—without any explicit prior approval from Congress.”66 While the Fed’s unprecedented efforts saved Wall Street investment firms and hedge funds from collapse, smaller subprime mortgage loan originators “folded up their tents like the Bedouin—over 100 different subprime mortgage origination companies systematically collapsed.”67 The failure of dozens of subprime mortgage origination companies seems appropriate, in light of the emerging evidence of predatory lending and discriminatory targeting of minority communities that many engaged in.68

Thus, TARP bailout funds, approved by Congress to save the economy from catastrophe, were used primarily to prop up Wall Street titans at a cost to U.S. taxpayers of more than $3 trillion dollars.69 Rather than free up lending, which was a portion of the stated purpose of the infusion of TARP funds, the banks hoarded the capital bestowed upon them from the Fed to improve their balance sheet performance.70 With that massive infusion of taxpayer capital and huge loans made available to Wall Street firms from the Fed Bank, Wall Street responded almost immediately by paying near record executive compensation bonuses for 2009 “performance” and simultaneously spending hundreds of millions of dollars lobbying fiercely against new financial services regulation.71


69 See Steven Ramirez, Subprime Bailouts and the Predator State, 35 DAYTON L. REV. 81, 91, 100 (2009); see also JOHNSON & KWAK, supra note 2, at ____.

70 See Steven Ramirez, Subprime Bailouts and the Predator State, 35 DAYTON L. REV. 81, 91, 100 (2009) (describing the hoarding of capital by Wall Street firms using taxpayer bailout funds to improve balance sheets and record record profits rather than lending to a cash strapped citizenry).

When news organizations and Congress both appealed to the Fed to provide full disclosure as to the use of TARP bailout funds and massive loans extended to Wall Street investment banks, including a request to see how the funds were dispensed, what tracking mechanisms were in place and who received what, the Fed stonewalled both news organizations and Congress claiming that the public had no right to see or know what was being done with taxpayer funds. The Fed’s failure to provide bailout fund disclosure to the public has been challenged in the courts.

Taxpayer bailout funds provided by the U.S. government was used indirectly by Wall Street firms to pay hundreds of millions of dollars in executive compensation. Taxpayer bailout funds derived from government largess was used by Wall Street firms to pay millions of dollars to lobbying firms employed to aggressively fight against new financial sector regulation. More than $3 trillion dollars have been spent by the Fed to prop up a system that has failed taxpayers without any interrogation of the system that enabled the meltdown and without any functional oversight or forced responsibility onto Wall Street elites.

More than $3 trillion dollars have been loaned by the Fed to Wall Street banks in order to prop up capitalism and free market fundamentalism, an ironic oxymoron. The Federal Reserve gave/loaned taxpayer funds to insulate “capitalism,” Wall Street excess and privilege sans examination of any sort. While a swath of Americans went very nearly crazy in opposition to passage of Health Care Reform legislation, the vitriol for Wall Street and the complete subjugation of taxpayer rights to corporate interests is ignored. Why would those that spit on Congresspersons, hurl racial epithets at minority members of Congress, scream homophobic slurs at gay Congressional leaders and phone in death threats to individuals with the audacity to vote for insurance company reform stand silent in the face of massive taxpayer bailout and the unfettered prop up of an entrenched system of corporate privilege?


The Fed Chair most responsible for co-opting the Wall Street agenda as federal policy, Alan Greenspan, has famously admitted the nature of his errors and the serious miscalculations that were made in the run-up to the financial market crisis.77 Greenspan claims “I was right 70% of the time. But I was wrong 30% of the time, and there were an awful lot of mistakes in 21 years.”78 Adopting Wall Street’s deregulatory agenda and anchoring his philosophy in an unbridled passion for *laissez faire* represent two of Greenspan’s most serious “mistakes.”

2. Gramm-Leach-Bliley

The Gramm-Leach-Bliley Amendment of 1999 is among the most significant injurious deregulatory actions that led to the financial crisis of 2008.79 While not alone in deregulatory enactments that precipitated the crisis, Gramm-Leach-Bliley is often linked to the malfeasance that collapsed the U.S. markets. Gramm-Leach-Bliley swept away all Glass-Steagall prohibitions against banks entering into the securities and insurance industries.80 Glass-Steagall had been enacted in 1933 to address the regulatory failures that led to the Great Depression.81 Following intense lobbying efforts by the banking industry, the Glass-Steagall firewalls that had been erected between consumer banks and the insurance and securities industries were eliminated by Gramm-Leach-Bliley, essentially brushing away six decades of consumer protection. Glass-Steagall which had

50% of Republicans polled do not believe that Wall Street banks were the cause of the financial market crisis).

77 See *supra* notes ___-___ and accompanying text.


been passed in the 1930’s, was designed to stamp out commercial speculation, and most perceived evils that Congress viewed at the time as leading to the Great Depression.\textsuperscript{82}

Upon passage of Gramm-Leach-Bliley, a frenzy of consolidation, merging and acquiring ensued wherein the primary banking institutions in the United States became ever larger and more powerful, and simply “too big to fail.”\textsuperscript{83} As was feared by the few Senators and Congresspersons that opposed passage of Gramm-Leach-Bliley, the banking industry became one of enormous “one-stop” financial institutions that engaged in not just consumer banking, but also in insurance activity and speculative investing with consumer deposits.\textsuperscript{84}

Once the firewalls were erased, the consolidation of the industry led in part to the market crisis that nearly collapsed every single banking institution that had lobbied so aggressively for passage of the very Act that would have swallowed each whole but for a government bailout, including Citigroup and Bank of America.\textsuperscript{85} That Congress bowed to the intense lobbying of Wall Street and the banking industry in passing Gramm-Leach-Bliley was not surprising as both Republicans and Democrats fell under the \textit{laiss\'ez-faire} sway of nearly every financial leader and lobbyist in place at the time.\textsuperscript{86} “This

\textsuperscript{82} Joseph Grant, \textit{What the Financial Services Industry Puts Together Let no Person put Asunder: How the Financial Services Modernization Act of 1999 – The Gramm-Leach-Bliley Act – Contributed to the 2008-09 American Capital Markets Crisis}, 73 A\textsuperscript{L}BAN\textsuperscript{Y} L. REV. \textsc{___}, \textsc{___} (2010) (“Passed during the Roosevelt administration, the Glass-Steagall Act directly responded to the belief that the stock market crash [of 1929] resulted from the lack of separation between lending and underwriting activities that had allowed banks to engage in speculative investments. Under the Glass-Steagall Act, Congress separated commercial banking from investment banking, thereby prohibiting commercial banks from underwriting most securities.”) (citations omitted); see also \textsc{JOHNSON & KWAK, supra} note 2, at \textsc{___}.


\textsuperscript{85} Joseph Grant, \textit{What the Financial Services Industry Puts Together Let no Person put Asunder: How the Financial Services Modernization Act of 1999 – The Gramm-Leach-Bliley Act – Contributed to the 2008-09 American Capital Markets Crisis}, 73 A\textsuperscript{L}BAN\textsuperscript{Y} L. REV. \textsc{___}, \textsc{___} (2010); see also \textsc{JOHNSON & KWAK, supra} note 2, at \textsc{___}.
monumental deregulatory moment fitted well with Greenspan’s laissez-faire position with regard to markets. It is the same free market belief that has led the Fed to turn a blind eye in the face of inflated asset prices.”

Of course, the Fed possesses the power to regulate commercial banks, which it failed to exercise, particularly following passage of Gramm-Leach-Bliley. Greenspan, believed and preached, as one of his primary tenets, that private industry was much better situated to police and regulate itself primarily because corporate executives and major financial institution directors would never risk their very existence in reckless or overleveraged positioning. In this belief, of course, Greenspan was badly mistaken. Per Posner, “[t]he successive Federal Reserve Chairmanships of Greenspan and Bernanke must be reckoned prime causes of the financial crisis and the slide into depression.” For a span in time, Alan Greenspan’s tremendous prestige allowed him nearly unfettered sway and with it, he blocked deregulation of derivative instruments and refused to use his power, the power of the Fed, to stave off the housing bubble by raising interest rates and failing to rein in the reckless lending by more assertively exercising the control that the Federal Reserve holds over commercial banks.

While Gramm-Leach-Bliley did not necessarily directly impact the actions of Wall Street investment banks Lehman Brothers and Bear Stearns, viewed as the main progenitors of

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86 See Hackney, supra note 80, at 541 (“The repeal of Glass-Steagall was the product of a Republican Congress, and a Democratic President (Bill Clinton), but had an ‘assist’ from the Federal Reserve. It was the Fed under the chairmanship of Alan Greenspan that approved the merger between Citicorp and Travelers Group in 1998. This forced the hand of Congress and President Clinton to repeal Glass-Steagall.”).

87 See Hackney, supra note 80, at 541.

88 See Hackney, supra note 80, at 541.

89 See Jacob M. Schlesinger and Michael Schroeder, Greenspan Defends Longer-Term Capital Plan, WALL STREET JOURNAL, Oct. 2, 1998 at A3 (“Despite acknowledging the potential dangers from Long-Term Capital’s near collapse – and the possibility of more such disruption – Mr. Greenspan said he didn’t think more regulation would work. Attempts to impose government controls on the unregulated hedge-fund industry, he said, would simply force those activities offshore.”); see also Allison Bisbey Colter, Hedge Funds Are Back in Spotlight, WALL ST. J., Feb. 17, 2004 at D11 (“Federal Reserve Chairman Alan Greenspan last week joined the debate over hedge-fund regulation, saying he objected to a proposal by Securities and Exchange Commission staff that hedge-fund managers be required to register as investment advisers. Such regulation would subject hedge-fund advisors to oversight for the first time.”); Alan Yonan Jr., Greenspan Backs Banking Overhaul Opposed by Rubin, WALL ST. J., Mar. 18, 1998, at A6 (“The Fed chief, however, said passage of the bill would be “an historic achievement that would update the increasingly antiquated laws that constrain the development and competitiveness of our financial system.” Mr. Greenspan said the bill would remove “obsolete barriers” that prevent banks, securities and insurance companies from merging.”); Joseph Rebello and Dawn Kopecki, Greenspan Urges Congress to Move on Derivatives, WALL ST. J., Feb. 11, 2000, at C20 (“Federal Reserve Chairman Alan Greenspan urged Congress to act quickly to exempt the $80 trillion over-the-counter derivatives market from government regulation, saying legal uncertainty is posing “unacceptable risks to the country’s financial system.””).

90 See POSNER, supra note 38, at 270.

91 See POSNER, supra note 38, at 270.
the early reckless trading in the subprime mortgage backed securities market (the Commodities Futures Modernization Act enabled investment banks to do most of their damage),\textsuperscript{92} Gramm-Leach-Bliley perpetuated the environment for commercial banking giants Citigroup, Bank of America, Washington Mutual and Wachovia to become so large and unwieldy that each faced certain collapse based on their subprime market exposure.\textsuperscript{93} Following passage of Gramm-Leach-Bliley, Citigroup and Bank of America both entered an era of near frantic acquisition, merging with regional banks, investment firms and insurance companies, in a misguided effort to offer consumers every conceivable service.\textsuperscript{94} No longer consumer lenders only, both banks required massive infusion of TARP bailout funds in order to stave off certain bankruptcy and collapse because of its investment related activity that introduced toxic securitized subprime assets onto its balance sheets.\textsuperscript{95}

3. Commodities Futures Modernization Act

An additional disastrous deregulatory decision that precipitated the market collapse was the 2000 promulgation of the Commodities Futures Modernization Act (“CFMA”).\textsuperscript{96} At a time when financial institutions were combining at a frenzied pace due to the recent enactment of Gramm-Leach-Bliley and as financial innovation in the derivatives trading industry was stressing the parameters of known regulation, Congress, at Greenspan’s urging, deregulated the over-the-counter derivatives trading market.\textsuperscript{97} Passed as a rider to an omnibus appropriations bill, the CFMA, against the pointed objection of Brooksley Born, then head of the Commodities Futures Trading Commission, prohibited any type of


governmental oversight over the trading of derivative investment vehicles. The CFMA explicitly forbade the government from conducting regulatory activity in connection with the over-the-counter trading of many derivative and futures investment vehicles.

Motivated by the claim that over-the-counter derivatives trading occurring between large financial institutions simply did not require governmental oversight, Congress stripped regulators of any realistic ability to oversee trading of these types of instruments. Therefore, derivatives trading between sophisticated investors could occur in the "shadows" without any requirement of transparency, clearing, reserve requirements or oversight of any kind – the legislation relies entirely upon the private market and its discipline. This legislation, as predicted, proved damaging.

The creation of Collateralized Debt Obligations ("CDOs") by Wall Street introduced a nascent industry to the exotic derivatives trading world focused on pooling and packaging home mortgage debt. CDOs offered investors rights to receive periodic payments from

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98 See andré douglas pond cummings, Still “Ain’t No Glory in Pain”: How the Telecommunications Act of 1996 and Other 1990s Deregulation Facilitated the Market Crash of 2002, 12 FORDHAM J. CORP. & FIN. L. 467, 529-32 (2007); see also Manuel Roig-Fanzia, Credit Crisis Cassandra, WASH. POST, May 26, 2009, available at http://www.washingtonpost.com/wp-dyn/content/article/2009/05/25/AR2009052502108.html; Anthony Faiola, Ellen Nakashima & Jill Drew, What Went Wrong, WASH. POST, Oct. 15, 2008, available at http://www.washingtonpost.com/wp-dyn/content/story/2008/10/14/ST2008101403344.html (describing the failed campaign of former CFTC director Brooksley Born to get the Clinton administration to seriously consider regulating over-the-counter derivative trading); see also JOHNSON & KWAK, supra note 2, at 135-36. A derivative investment instrument is a financial instrument whose characteristics and value depend upon an underlying security, commodity or contract, such as bonds, equities, commodities (gold, oranges, corn) and currency. Typical examples of derivatives include futures and options. Often derivatives are used to hedge risk against loss on investments in the actual commodity or currency. See http://www.investorwords.com/1421/derivative.html.


the cash flows associated with particularized bundles of home mortgages. The initiation of Credit Default Swaps ("CDSs"), private quasi-insurance like contracts that act to hedge against the default risk posed by CDOs, introduced a nascent hedging mechanism into the exotic derivatives trading world and evolved into a cottage trading industry. The origination of CDOs and CDSs occurred in the shadows and back alleys fashioned by the CFMA. Both the bundling of CDOs and the hedging of CDO default by insuring against failure through CDSs, were unregulated. "The [CFMA] not only allowed for the unregulated formation of CDOs, but also the market in CDSs . . . . One of the insurers of choice was American International Group (AIG)." With an unregulated market in which to devise innovative new derivatives and contracts, several trading desk leaders at major financial institutions on Wall Street devised the CDS as an insurance contract against the failure of the risky securitizations that they were creating and trading in the mortgage market. In this unregulated environment, investment banks were both creating and trading CDSs, while at the same time underwriting CDOs, essentially creating investment vehicles to sell to clients while simultaneously trading in that same vehicle or selling to other clients often on the other side of the very vehicle they sold to their clients. Both the securitized subprime mortgage investment vehicles and the CDSs that insured against the failure of those securitized subprime vehicles were completely unregulated by any governmental agency or oversight body. Trading CDS contracts and CDOs in the shadows allowed enormous malfeasance and reckless risk taking. Investment banks and large financial institutions purchased CDOs

103 See Kristin Johnson, Things Fall Apart – The Case of the Credit Commons and Credit Default Swaps, 81 COLORADO L. REV. ___ (forthcoming 2010).

104 See What Does Credit Default Swap Mean?, Investopedia: A Forbes Digital Company, available at http://www.investopedia.com/terms/c/creditdefaultswap.asp (last visited Mar. 26, 2010) (A credit default swap is, "The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap.").

105 See Kristin Johnson, Things Fall Apart – The Case of the Credit Commons and Credit Default Swaps, 81 COLORADO L. REV. ___ (forthcoming 2010).

106 See Hackney, supra note 80, at 541.

107 See Kristin Johnson, Things Fall Apart – The Case of the Credit Commons and Credit Default Swaps, 81 COLORADO L. REV. ___ (forthcoming 2010); see also MICHAEL LEWIS, THE BIG SHORT: INSIDE THE DOOMSDAY MACHINE (2010); Sixty Minutes, Steve Kroft interview with Michael Lewis, (CBS television broadcast Mar. 14, 2010).

108 See JOHNSON & KWAK, supra note 2.

109 See Kristin Johnson, Things Fall Apart – The Case of the Credit Commons and Credit Default Swaps, 81 COLORADO L. REV. ___ (forthcoming 2010); see also MICHAEL LEWIS, THE BIG SHORT: INSIDE THE DOOMSDAY MACHINE (2010).

110 See Kristin Johnson, Things Fall Apart – The Case of the Credit Commons and Credit Default Swaps, 81 COLORADO L. REV. ___ (forthcoming 2010); see also MICHAEL LEWIS, THE BIG SHORT: INSIDE THE
and securitized subprime mortgage instruments in a frenzied money grab, as the investments were rated as “safe” (Aaa) by compromised credit rating agencies, and the capital was immediately available based on flawed risk modeling designed to show the percentages at which the underlying mortgages would be paid by consumers. As these unregulated instruments were purchased, traded, passed and sold, these large financial institutions were “hedging” by purchasing unregulated insurance contracts, CDSs, that would pay out if the subprime mortgage consumers defaulted and homes were foreclosed. In agreeing to the hedge contract, insurance giants like AIG charged hefty premiums to “guarantee” against default of the CDOs, which were bundled, securitized and sold all based on an unstable housing bubble and flawed quant modeling. CDOs and CDS contracts were then traded freely in an unregulated over the counter derivatives market wherein a credit default swap contract could end up in the hands of a small hedge fund that had neither the resources nor the wherewithal to pay out its insurance obligation if in fact a CDO default occurred. Further, on these unregulated markets where CDSs


See infra Part II.C.3.


See William K. Sjostrom, Jr., The AIG Bailout, 66 WASH. & LEE L. REV. 943 (2009) (describing the role that credit default swaps played in the collapse of AIG and the “regulatory gap” that existed enabling AIG to take enormous risk positions in the CDS market).

and CDOs were sold, traded and swapped, they were also short sold, a bet that the underlying instrument would fail.\textsuperscript{117} All of the trading, hedging, shorting and swapping occurred in an atmosphere of recklessness and avarice. Truly, the environment was a recipe for disaster, enabled by Gramm-Leach-Bliley and the CFMA.

Former President Bill Clinton acknowledged the errors of the deregulation legislation enacted during his administration admitting that he should have better regulated the trading of derivatives while he presided over the country.\textsuperscript{118} President Clinton’s financial team during the course of his presidency, including Robert Rubin, Lawrence Summers and Alan Greenspan, famously battled furiously against any form of regulation over derivatives and derivatives trading.\textsuperscript{119}

4. Private Securities Litigation Reform Act

A further legislative blunder enacted during the deregulation movement that gripped Congress in the 1990s was the Private Securities Litigation Reform Act (“PSLRA”).\textsuperscript{120} The PSLRA made it very difficult for securities fraud plaintiffs to plead fraud in a complaint to such a degree that the pleading would survive a motion to dismiss.\textsuperscript{121} Enacted to combat “strike suits” that were purportedly stifling corporate growth and shareholder earnings, the PSLRA changed the securities fraud class action scheme in debilitating ways.\textsuperscript{122} Because it was much more difficult for private plaintiffs to get into court following passage of the PSLRA, corporate executives were freed to engage in


behavior that they would ultimately not be held accountable for in any recognizable way.\textsuperscript{123}

With pleading standards making it more difficult for securities fraud plaintiffs to survive a motion to dismiss and discovery stayed until a federal district court judge had ruled on the motion to dismiss, the deliberate weakening of investors’ private legal rights of action crystallized.\textsuperscript{124} “Beginning in the 1990s and into the early part of the next decade, the legal rights of defrauded shareholders were greatly restricted. Combined with Congress’s failure to fix new litigation obstacles primarily created by the U.S. Supreme Court, it seems everywhere one turned there were roadblocks to legal accountability, leaving ‘private enforcement of the federal securities laws in near terminal condition.’”\textsuperscript{125} The impact of the PSLRA has been severe. Abner Mikva, former federal judge, Congressperson and White House counsel wrote “[b]y inhibiting the rights of individuals to seek damages, we lowered the risks for securities fraud, eliminated deterrence and fostered a culture of laxity. Arthur Levitt, [former] chairman of the [SEC] . . . has observed that what used to be unthinkable is now commonplace in the marketplace.\textsuperscript{126}

The PSLRA severely restricted the private enforcement component of successful capital markets. The “most efficient and productive” capital markets are those that combine a strong private enforcement function through shareholder lawsuit and effective governmental regulation.\textsuperscript{127} A leading study of the forty-nine largest stock markets in the world, conducted by “a troika of Ivy League economists — Dartmouth’s Rafael La Porta, Yale’s Florencio Lopez De Silanes, and Harvard’s Andrei Shleifer,” found that “private lawsuits, combined with common-sense regulation and governmental control, is by far the most effective method to manage a national capital market.”\textsuperscript{128} Indeed, La Porta, De


Silanes and Shleifer discovered that “markets develop better when civil — not criminal — law is strong.” The PSLRA got this capital market truism backward: it restricts the private enforcement component of stable, healthy capital markets. Instead, it disincentivizes careful corporate leadership by restricting private shareholders from bringing legitimate enforcement actions.

The deregulatory strategy that descended on Capital Hill in the 1990s and early 2000s actually took the exact opposite tack than that identified in the healthy capital markets construction outlined above. Successful capital markets require the threat of strong “private lawsuits combined with common-sense regulation and governmental control.”

Nearly every financial market legislation enacted by Congress in the 1990s either weakened the private lawsuit component or scaled back common-sense governmental regulation of the financial services sector – precisely the opposite of what is commonly understood to be the best approach to maintaining the integrity of strong and sustainable capital markets.

While the Fed, Gramm-Leach-Bliley, the CFMA, and the PSLRA represent destructive deregulatory enactments adopted by Congress in the run up to the 2008 collapse, many other unfortunate enactments contributed, including the Telecommunications Act of 2006, the Securities Litigation Uniform Standards Act of 1998, the SEC and court’s failure to regulate hedge funds, and numerous Securities and Exchange Commission rules promulgated under its rulemaking authority. The SEC’s sins included exempting large Wall Street investment firms from minimum capital requirements, repealing a rule designed to prevent manipulative short selling and limiting shareholder’s ability to recover for securities fraud.

http://www.afajof.org/afa/forthcoming/laporta.pdf (“We examine the effect of securities laws on stock market development in 49 countries. We find almost no evidence that public enforcement benefits stock markets, and strong evidence that laws facilitating private enforcement through disclosure and liability rules benefit stock markets.”).


133 See Norman S. Poser, Why the SEC Failed: Regulators Against Regulation, 3 BROOK. J. CORP. FIN. & COM. L. 289, 309 (2009). Professor Poser notes four SEC “deregulatory” rules that contributed to the market meltdown of 2008:
Those that continue to honestly resist deregulation as a primary trigger of the financial market crisis of 2008 must now ignore the conclusions of an iconic free market voice, Judge Posner who concludes “[t]he seeds of failure were sown in the movement to reduce the regulation of banks and credit, which began in the 1970s. They germinated during the Clinton Administration, when the housing bubble began and the deregulation of banking culminated in the repeal of Glass-Steagall . . . and it was decided not to bring the new financial instruments, in particular credit default swaps, under regulation.”\(^{134}\)

Of course, proponents of \textit{laissez faire} economics are loathe to embrace any characterization of the financial market crisis that implicates deregulation as a primary progenitor. In the face of overwhelming evidence that neoclassical economic theories of efficiency and private market discipline broke down in the face of newly deregulated markets,\(^{135}\) market fundamentalists still cling to the notion of completely free markets as the answer. In order to support this unfettered market claim, market fundamentalists must reject deregulation as a cause and instead seek to re-focus public attention on crisis causes other than deregulated markets. Market fundamentalists have seized upon governmental intrusion into the housing markets through social steering and the myth of the minority borrower as their base cause of the market failure.\(^{136}\) Despite this misdirection by market fundamentalists, deregulation cannot be framed as the sole cause of the financial market crisis. The housing bubble and mortgage markets that developed in the early part of the 21\textsuperscript{st} century played a major role in the meltdown as well.

**B. Housing Bubble**

“As long as the music is playing, you’ve got to get up and dance.”

——Charles O. Prince III, CEO Citigroup\(^{137}\)

During the past decade, the SEC made important regulatory changes that weakened the regulatory system and turned out to be a disaster for investors, significantly contributing to the 2008 financial crisis. First, the SEC exempted the largest investment banking firms from the minimum capital requirements imposed on broker-dealers. Second, the SEC repealed a rule designed to prevent manipulative short selling of securities. At the same time, the Commission’s other deregulatory actions included limiting shareholder access to the proxy voting system and repeatedly urging the Supreme Court to limit investors’ ability to recover their fraud losses by means of private lawsuits.


\(^{134}\) See POSNER, \textit{supra} note 38, at 281.


\(^{136}\) See \textit{infra} Part III.
The second conflation of causes of the financial crisis can be explored by deconstructing the “housing bubble” that ballooned and collapsed with its attendant consequences. “In the past two years, subprime mortgage lending has forced the American economy to the brink of a depression and fundamentally undermined world faith in American consumer financial markets. A host of dubiously underwritten mortgage loans helped inflate a bubble in residential real estate values.”138 Once it was obvious that millions of American homeowners would not be capable of repaying mortgage loans crafted for them by commission frenzied brokers, the liquidity of securitized instruments drawn from those loans froze.139 Currently more than one quarter of all subprime home mortgages are in default with millions more likely on the horizon.140 Rating agencies are predicting that 40% to 50% of all subprime mortgages, originated since 2006, will end up in foreclosure.141 Estimates indicate that more than 25% of all U.S. households currently show that they owe more on their home mortgage than their home is worth.142 In other words, negative equity indicates that nearly half of all homeowners that entered subprime mortgages are under water on their loans, causing many to abandon their homes.143 “Thousands of financial ‘foreclosure rescue’ predators and con artists are openly stalking desperate families looking for a financial lifeline. County and municipal governments in the Los Angeles area have begun campaigns to exterminate a scourge of mosquitoes breeding in the rotten water of swimming pools behind thousands of abandoned suburban homes.”144

In Detroit, Michigan, more than 40 square miles of abandoned housing sits vacant within its city limits as foreclosures and unemployment have wreaked havoc on the city.145 To


appreciate a 40 square mile vacancy approximation in Detroit, consider that Manhattan Island in New York City is 23 square miles. An area larger than Manhattan sits vacant and idle in Detroit. Additionally, with unemployment now by some estimates at nearly 50%, Detroit suffers from a foreclosure disaster that has left a black hole within city limits. Detroit is far from Wall Street, yet the repercussions of the actions of an elite few, almost a thousand miles away, are laying waste to a city once an icon of America’s productivity.

The reckless overleveraging on Wall Street discussed above and below, combined with losses in mortgage securities has devastated “[t]wo of the nation’s formerly most reputable investment houses, Bear Sterns and Lehman Brothers, collaps[ing] when it became clear that its billions of dollars of . . . subprime mortgage assets were virtually worthless.” Currently more than seven hundred banks have been identified by the FDIC as “problem” banks and in danger of failing. Several contributing factors led to the development of the housing bubble and its subsequent failure.

Contributing to the housing bubble that expanded and then burst devastating millions of homeowners and investors included lax oversight over important segments of the lender market, the expansion of predatory lending into minority and poor communities, the growth of predatory borrowing or irresponsible borrowing engaged by dishonest or greedy borrowers, and housing market cover introduced by governmental policies that protected the growing subprime markets that collapsed under their own weight.

1. Lax Lender Oversight

Before financial deregulation and Gramm-Leach-Bliley, commercial banks wrote mortgages and mortgages were primarily based on an individual’s demonstrated ability to repay the loan, based upon credit worthiness. Typically, the commercial bank would

146 See Detroit’s Unemployment Rate is Nearly 50% DETROIT NEWS, Dec. 16, 2009 (article on file with author; see also Steven Gray, In Detroit, Unemployment Rate Nearly 50%?, DETROIT BLOGS TIME, available at http://detroit.blogs.time.com/2009/12/16/in-detroit-nearly-50-unemployment-rate/.


then hold the mortgage, collecting payments until the mortgage was ultimately paid off by the credit worthy borrower. Commercial banks were generally careful in how and to whom they wrote mortgages because they held the loan and relied on timely payments to conduct business.151

Following the Great Depression, the government became critically involved in the home mortgage business originating government entities to purchase loans and guarantee payment of mortgages in many instances via its initiation of Fannie Mae, Ginnie Mae and Freddie Mac.152 Soon thereafter, securitization of home mortgages was initiated by these government sponsored enterprises allowing investors to purchase mortgage-backed securities that had both liquidity and stability “which generated greater spreads over comparable term treasury obligations than securities of similar risk. Securitization of mortgage loans by [Fannie, Ginnie and Freddie] allowed the larger capital markets to directly invest in American home ownership at a lower cost than the older depository lending model of business.”153

When the private sector was finally able to burst through and carve itself out a place in the mortgage loan securitization industry – an evolution that spanned decades – while providing consumers some benefits previously unavailable, it ultimately unleashed a shadow system that eventually spun out of control.154

While the government sponsored enterprises (“GSEs”), Fannie, Freddie and Ginnie, typically invested in mortgages with particular middle class focused policy objectives in mind, typically refusing to purchase unusually large (“jumbo”) mortgages, home equity loans, variable interest rate mortgages or most importantly subprime mortgages, purely private institutions recognized these market gaps as potentially lucrative.155 In the 1970s, as the baby boomers were reaching home buying target ages, the private sector felt the potential benefits of pooling jumbo, variable rate and subprime home mortgages into mortgage-backed securities and soon began channeling capital into home mortgage

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152 See Christopher Peterson, Predatory Structured Finance, 28 CARDOZO L. REV. 2194-2200 (2007) (describing the evolution of home mortgage financing following the Great Depression including the creation of government sponsored enterprises Fannie Mae, Ginnie Mae and Freddie Mac).


lending similarly to the ways the GSEs did with prime mortgages. Private financiers and investors were anxious to mobilize capital to serve this massive potential demand for mortgage credit. Unmet demand in the mortgage market segments too risky for the GSEs, including variable rate, home equity and subprime, left enticing and substantial niches for private investors.\footnote{See Lewis S. Ranieri, The Origins of Securitization, Sources of Its Growth, and Its Future Potential, in A Primer on Securitization 31 (Leon T. Kendall & Michael J. Fishman, eds., 1996); see also Christopher Peterson, Fannie Mae, Freddie Mac and the Home Mortgage Foreclosure Crisis, 10 LOYOLA J. OF PUBLIC INTEREST LAW 149, 157-58 (2009).}


A further development in the private sector that led to reckless trading was the eventuation of the “mortgage broker.” For the new completely unregulated private mortgage broker industry, the broker foraged for borrowers to whom it could sell a mortgage typically on behalf of a bank. Often, the mortgage brokers sold subprime mortgages to individuals that presented substantial credit risk. In many instances, these subprime loans were written on a predatory basis.\footnote{See infra Part II.B.2.} Banks that closed mortgages through brokers were then able to turn around and sell the mortgage on an unregulated
secondary market.\textsuperscript{166} Often, these loans were then packaged as investment vehicles, CDOs, and again, sold in an unregulated market.\textsuperscript{167}

The mortgage lending market, once one of careful weighing and balancing and where actual concern for the consumer was clear, turned into a money grinding market where brokers connected lenders with borrowers, loans were often packaged at the best fee arrangement for the broker and the bank, rather than the consumer, and loans were sold in secondary markets and then packaged as investments, so the risk of return was no longer the concern of one commercial bank, but was spread out over multiple parties.\textsuperscript{168} No longer was any party concerned with repayment, default or the consumer’s interests because much of the money and fees were paid and collected up front.\textsuperscript{169} Once the mortgages were privately securitized and packaged, and once the owner of the securitized mortgage was an investment bank, then very little care or connectivity existed between the mortgage payor and the owner. This unregulated mortgage lending industry led to a confluence of irresponsibility.

First, banks became detached from the credit-worthiness of borrowers as they could immediately resell mortgages in a secondary market.\textsuperscript{170} Second, unregulated mortgage brokers made loans to borrowers that were not qualified and often on a predatory basis.\textsuperscript{171}

\begin{itemize}
\item \textsuperscript{168} See generally Mitchell, \textit{supra} note 37, at 171.
\item \textsuperscript{169} See Allistair Barr, \textit{Subprime Crisis Shines Light on Mortgage Brokers}, \textit{Market Watch}, Apr. 19, 2007, available at http://www.marketwatch.com/story/subprime-crisis-shines-spotlight-on-mortgage-broker-practices (“The main problem is that, counter to common perception, mortgage brokers do not represent the borrowers who pay them for advice. Instead, they are more like independent salespeople who are often paid as much by the lenders offering loans as borrowers.”); see also Mara Der Hovanesian, \textit{Nightmare Mortgages}, \textit{Business Week}, Sept. 11, 2006, available at http://www.businessweek.com/magazine/content/06_37/b4000001.htm (“Why are hedge funds willing to buy risky loans directly? Because they can demand terms that help insulate them from losses. And banks, knowing what the hedge funds want in advance, simply take it out of the hides of borrowers, many of whom qualify for lower rates based on their credit histories.”); Kimberly Amadeao, \textit{Could the Mortgage Crisis and Bank Bailout Have Been Prevented?} \textsc{About.Com}, 2010, available at http://useconomy.about.com/od/criticalsues/a/prevent_crisis.htm (“Banks had hired sophisticated ‘quant jocks’ who wrote computer programs that could repack ake these mortgage backed securities into high risk and lose risk product bundles. The computer programs were so complicated that no one really understood what exactly was in each product bundle or how much of the bundle had subprime mortgages.”).
\end{itemize}
Third, many borrowers entered into interest-only loans, many adjustable rate, in order to secure lower monthly payments.\textsuperscript{172} When the housing bubble burst and mortgage rates reset at higher levels, many of these homeowners could not pay their mortgage nor sell their homes for a profit, leading to defaults.\textsuperscript{173} Fourth, and perhaps most important, mortgages were repackaged as mortgage-backed securities and sold in an unregulated market to investors.\textsuperscript{174} “Banks had hired sophisticated ‘quant jocks’ who wrote computer programs that could repackage these MBS into high risk and low risk product bundles. The computer programs were so complicated that no one really understood what exactly was in each product bundle or how much of the bundle had subprime mortgages.”\textsuperscript{175} When the housing bubble was inflated, the repackaged securities were fine as many investors opted for the high risk bundles of subprime and adjustable rate mortgage-backed securities based on the higher rate of return. When the housing market collapsed, because the unregulated subprime mortgage-backed securities had spread throughout the entire economy, including Wall Street investment banks, national commercial banks, small regional banks, hedge funds, pension funds, and individual investors, the trajectory of the downturn was massive.\textsuperscript{176} Further, as hedge funds were left unregulated by the SEC and the buying, selling and swapping of CDOs and CDSs were traded in the shadows, banks and hedge funds could engage in highly speculative, outrageously risky trading and betting.\textsuperscript{177}

\begin{footnotesize}


\end{footnotesize}
Mortgage broking, private securitization origination, investment pooling of mortgage backed securities, credit rating agency activity and insuring against default on the mortgage backed securities all existed in an unregulated market that acted to torpedo the world economy.

2. Predatory Lending

Unregulated lenders, including unregulated mortgage brokers that engaged in predatory lending, bear significant responsibility for the financial crisis. \(^{178}\) Predatory lending occurs when a lender deceptively convinces borrowers to agree to unfair and abusive loan terms, or by systematically violating terms in ways that is difficult for a borrower to defend against. \(^{179}\) Subprime loans are those loans most often at risk to be written through predatory lending practices to borrowers who do not meet prime underwriting borrower guidelines and are preferred by lenders because profit margins can be significant if a borrower pays out the loan. \(^{180}\) Subprime mortgages are typically written for borrowers who are adjudged to have very high credit risk, often because they lack a strong credit or work history or have other characteristics that are associated with strong probabilities of default. \(^{181}\) Subprime loans typically carry much higher interest rates than conventional loans. \(^{182}\)

The development of the subprime lending market and its evolution into an oft times predatory market began in the early 1990s when private label securitization conduits became entrenched as an accepted method of financing home mortgages. \(^{183}\) During the 1990s, the U.S. witnessed an explosion of a new and aggressive form of “subprime” mortgage lending. \(^{184}\) Prior to this explosion, “prime” mortgages were generally considered those qualified to be resold to Fannie Mae and Freddie Mac as both adhered


to strict automated underwriting standards, using widely embraced financial modeling that required standardized documentation and pay practices that were similar for all loans purchased by them. These standards led to stable and homogenized prime mortgage loans thereby permitting secondary markets to treat prime loans similar to a commodity instead of a tenuous long-term financial association. In contrast to “prime” mortgages, “subprime” mortgages are typically written for borrowers with poor credit histories that did not historically meet the guidelines established by Fannie Mae and Freddie Mac. Further, unlike prime lenders, those lenders that specialize in writing subprime loans typically securitize their own loans and thus have much more freedom to set rates and establish underwriting standards leading to a drastically different set of rates, fees and guidelines for borrowing depending on which broker or lender a consumer borrows from. The result is that during the housing bubble, unregulated lenders were in a rush to originate new subprime loans in order to securitize and sell to investors for large profits, often disregarding their own underwriting guidelines when writing the subprime mortgages. “Unlike prime loans, where access to the secondary market is guarded by the play-it-safe GSEs, the secondary subprime market is filled with aggressive investors and businesses looking to maximize their profits by any possible means.”

Resulting from this “by any means possible” approach to originating subprime loans has been a steady stream of consumer horror stories and wide ranging allegations of predatory lending. Commentators now point to the powerful connection between

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191 See Creola Johnson, The Magic of Group Identity: How Predatory Lenders Use Minorities to Target Communities of Color, 17 GEORGETOWN J. ON POVERTY LAW & POL’Y 165 (2010); see also Christopher
predatory lending and securitization signaling that securitization allows lenders with limited capital available to “churn” a significant number of loans. Churning in this context describes securitization originators quickly assigning their subprime loans, so that their own capital is invested for just a short period of time and once a subprime loan is securitized and sold, the originating lender can use the capital from that sale to find a new consumer to write a new subprime loan continuing this pattern repeatedly. “In effect, securitization uses Wall Street capital to transform relatively small businesses into multi-million dollar institutions with a tremendous impact on the lives of entire communities.”

Scholars believe that the secondary lending market is fully capable of recognizing those loans that include predatory terms and markers. Recent media exposés are now exposing Wall Street executive greed as the basis for the subprime appetite behind the motivation to purchase subprime loans with the knowledge that these loans were being written on a predatory basis. “And a growing chorus of regulators, consumer advocates, student groups, and faith-based investment companies have all alleged that secondary mortgage market participants are willfully profiting from predatory lending.”

That predatory lending ran amok in the run-up to the financial market crisis is now well established. Mortgage brokers, seeking higher origination fees and profit spreads,
fervently sought out borrowers to whom they could sell subprime mortgages. Often, minority communities were targeted for the predatory loans. In 2006, 55% of loans to African Americans were subprime, despite the fact that many of those borrowers qualified for prime loans.

While the law has been very slow to react to the trend of securitizing predatory loans, mortgage lenders, brokers, and servicers have moved quickly to now actively bargain with a discerning view toward the ultimate end-game destination of the loans they facilitate. In this end-game contingency, mortgage loans, particularly more expensive loans marketed to those with poor credit histories, will be purchased by investment trusts, bundled into sizeable geographically diverse pools with many other mortgage loans, and then sold as securities to investors. The mortgage industry has radically changed from one where lenders “lend” in the sense that they themselves expect repayment, to an industry where lenders now “manufacture a commercial product—borrowers—that are measured, sold, and at times discarded by a consuming capital market.” The mortgage lending industry has become an industry where “today’s mortgage lenders are assignment production companies that create income streams for the nation’s capital markets.”


202 See Christopher Peterson, Predatory Structured Finance, 28 CARDOZO L. REV. 2186-87 (2007) (“Predatory home loans, like all home mortgages, are increasingly subject to assignment. Now, more than ever before, a market in assignment of loans casts a shadow over how those loans are originated and serviced. While assignment of loans has always been common, relatively new and complex patterns, alternatively referred to as structured finance or securitization, have rendered the assumptions of traditional assignment law quaintly over-generalized.”); see also Jeremy Carter, Highlights from Securitization News, 10 J. STRUCTURED FIN., Winter 2005, at 97.

203 Christopher Peterson, Predatory Structured Finance, 28 CARDOZO L. REV. 2186-87 (2007)

That borrowers are now “discarded” by Wall Street and that mortgage lenders began viewing mortgage consumers as “income streams for the nation’s capital markets” represents an astonishing perspective change from the original homeowner, mortgage lender American dream paradigm imagined by President Franklin Roosevelt and the originators of the government guaranteed home loan. Predatory lending has flourished in this new era market and industry. With promises of ever increasing housing market inclines and with loan instruments that allowed even the most risky applicant to win loan approval, mortgage brokers sold subprime mortgages with abandon. Those that recklessly sold and then bundled predatory subprime loans bear grave responsibility for the financial market crisis.

3. Predatory borrowing

Deeply embedded in the web of corporate deceit outlined above are the borrowers that are currently defaulting in staggering percentages on their loans, many of them subprime. The role of personal borrower culpability for the financial crisis is one that must be addressed. Despite clear evidence of predatory lending as shown above and below, the mortgage crisis can also be attributed in many respects to “predatory borrowing.” In 2006, more than 40% of all subprime loans originated were written to borrowers that qualified as “affluent” and identified as white. With easy credit available and a voracious Wall Street appetite for subprime loans for securitization purposes, together with popular culture programs such as “Flip This House” and “Curb Appeal,” individual borrowers were more than willing to get in over their heads in order to purchase a home they could not afford or in an attempt to make a swift profit by purchasing and immediately reselling (flipping) based on the ever increasing housing bubble.


207 See generally Flip This House (A&E Television 2010); see also Flip This House, available at http://www.aetv.com/flipthishouse/.


According to economics professor Tyler Cowen: “There has been plenty of talk about ‘predatory lending,’ but ‘predatory borrowing’ may have been the bigger problem. As much as 70 percent of recent early payment defaults had fraudulent misrepresentations on their original loan applications, according to one recent study.”

In a study that evaluated more than three million loans entered into between 1997 and 2006, many of the loan applications included misrepresentations and those that included fraudulent information, were more than five times as likely to default. The study indicated that much of the fraud was simple, misstating income levels or employment, and that mortgage brokers were content to acquiesce or “look the other way” in order to secure the valuable subprime loan. “In other words, many of the people now losing their homes committed fraud. And when a mortgage goes into default in its first year, the chance is high that there was fraud in the initial application, especially because unemployment in general has been low during the last two years.”

Without doubt, personal borrowers on many levels entered into mortgages that they never should have and many borrowers lied to get approved. That said, the depth of the predatory nature of the origination of subprime loans and the fact that several studies exist that indicate that mortgage brokers actually committed egregious fraud on many loan applications, rather than borrowers, should at least mute those that attempt to place singular blame on borrowers. Still, borrower irresponsibility and overreaching by consumers played a critical role in the economic breakdown.

4. Governmental Cover

Some commentators and think tanks present an interesting view of the underlying cause of the financial market crisis. Many argue that governmental cover remains the primary reason that the appetite for subprime loans grew so voracious.

Commentators focus on subprime and Alt-A (nonprime) mortgages, recognizing that those defaults caused the collapse of the asset-backed finance market in 2007 and 2008.

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but then claiming that it was Fannie Mae, Freddie Mac and the Community Reinvestment Act that motivated the origination of subprime and Alt-A loans based on government appetite for junk loans.216 “Although the [Obama] administration blames the production of these deficient loans primarily on unregulated mortgage brokers, many of whom it calls ‘predatory lenders,’ this turns the mortgage market on its head. Mortgage brokers – even predatory ones – cannot create and sell deficient mortgages unless they have willing buyers, and it turns out that their main customers were government agencies or companies and banks required by government regulations to purchase these junk loans.”217 Some commentators and economists argue that nearly two-thirds of all subprime loans in 2008 were held by government enterprises.218 That the Federal Housing Administration, Fannie Mae and Freddie Mac held millions of subprime and Alt-A loans indicates the willingness of the private quasi governmental enterprises to engage in the same risky profiteering that Wall Street investment firms and commercial banks engaged in through purchase of securitized subprime mortgage-backed instruments.219

Fannie Mae and Freddie Mac, while entering the private securitized subprime mortgage-backed market late in the game, entered that market seeking profit.220 Appropriate blame must be attributed to these GSEs for buttressing the market and creating additional outlets for purchase of subprime loans and the securitization of those loans. Due to the massive scope of Fannie and Freddie in the mortgage market, their presence in the market, though late, created a significant leveraged position. Still, despite attempts to pin singular blame on the government for the market crisis, particularly on Fannie Mae and Freddie Mac, favored in many conservative circles, the truth indicates that while Fannie and Freddie did in fact play a role in the financial market crisis, it was not a major one.221


Further examples of governmental cover include reports indicating that the U.S. Housing and Urban Development agency played a role in encouraging Fannie and Freddie’s entrée into the subprime mortgage market. 222 HUD, eager to see homeownership more available to low-income families, urged Fannie and Freddie to purchase increasingly more subprime loans by categorizing them as “affordable” through use of an outdated policy allowing the government-chartered firms to count subprime loans as a “public good that would foster affordable housing.” 223 HUD policy allowed the agency to neglect to examine borrowers’ ability to make payments on loans that Freddie and Fannie characterized as “affordable.” 224 Reportedly, between 2004 and 2006, Freddie and Fannie purchased $434 billion in securities backed by subprime loans, thus fostering a greater market for such subprime lending. 225 Based on this late game reckless overleveraging in subprime loans, Fannie and Freddie collapsed under the weight of millions of loan defaults requiring governmental seizure and bailout. 226

The collapse of Fannie Mae and Freddie Mac was precipitated by a number of important factors. First, taking its lead from Clinton and George W. Bush administrations that both heavily promoted homeownership, Fannie and Freddie recklessly entered the subprime mortgage market in both securitizing subprime mortgages and selling them to investors and in buying up subprime loans sustaining and incentivizing a robust market of the freewheeling writing of subprime loans. 227 With HUD policies promoting homeownership and governmental policies providing cover, Fannie and Freddie, newly privatized, joined Wall Street in reckless pursuit of profit and exorbitant bestowal of compensation upon its executives. Fannie and Freddie’s reckless pursuit of profit must be considered against their new found status, in advance of the housing bubble, as privatized entities. Fannie and Freddie acted during the subprime bubble and breakdown as private firms—private firms with an implicit governmental guarantee of its mortgage buying activity. In a deregulated environment and as private actors, Fannie and Freddie joined their Wall Street brethren in reckless pursuit of profit.


Critics of Fannie and Freddie immediately seized upon their collapse as validation of previous opposition to the housing GSEs. As indicated above, some have gone so far as to pin the housing crisis and the severe recession triggered by it as actually caused by Fannie and Freddie, rather than caused by foreclosure on privately originated and securitized subprime mortgages or risky speculation in the CDOs and CDS derivatives.\(^{228}\)

While true that Fannie and Freddie became involved in the subprime mortgage and securitization market, and bear responsibility for contributing to the subprime mortgage crisis, the role of the government sponsored enterprises was one of many causes of the meltdown.

Admittedly, the GSEs began to engage widely in unacceptably risky investment decisions. That said, “allegations that the financial crisis is attributable to the GSEs are both an oversimplification and a falsehood. Instead . . . while the GSEs became an important part of the problem, the cause of the financial crisis is a much more complex amalgam of factors” that include monetary policy established by the Fed, deregulation of the financial sector and derivatives trading, regulatory dereliction, judicial passivity, predatory borrowing, and reckless and dishonest brokering, appraising, lending, servicing, and securitizing by private financial services companies.\(^{229}\)

Unregulated lending, predatory borrowing, predatory lending and governmental cover all played a role in the collapse of the subprime loan market which led to the financial market crisis. While none were singularly responsible, each must be acknowledged as an important cause. Acknowledging the role of the government and its homeownership policy in the financial market crisis serves to attach an honest appraisal of all crisis causes.\(^{230}\)

The dirty little myth however, in its distortion of honest causation distillation, places minority borrower culpability as the primary cause of the financial market crisis as perpetuated by governmental homeownership welfare through the Community Reinvestment Act and the subprime activity of Fannie Mae and Freddie Mac. As demonstrated above, borrower irresponsibility played a role in the meltdown. In addition, Fannie and Freddie cannot escape blame or responsibility for enabling the crisis to occur.\(^{231}\)

Still, borrower failure and the role of Fannie and Freddie are merely minor pieces of the meltdown puzzle.

\(^{228}\) See Christopher Peterson, \textit{Fannie Mae, Freddie Mac, and the Home Mortgage Foreclosure Crisis}, 10 Loy. J. Pub. Int. L. 149 (2009) (“For example, in 2008, Alaska Governor Sarah Palin, the Republican Party’s nominee for the Vice Presidency, argued that the solution for the nation’s economic woes was reform of oversight of quasi-government agencies like Fannie Mae and Freddie Mac.”).


\(^{230}\) See JOHNSON & KWAK, supra note 2, at 144-47.

\(^{231}\) See id.
C. Securitization and Derivatives

“[T]he basic responsibility for the [financial crisis] rests with the private sector – with decisions such as Citigroup’s to increase the amount of risk in its lending.”

—Judge Richard Posner

If deregulation and the housing bubble set the stage for the financial market crisis, the securitization of subprime mortgage loans and the shadow trading of the derivative instruments thrown off of the securitized mortgages overturned the table entirely. The profits available to those institutions that traded in securitized mortgage backed securities overwhelmed most to the point of recklessness. The cottage industry that was established to perpetuate the market served only to protect the trading of subprime derivatives and ignored all warning signs as it was captured by the industry itself. The mortgage crisis resulted in large part from the private securitization of subprime mortgages, the shadow banking industry that allowed the origination and assigning of these instruments sans regulation, the credit rating agencies that became mere conduits of the investment banks, the regulators who failed to recognize all of the warning signs, balance sheet fraud and manipulation that most of the Wall Street firms engaged in and the reckless executive leadership that pursued short term profit at all costs, collapsing their companies in the process. Private market discipline failed.

1. Private Securitization of Subprime Mortgages

Mortgage loan securitization seized the imaginations of private sector institutional investors and securities speculators in an unprecedented fashion in the past decade. The profit margins and income streams available from bundling subprime home mortgages into derivative investment vehicles that were bought and sold in unregulated shadow markets, was too potentially profitable to pass up. Securitization, once a market controlled by GSEs and involving only prime mortgage loans, became unmoored from these places of relative safety in the 1990s. When the private sector seized subprime loans as a securitization vehicle, the frenzied profit pursuit began. The role of securitization and derivatives trading led in large part to the financial collapse of 2008.

Since the government origination of mortgage securitization in the 1940s and 1950s, the ability to profit on pass-through interest based on homeowner payments that traditionally only default in very small percentages, was of keen interest to the private markets. The securitization of subprime mortgages was extremely attractive to the private markets because subprime securitization had been historically avoided by Fannie and Freddie and because despite a higher default rate risk, the available interest rates and potential income available (under appropriate risk modeling) were particularly lucrative. Securitizing subprime mortgages typically occurred in the market crisis run-up as follows:

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232 See POSNER, supra note 38, at 269.

At the outset, a mortgage broker identifies a potential borrower through a plethora of marketing approaches, including telemarketing, door-to-door solicitation, direct mail and radio or television advertising.\(^\text{234}\) After contact with a potential borrower is made, the loan broker and loan originator together identify a loan instrument which may or may not suit the needs of the borrower.\(^\text{235}\) Typically, a home mortgage will fund the purchase price of a home, but it might instead consolidate a borrower’s other debts or refinance a pre-existing home mortgage. The borrower is assigned a credit score that plays a significant role in determining the interest rate and other pricing contingencies designated by the broker and originator who use consumer credit scoring agencies that track outstanding debt, bankruptcies and prior civil judgments to assign the credit score and determine the interest rates.\(^\text{236}\) Once interest rates and pricing terms are set, the consumer formally applies for the mortgage which then typically closes one to two weeks later where the borrower signs all of the necessary paperwork wherein the borrower become bound to the terms as settled upon.\(^\text{237}\) At this point, some mortgage brokers fund the loan directly with their own funds or with a warehouse line of credit, while other mortgage brokers act as an agent and use the originator’s capital to fund the loan initially.\(^\text{238}\)

Quickly thereafter the loan originator will transfer the mortgage loan to a subsidiary of an investment bank, typically called a securitization sponsor or seller, who then transfers the loan forward into a pool with hundreds of others similarly situated mortgage loans.\(^\text{239}\) This pool of mortgage loans will become its own entity typically called a special purpose vehicle (“SPV”) which can be organized as a corporation, partnership, limited liability company, but is most often a trust.\(^\text{240}\) This SPV trust holds no other assets, employs no individuals or has any function other than owning a pool of mortgage loans.\(^\text{241}\) Under the contract that transfers the loans into the pool, the SPV agrees to sell equity pieces, or

\[\text{Equation}\]

\[\text{Equation}\]

\[\text{Equation}\]

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\(^{238}\) See Kurt Eggert, Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine, 35 CREIGHTON L. REV. 503, 538 (2002).

\(^{239}\) See Kurt Eggert, Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine, 35 CREIGHTON L. REV. 503, 538 (2002); see also Steven L. Schwarcz, The Alchemy of Asset Securitization, 1 STAN. J. L. BUS. & FIN. 133, 142 (1994).


tranches, of itself to various investors. In the typical securitization arrangement, an underwriter "purchases all of the 'securities'—here meaning derivative income streams drawn from payments on the underlying mortgages—issued by the pool." Thereafter, the underwriters employ placement agents who work on commission to sell the tranched securities to various investors based on portfolio needs and risk tolerance.

Prior to engaging the placement agents and selling the securitized mortgage loans, the seller in designing the SPV and its investment tranches, works quite closely with a credit rating agency that is paid by the seller to rate the credit risk of each tranche. The credit rating agency is tasked with investigating the credit risk of the underlying mortgages together with investigating the risks posed from pooling the mortgages together, called "mortgage risk" and "pool risk." Evaluating mortgage risk requires the credit rating agency to focus on borrower net equity over time, the risk that foreclosure on a defaulting mortgage will not recoup invested funds. Evaluating pool risk requires the credit rating agency to examine factors such as geographic diversity of underlying mortgages and the size of the various loan pools. To say that the credit rating bestowed by the credit rating agency is crucial in the securitization of mortgage backed securities is an understatement. Credit ratings on each tranche of securities offered for sale were perceived as obviating the need for individual investors to conduct careful due diligence

242 See Kurt Eggert, Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine, 35 CREIGHTON L. REV. 503, 539 n. 156 (2002).


of the underlying mortgages because this has become the responsibility of the credit rating agencies.249 Often, in order to settle at an agreeable credit rating, the credit rating agency will require the seller to provide some form of credit enhancement on the riskier tranches in order to allow assignment of a higher credit rating.250 This credit enhancement typically entails a third party guarantee from an insurance company, insuring against losses from mortgage default and prepayments.251

Further distancing loan originator from consumer, many sellers of securitized mortgage loans sell the rights to service the loan pool to a separate company that will then be responsible for corresponding with the consumers, monitoring collateral, receiving monthly mortgage payments and when necessary foreclosing on homes.252 Occasionally the originator retains the right to service the mortgages, maintaining some connection with homeowners, but typically servicing is outsourced to a company specializing in loan servicing.253 Often, originators require servicers under the servicing agreement to purchase subordinated tranches issued from the mortgage pool in order to incentivize the servicer to collect the underlying mortgage payments aggressively.254 Further, servicing rights change hands often and in some cases several times a year for the same loan, for reasons that include a servicing company not meeting collection goals or for charging too much in its servicing agreement.255 Additionally, securitization deal sellers and trustees typically hire a document custodian to track the voluminous information and paperwork on loans in a pool.256 In recent years, the emergence of a unique company called the Mortgage Electronic Registration System, Inc. (“MERS”) has played a controversial role


250 See infra Part II.C.3.


in representing originators and sellers and often acting as a foreclosure agent. All said, the mortgage loan securitization process described above, including all of the business involved, have created a very powerful and lucrative device for marshaling capital into and from home mortgage loans.

This convoluted and complex process is primarily conducted on an unregulated playing field. Crucially, in this regulation-free zone, nearly every step of the subprime securitization process above includes junctures or mechanisms that are fraught with potential for deception, manipulation and reckless decision making. To wit, at the subprime loan origination stage, unregulated mortgage brokers can and do act with wanton disregard for the consumer and the system by engaging in predatory lending and in writing loans that consumers have no business entering. At the “closing” step of the subprime mortgage process, the financial market crisis underscores the negligence or complicity of real estate lawyers that engaged in the signing off on millions of loans whose terms could not possibly be met. At the next stage, once the mortgage is closed, the original mortgage lenders have the ability to immediately dispose of the loan through an unregulated sale and assignment of the loan into a secondary market for pooling and bundling into an investment vehicle. This process disengages the borrower from the lender and commodifies the borrower as a capital stream rather than a consumer. In the pooling process where subprime loans are bundled into special purpose vehicles, this unregulated process allows the haphazard pooling of various types and qualities of loans, including prime loans, subprime loans and Alt-A loans, into the same investment vehicles, making categorization and risk factoring difficult. Once the special purpose

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262 See supra Part II.B.2.

vehicles have bundled the mortgages into an investment, then credit rating agencies are employed to assign a risk rating to each securitized tranche.\textsuperscript{264} That credit rating agencies were mis-rating the securitized mortgages is now widely understood based on the intimate, conflicted relationship between the underwriting industry and the credit rating agencies who are paid by those the agency is assigned to rate.\textsuperscript{265} Once investors made unregulated purchases of the subprime mortgage backed securities investments, they immediately negotiated credit default swap contracts with insuring firms in order to hedge against the potential loss these investments represented. Of course, the credit default swap contracts were not regulated, so whether or not the insuring firm could even fulfill the terms of the quasi-insurance contract was never queried.\textsuperscript{266} Prior to the market collapse, it is now widely accepted that each firm that engaged every step of the subprime securitization process profited handsomely, some would say obscenely.\textsuperscript{267}

Every step in the unregulated and/or deregulated securitization process just described was manipulated by nearly every party along the way as each engaged in the process that precipitated the market collapse. While the governmental sponsored enterprises were initially only engaged in traditional prime loan securitization, leaving the nontraditional loans to the private sector, all parties involved became infatuated with the profits available in the past decade as the housing markets in the United States heated up to unbelievable levels. Additionally, because the subprime securitization industry had spread so deeply throughout the economy, almost every single Wall Street investment bank and nearly every large commercial bank stared near certain collapse in the face if Washington D.C. did not provide a lifeline.

2. Shadow Trading

Over the counter derivatives trading, including CDOs and CDSs, can fairly be described as the straws the nearly broke the camel’s economic back. Lehman Brothers and Bear Stearns were deeply involved in purchasing bundled subprime securities, as were dozens of Wall Street titans, such that when the housing market dropped off its heated pace, each


\textsuperscript{265} See Joseph Bunn, The Structured Product Exception: Giving Rating Agencies Credit Only when Credit is Due (forthcoming 2010); see also infra Part II.C.3.

\textsuperscript{266} See infra Part II.C.2.

A deeply entrenched institution was left desperate as borrowers began to default on subprime loans. Each institution that had purchased the securitized subprime mortgage investments had hedged their reckless subprime money grab by entering into credit default swaps contracts primarily purchased through insurers like AIG. As described briefly above, CDSs are essentially private bets for insurance-like contracts that are sold as protection against default on loans. They most often apply to municipal bonds, corporate debt, and mortgage securities, and are sold by banks, hedge funds, and other parties over-the-counter. The buyer of the CDS pays significant premiums over a period of time in return for peace of mind, knowing that losses will ostensibly be covered if a default occurs. CDS contracts are purportedly to work similarly to homeowners insurance that protects against losses from fire, theft and the like—except that they don’t. Banks and insurance companies are regulated and required to meet capital market reserves while the CDS market is not. As a result, contracts can be traded – or swapped – from investor to investor without anyone overseeing the trades to ensure the buyer has the resources to cover the losses if the security defaults.

AIG had engaged so recklessly in the shadow credit default swap market, that it had written billions of dollars worth of quasi-insurance policies to cover CDOs in the event of default, that it did not have nearly the capital to repay in a situation where any significant number came due. When Bear Stears and Lehman Brothers needed insurance pay out

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269 See supra Part II.A.3.


for defaulted securitized vehicles, AIG had no ability or capital to repay. Additionally, due to the shadow markets, CDSs had been traded and shorted to the point that many CDOs were insured by firms that the CDO holder had no clue as to where the CDS currently resided or what the underlying firm’s capitalization or prospects to pay looked like.274

That firm’s could wager on the ability of the CDS payee to default, through an unregulated short sale, simply added to the economic morass that enabled the meltdown.275 That firm’s could purchase CDS contracts on CDOs that they did not own—not for hedging purposes, but for straight up betting purposes, commonly referred to as a naked contract—speculating on the potential failure of a particular pool of securitized subprime loans, contributed to the wild unregulated atmosphere that permeated at the time the capital markets collapsed.276 Subprime mortgage pools were bought up in a frenzy by commercial banks, investment banks, insurance companies, hedge funds, GSEs and others, and these subprime pools were overrated by credit rating agencies and ending up falling precipitously in value as foreclosures mounted on the underlying mortgages in the pools.277 Perhaps more devastating, however, was that speculators sold and bought trillions of dollars of insurance contracts, without owning the underlying pool or contract, betting on whether these pools would, or wouldn’t default.278 Prior to the meltdown, CDSs exploded into the secondary market, where speculative investors, hedge funds, and others similarly situated would buy and sell CDS instruments from the sidelines without having any direct relationship with the underlying investment.279 “They’re betting on whether the investments will succeed or fail – it’s like betting on a sports event. The game is being played, and you are not playing in the game,

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274 Kristin Johnson, Things Fall Apart – The Case of the Credit Commons and Credit Default Swaps, 81 Colorado L. Rev. ___ (forthcoming 2010).


but people all over the country are betting on the outcome.”

When the housing market slowed and the economy soured, the subprime credit collapse began expanding into other credit areas and CDS investors and speculators became nervous. CDS investors wondered if the parties holding the CDS insurance after multiple trades had the financial wherewithal to meet its contract obligations in the event of mass defaults.

The situation was exacerbated by the heavy trading volume of the CDS instruments, the secrecy surrounding the trades, and most importantly, the lack of regulation in this quasi-insurance over the counter derivative contract business. Some CDS contracts had been traded or swapped fifteen to twenty times. So when a default occurred, the insured party or hedged party often had no idea who was responsible for making up the default or whether that end player had the resources to cure the default. The sellers of this CDS insurance were crushed as defaults rose precipitously and the insurers had no ability to pay the CDS contracts it had recklessly written. Trading of these instruments occurred on shadow markets, where capital reserve requirements and clearing were unnecessary and in some instances legislatively prohibited by the CFMA.

One of the largest abusers of the shadow markets described above was Lehman Brothers which had for years behaved recklessly and in the view of some nefariously, in the “predatory structured finance” market. Lehman was not only deeply involved with firms that engaged in predatory lending while its balance sheets were overborne with subprime mortgage-backed securities, but it was simultaneously defrauding investors by hiding losses on public balance sheets engaging in fraudulent accounting practices.

280 See Kristin Johnson, Things Fall Apart – The Case of the Credit Commons and Credit Default Swaps, 81 COLORADO L. REV. ___ (forthcoming 2010); see also Shah Gilani, The Real Reason for the Global Financial Crisis…. The Story No One’s Talking About, Money Morning, September 18, 2008; available at http://moneymorning.com/2008/09/18/credit-default-swaps/.


282 See supra Part II.A.2.

3. Credit Rating Agency Capture

The credit rating agencies that provided bond ratings for the subprime mortgaged-backed investment market shoulder a significant amount of responsibility for the financial market crisis of 2008. The primary credit rating agencies, Moody’s, Standard & Poor’s and Fitch’s began rating investment instruments early in the 20th century continuing through today by giving letter grades to debt vehicles in connection with the likelihood of the instrument’s default or failure to pay. The ratings typically range in descending order of risk from triple A (Aaa) to C, with Aaa representing the highest quality debt instrument with minimal credit risk and C indicating the lowest rated bond class that would currently be in default with no real prospect for recovery of principal or interest.

As the private securitization of subprime mortgages market ramped up, credit rating agencies stepped in to provide ratings on the various tranches of subprime securitizations that were being structured. The goal of the investment banks and underwriters was to gain an Aaa rating for as many of the mortgage backed securities instruments that they could and the credit rating agency system of assigning ratings was primed for manipulation, cover and capture. The credit rating agency model failed badly. First, the credit rating agencies adopted the “issuer pays” model of compensation for delivering ratings, meaning that gross conflicts occurred when the very parties (investment banks and underwriters) structuring the vehicle and seeking the rating were also the parties paying the fees for the ultimate rating that was delivered. Second, credit rating agencies were not adequately staffed to deal with the securitized subprime market explosion (either staff was not professionally trained or was not provided the time to understand or deconstruct the vehicles). Third, based partially on the breakneck pace that subprime mortgages were being sold and securitized, the credit rating agencies did not adequately document the crucial steps along the way of providing a rating and tracking the substantial participants in the process. Fourth, the credit rating agencies

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289 See Securities & Exchange Commission, Summary Report of Issues Identified in the Commission Staff’s Examinations of Select Credit Rating Agencies 7-10 (July 2008); see also Joseph G. Bunn, The Structured Product Exception: Giving Rating Agencies Credit Only When Credit Is Due, pp. 9, unpublished manuscript (on file with author).


291 See Securities & Exchange Commission, Summary Report of Issues Identified in the Commission Staff’s Examinations of Select Credit Rating Agencies 13-20 (July 2008); see also Joseph G. Bunn, The Structured...
overrelied on outdated risk modeling and dissimilar historical data which negatively impacted the accuracy of the ratings that they provided. Finally, external pressures contributed to flawed rating methodologies, including the concentrated market of subprime mortgage-backed investment originators causing the credit rating agencies to concede on important negotiating positions during the rating process in order to prevent losing an important underwriting client.

These failures and pressures set the table for the ratings disaster that eventuated. Nearly “eighty percent (80%) of $1.4 trillion in subprime debt issued between 2005 and 2007 was wrongly represented as triple-A rated securities.” Investors purchased subprime mortgage backed bonds that were rated Aaa, indicating an absolutely safe investment vehicle that would have no trouble paying interest or principal, and 80% of those securitized instruments had been assigned a misleading rating. Investors relied upon a rating system that had been captured. Much of the rating malfeasance was driven by greed, pressure, avarice and flawed modeling. Credit rating agencies are culpable in part, for igniting the subprime mortgage bond market.

4. Regulatory Capture

Arthur Levitt, former chair of the SEC stated regarding his former agency in connection with the financial market meltdown “As an overheated market needed a strong referee to rein in dangerously risky behavior, the commission too often remained on the sidelines.” Sean Coffey, a former fraud prosecutor, believes the SEC “neutered the ability of the enforcement staff to be as proactive as they could be. It’s hard to square the motto of investor advocate with the way they’ve performed the last eight years.” Not only was there a relaxation of enforcement, there was also a reduction in SEC staff. Coffey asserts that the Bush administration used the argument that loosening up regulations was necessary in order to make it possible for American companies to compete globally.

Product Exception: Giving Rating Agencies Credit Only When Credit Is Due, pp. 9, unpublished manuscript (on file with author); AMERICAN CASINO (Table Rock Films 2009).

See Securities & Exchange Commission, Summary Report of Issues Identified in the Commission Staff’s Examinations of Select Credit Rating Agencies 35 (July 2008); see also Joseph G. Bunn, The Structured Product Exception: Giving Rating Agencies Credit Only When Credit Is Due, pp. 9, unpublished manuscript (on file with author).

See id. at 31.


Id.

See id.
Regulators, a favorite target of many in post-crisis America, are often ill-equipped or undermotivated to use the tools at their disposal to capture fraud and malfeasance. The case of Bernie Madoff provides the clearest example. At least five or six times, the SEC was presented with evidence that Madoff was engaged in a scheme that could not possibly be sustained if the numbers were run carefully.298 On each occasion these warnings and beseeching invitations to investigate either fell on deaf ears or a cursory investigation was opened and immediately closed with a finding of “no cause.”299 When the global meltdown exposed Madoff, the truth revealed that he had in fact been running perhaps one of the grandest ponzi schemes of all time.300 The SEC drew significant fire for its failure to properly regulate and investigate Bernie Madoff.301

In light of such regulatory failures, some argue that regulators are too careful not to offend Wall Street giants in order to preserve opportunities to enter the much more lucrative private sector after paying dues on the regulator side for a space.302 Others

298 See United States Securities and Exchange Commission Office of Inspector General, Investigation of Failure of the SEC to Uncover Bernard Madoff’s Ponzi Scheme, Case No. OIG-509 (Aug. 31, 2009), available at http://www.sec.gov/news/studies/2009/oig-509-exec-summary.pdf (submitted by Inspector General H. David Kotz) (“The OIG investigation did find . . . that the SEC received more than ample information in the form of detailed and substantive complaints over the years to warrant a thorough and comprehensive examination and/or investigation of Bernard Madoff and BMIS for operating a Ponzi scheme, and that despite three examinations and two investigations being conducted, a thorough and competent investigation or examination was never performed.”); see also Binyamin Appelbaum and David S. Hilzenrath, SEC Didn’t Act on Madoff Tips: Regulator Was Warned about Possible Fraud as Early as 1999, WASH. POST, Dec. 16, 2008, available at http://www.washingtonpost.com/wp-dyn/content/article/2008/12/15/AR2008121502971.html.

299 See Binyamin Appelbaum and David S. Hilzenrath, SEC Ignored Credible Tips About Madoff, Chief Says, WASH. POST, Dec. 17, 2008, available at http://www.washingtonpost.com/wp-dyn/content/article/2008/12/16/AR2008121602926.html (“‘Our initial findings have been deeply troubling,’ Cox said. ‘I am gravely concerned by the apparent failures over at least a decade to thoroughly investigate these allegations or at any point to seek formal authority to pursue them.’”).


302 See Norman S. Poser, Why the SEC Failed: Regulators Against Regulation, 3 BROOK. J. CORP. FIN. & COM. L. 289, 309 (2009) (“The ‘revolving door’ practice, under which SEC staff members may be tempted to ‘go easy’ on enforcing securities laws because they have the prospect of high-paying Wall Street jobs, has been widely commented on (and will be discussed below), particularly in connection with the recent SEC enforcement failures.”); see also HARRY MARKOPOLOS, NO ONE WOULD LISTEN: A TRUE FINANCIAL
argue that regulators are not financially savvy enough to combat creative and bold financial fraud (as many regulators are lawyers, trained in the law, not in economics or corporate finance) thereby allowing obvious financial fraud to go undetected. The financial market minefield is littered with failed regulators, beginning with the SEC and carving a wide swath through the Federal Reserve Bank, the FDIC, the CFTC and the Office of Thrift Supervision.

Further exacerbating the failures are reports that during the most intense moments of the financial market crisis, senior level SEC attorneys and accountants were spending working hours viewing pornography on their government issued computers. While the SEC works to repair its image and restore its relevance, particularly by levying fraud charges against Goldman Sachs for allegedly materially misrepresenting financial information in connection with its Abacus 2007-AC1 investment vehicle structured in consultation with client John Paulson, it continues to receive withering criticism for its myriad shortcomings.

5. Balance Sheet Fraud

Despite the machinations of the Sarbanes-Oxley Act, criticized at its inception as legislation that was mere “window dressing” and did nothing to meaningfully respond to the Enron, WorldCom, Adelphia, Tyco, Global Crossing accounting scandal era, accounting fraud continues to be perpetrated by some of the nation’s most important financial institutions. Sarbanes-Oxley increased accounting oversight, separated accounting and consulting services, increased audit frequency and significantly increased internal controls, adding incredible new costs, and still, was unable to capture deft

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307 See andré douglas pond cummings, “Ain’t No Glory in Pain”: How the 1994 Republican Revolution and the Private Securities Litigation Reform Act Collapsed the U.S. Capital Markets, 83 NEB. L. REV. 979, 1061 (2005) (“While it appears unlikely that SOX will have any significant effect on improving investor protection, on ensuring capital market integrity, or even on encouraging appropriate behavior from corporate executives, the Act certainly busies itself with window dressing . . . .”).
accounting fraud engaged by some of Wall Street’s most important players.\textsuperscript{308} As the gravity of the subprime crisis failures became apparent to Lehman Brothers, company executives engaged in accounting fraud to secrete the losses from the public and present a picture of vitality to the investing community.\textsuperscript{309} The very fraud that Sarbanes-Oxley was supposed to capture, accounting irregularities and financial malfeasance, played a critical role in the collapse of Lehman Brothers.

Executive dishonesty, apparently, can escape even the most rigid accounting oversight, particularly if a major accountant is willing to be complicit, as Ernst & Young was in the Lehman Brothers use of “Repo 105.”\textsuperscript{310} Indeed, reports indicate that Bank of America may have also used the same accounting mechanism to also conceal bad assets in order to prop up its balance sheet during the same crisis period.\textsuperscript{311}

Further, if not outright fraudulent, recent reports indicate the nearly every investment bank on Wall Street and many national commercial banks engage routinely in balance sheet manipulation in order to mask risk levels and improve leverage levels in mandatory periodic reporting.\textsuperscript{312} “A group of 18 banks—which includes Goldman Sachs Group, Inc., Morgan Stanley, J.P. Morgan Chase & Co., Bank of America, Corp. and Citigroup Inc.—understated the debt levels used to fund securities trades by lowering them an average of 42% at the end of each of the past five quarterly periods. . . . The banks, which publicly release debt data each quarter, then boosted the debt level in the middle of successive quarters.”\textsuperscript{313} Similar to Lehman’s use of Repo 105, these financial titans manipulate debt reporting through repurchase market data by underreporting its risk and debt levels directly before quarterly reports are due providing the investing public an inaccurate picture of its risk levels and leveraged debt.

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\item See id.

\item See id.


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In February 2002, Greenspan underscored how simple it was for CEOs to “craft” financial statements in a way that was deceptive to the general public saying “[t]here’s been too much gaming of the system. Capitalism is not working! There’s been a corrupting of the system of capitalism.”

That Greenspan recognized balance sheet manipulation was occurring and was likely to continue should have sounded a warning signal to Wall Street, but clearly, it was ignored and continues to be by Wall Street executives and its regulators.

6. CEO Primacy

Commentators now argue that corporate law in the United States has evolved to a point where the Chief Executive Officer reigns supreme as nearly untouchable in the modern marketplace. The model of shareholder democracy has been ameliorated to the point that the CEO and his pursuit of personal fortune is the primary driver behind most corporate positioning. The CEO dominates American corporations to the extent that he is held to very few standards of responsibility and is able to stave off all shareholder dissent through careful calculation. According to Professor Steven Ramirez “CEOs of public companies have the unique privilege of picking their own nominal supervisors—the board of directors.”

The CEO in the United States has the power to appoint the board of directors that “oversees” his performance, to maneuver board members off of the board if they challenge his decisions, to establish his compensation through the board committee


315 Steven Ramirez, The Special Interest Race to CEO Primacy and the End of Corporate Governance Law, 32 DEL. J. CORP. LAW 345 (2007) (“Corporate governance law in the United States is deeply flawed.”).


318 Steven Ramirez, American Corporate Governance and Globalization, 18 BERKELEY LA RAZA L.J. 47, 55 (2007) (describing the proxy rules that essentially allow the CEO and management to determine who leads a corporation and established significant obstacles for shareholders who wish to nominate persons for the board of directors); see also Steven Ramirez, The End of Corporate Governance Law: Optimizing Regulatory Structures for a Race to the Top, 24 YALE J. REGULATION 329 (2007).

319 Steven Ramirez, American Corporate Governance and Globalization, 18 BERKELEY LA RAZA L.J. 47, 56 (2007) (“This means that the CEO may stack the board with cultural and social clones in order to maximize compensation. Shareholder democracy is a myth in the U.S., and management interests have worked to keep it a myth.”).
that he appoints;\textsuperscript{321} to make reckless decisions that are protected by the business judgment rule;\textsuperscript{322} to exercise nearly unfettered power as the duty of care and duty of loyalty have been judicially emasculated to the point of near nonexistence;\textsuperscript{323} and to escape private shareholder lawsuits as class action securities fraud actions have been Congressionally neutered to a near terminal state.\textsuperscript{324} CEOs and corporate management have been empowered by U.S. corporate law to generate personal short term profit and gain at the expense of long term vitality and shareholder profit maximization in breathtaking ways.\textsuperscript{325}

One of the enduring themes of the financial market crisis is that Wall Street executives overleveraged or allowed such reckless overleveraging of their balance sheets that nearly every major firm faced imminent collapse and bankruptcy. The simple reason that these CEOs and other executives allowed their firm’s to walk to the very edge of the bankruptcy precipice is because they all pursued the fantastic profits that were being kicked off in the securitized subprime mortgage industry. Short term profit, tied into his executive compensation, motivated the audacious decision making and recklessness that forced a federal taxpayer bailout. The reckless pursuit of profit in the above described subprime mortgage-backed securities market is a powerful example of this short term personal profit driven vision.\textsuperscript{326}

Most of the corporate executives that steered their companies into the subprime mortgage morass walked away with bonuses and compensation, not jail time.\textsuperscript{327} In the ultimate irony, some of the compensation paid to these reckless executives came from the very

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\item \textsuperscript{320}See CNBC on Assignment: Rebellion in the Magic Kingdom (CNBC television broadcast Jan. 24, 2005) (Maria Bartaromo reports on the famed Disney shareholder lawsuit in the Michael Ovitz executive compensation case where CEO Michael Eisner deftly maneuvered Roy Disney off of the Disney board of directors when he began challenging Eisner’s authority).
\item \textsuperscript{321}See Steven Ramirez, \textit{The End of Corporate Governance Law: Optimizing Regulatory Structures for a Race to the Top}, 24 YALE J. REGULATION 329 (2007).
\item \textsuperscript{322}See Marc I. Steinberg, \textit{The Evisceration of the Duty of Care}, 42 SW. L.J. 919 (1988); see also Steven Ramirez, \textit{The Chaos of Smith}, 45 WASHBURN L.J. 343, 344 (2006).
\item \textsuperscript{324}See supra Part II.A.C (describing the Private Securities Litigation Reform Act); see also Steven Ramirez, \textit{Arbitration and Reform in Private Securities Litigation: Dealing with the Meritorious as Well as the Frivolous}, 40 WM. & MARY L. REV. 1055 (1999).
\item \textsuperscript{325}Steven Ramirez, \textit{The End of Corporate Governance Law: Optimizing Regulatory Structures for a Race to the Top}, 24 YALE J. REGULATION 329 (2007).
\item \textsuperscript{326}See generally MICHAEL LEWIS, \textit{THE BIG SHORT: INSIDE THE DOOMSDAY MACHINE} (2010).
\item \textsuperscript{327}See Steven Ramirez, \textit{Subprime Bailouts and the Predator State}, 35 DAYTON L. REV. 81, 91, 100 (2009) (describing the hoarding of capital by Wall Street firms using taxpayer bailout funds to improve balance sheets and record record profits rather than lending to a cash strapped citizenry).
\end{itemize}
TARP bailout funds that were needed to keep the overleveraged firms afloat. While corporate executives that recklessly capsized their firms avoid jail time and any significant consequence for their actions, many minority borrowers, who are blamed by some for causing the crisis, find themselves saddled with subprime mortgages that were delivered to them predatorily.

D. Summation

Commenting on the risky derivatives trading and selling, purchasing, swapping and insuring securitized mortgage investments, Professor James Cox admitted that:

[W]e foolishly believed that the firms had a strong culture of self-preservation and responsibility and would have the discipline not to be excessively borrowing. Letting the firms police themselves made sense to me because I didn’t think the S.E.C. had the staff and wherewithal to impose its own standards and I foolishly thought the market would impose its own self-discipline. We’ve all learned a terrible lesson.

The “Group of 20,” meeting shortly after the U.S. Government acted in a desperate attempt to keep its primary financial institutions from collapsing by passing TARP, released on November 15, 2008 its “Declaration of the Summit on Financial Markets and the World Economy” wherein it summarized its findings as to the causes of the near global meltdown:

During a period of strong global growth, growing capital flows, and prolonged stability earlier this decade, market participants sought higher yields without an adequate appreciation of the risks and failed to exercise proper due diligence. At the same time, weak underwriting standards, unsound risk management practices, increasingly complex and opaque financial products, and consequent excessive leverage combined to create


331 See About G-20, REPUBLIC OF KOREA, available at http://www.g20.org/about_what_is_g20.aspx (last visited Apr. 6, 2010) (“The Group of Twenty (G-20) Finance Ministers and Central Bank Governors was established in 1999 to bring together systemically important industrialized and developing economies to discuss key issues in the global economy.”)

vulnerabilities in the system. Policy-makers, regulators and supervisors, in some advanced countries, did not adequately appreciate and address the risks building up in financial markets, keep pace with financial innovation, or take into account the systemic ramifications of domestic regulatory actions.\(^3\)\(^3\)\(^3\)

The material above seeks to present an honest picture as to the reality of the financial market collapse of 2008. As detailed, the causes for the collapse are numerous, and intersect in a web of secrecy, negligence, complexity, ignorance and greed. While not capturing every single piece of the puzzle, the discussion above undertakes to describe most of the principle players in the economic collapse. In light of the many and varied causes carefully described above, Congressional leader’s must take notice and thoughtfully consider ways in which to protect investors from the reckless excess of Wall Street promulgated by its leadership and from its own short-sighted legislative and policy mistakes.

The U.S. Congress is notorious for adopting lightly considered, knee jerk legislation in response to crises that threaten the confidence of American investors.\(^3\)\(^3\)\(^4\) As “Main Street” citizens continue today to suffer from rugged unemployment statistics, continued tightening of credit, continuing depression of housing prices and destroyed retirement and college savings accounts, it is incumbent upon Congressional leaders, academics and economists to seriously examine the true causes of the meltdown, across the board, and to adopt new, fresh, sensible regulation that protects the American investor and citizen.\(^3\)\(^3\)\(^5\)

In thoughtfully interrogating the causes of the market collapse, Congress must ignore the clarion calls of those that purport to have distilled the cause of the crisis down to one factor or one reason, but for its existence the crisis would have been averted. Honest reflection demonstrates that a multiplicity of failures precipitated the meltdown.

Further, Congressional leaders must also discard the market crisis causation explanations that serve as misdirection or distortion meant to circumscribe honest and genuine exploration of the crisis causes. Several distortions exist, the most nefarious of which is the dirty little myth that has been disseminated and adopted by a curious swath of American citizens and commentators. The dirty little myth, in the ultimate misdirection, attempts to pin ultimate blame for the financial market crisis on minority borrowers and the Community Reinvestment Act.


III. Financial Market Crisis Myth

As described carefully above, the financial market crisis of 2008 has at its root the failure of dozens of mechanisms, laws, individuals and decisions. Still, despite overwhelming evidence that nearly every one of the spectacular failures were perpetrated by a mostly white male Congress, mostly white male Wall Street insiders and mostly white male securities speculators, the dynamic and relentless nature of American racism still emerged in a startling way. As described by Critical Race Theory, institutional and structural racism has never been appropriately dealt with or eliminated in the United States, and because it has not, continuing manifestations of race hatred simply mutate and find expression in ways that serve to further the interests of the majority. This mutation was on clear display in the days, weeks and months following the financial market meltdown of 2008, as the dirty little myth spread like a virus throughout the nation.

A. The Dirty Little Myth

In the days following the collapse of Lehman Brothers and as Congress was intensely debating and posturing in connection with whether to pass TARP, a stunning message began to seep out from Fox News, conservative commentators and Web 2.0.336 A dirty little myth began to be peddled that essentially blamed the failure of the U.S. capital markets on minority borrowers who were now defaulting on their subprime mortgages, which was the primary factor leading to the collapse of the global economy.337 Through federal governmental intervention, in the form of the Community Reinvestment Act of 1977 and the securitized subprime loan purchasing activity of Fannie Mae and Freddie Mac, lenders were “forced” to provide undeserving minorities with mortgage loans that never should have been written. Subprime mortgage loans were required to be written, according to the dirty little myth, against the will of the lenders.338

In September 2008, when Senator Chris Dodd and Representative Barney Frank emerged from an emergency closed door meeting with then Treasury Secretary Henry Paulson and Federal Reserve Chair Ben Bernanke, both Dodd and Frank appeared ashen faced and


337 See id.

visibly shaken.  Congressional leadership had just been told that if a $700 billion dollar bailout of the U.S. financial system was not approved immediately, financial Armageddon would ensue. Thereafter a strange dance materialized where a failed Republican presidential administration in lock step with Democratic congressional leadership rushed through legislation that eventually committed $850 billion dollars of taxpayer money to “save” and shore up the U.S. economy by bailing out Wall Street financial institutions whose leadership had driven them to the point of utter collapse.

When the dirty little myth began to emerge, it did so with force. Financial Armageddon as the fault of minority borrowers in urban centers around the country who took out loans they could not possibly re-pay all made possible by the Community Reinvestment Act, Fannie Mae and Freddie Mac seemed absurd to many, but found unbelievable traction. Neal Cavuto on Fox News stated “loaning to minorities and risky folks is a disaster.” Ann Coulter in an article she authored stated in headline “They Gave Your Mortgage to a Less Qualified Minority.” Congressperson Michelle Bachman (R., MN), on the House Floor and later on Larry King Live said, “Look at the housing crisis. Government has to take its share of the blame. After all, government was goading these mortgage lenders [saying] ‘if you don’t give loans out to marginally credit worthy people, we’re going to come after you.’” In fact, according to the myth, the overzealous enforcement by the


343 The CRA, enacted by Congress in 1977, was intended to encourage depository institutions to help meet the credit needs of the communities in which they operate. http://www.ffiec.gov/cra/.


government of the Community Reinvestment Act forced quotas on banks to encourage diversity in the housing market by lending solely “on the basis of race.” This is simply false.  

Former Republican Presidential candidate Pat Buchanan on MSNBC’ Morning Joe stated flatly “the Feds leaned on banks and threatened some of these banks [saying] ‘you’ve got to make more loans,’ and pushed them out . . . frankly, in minority communities. And they pushed them out and the guys put nothing down . . . and then the banks sell the loans off to Fannie and Freddie.” To which Joe Scarborough responded “And that’s what happened. Banks made bad loans. They sold it to Fannie and Freddie.” While many reputable sources were quick to denounce Buchanan, Scarborough, Cavuto and Coulter, the myth had been unleashed and it began to creep into households and mindsets across the country. Politicians, pundits and economists serve up minority
borrowers and governmental social steering as the primary cause of a near global meltdown.

Of course, driving the myth firmly into the households and minds of a willing undercurrent of Americans was Rush Limbaugh, who spun out his own particular mischaracterization for the financial market crisis: illegal Latino immigrants. Together with blaming Latino illegal aliens for entering into home mortgages that they could not afford (and had no legal right to enter), Limbaugh also placed blame squarely upon Fannie Mae and Freddie Mac for their role in buying up subprime mortgage-backed securities. Despite overwhelming evidence that the private sector’s profligation was at the root of the subprime securitization frenzy, Limbaugh suspended the truth to perpetuate his own peculiar mythmaking.

The dirty little myth has since evolved into a flowing characterization that the federal government used its powers to force the expansion of homeownership to people who had been shut out for economic reasons, or sometimes, because of racial and ethnic discrimination, but that these loan recipients, primarily minorities, and generally poor, must now shoulder the blame for the failing global financial markets because they were ultimately unqualified for the loan, were overreaching in seeking homeownership and were now defaulting on their subprime mortgages. In addition, the myth contends that the federal Government must accept responsibility for the failure of private market discipline because it was policy driven social engineering by government officials that forced banks to lend to unworthy minority borrowers in the first instance.

While the myth was pervasive and dirty in the panic stricken period that gripped Congress and the nation in September and October 2008, it found traction at America’s dinner tables and some boardrooms and now continues to rear its head in

Democrats say they do, and again nearly as many independents, 72 percent, agree. It’s also a majority among Republicans, but a much smaller one, 54 percent.”).

353 See Cheryl Wade, Financial Market Crisis Symposium, University of Utah S.J. Quinney College of Law, Sept. 25, 2009, webstream available at http://www.ulaw.tv/watch/791/financial-crisis-symposium---morning-session; see also Larry Keller, Minority Meltdown: Immigrants Blamed for Mortgage Crisis, Southern Poverty Law Center (2009) available at http://mediamatters.org/research/200902200006 (“Rush Limbaugh stated on his radio program that HUD was ‘admitting 5 million illegal aliens were given mortgages … with fake Social Security numbers and so forth to go out and purchase homes that they didn’t have to pay back.’”).


355 See supra Part II.C.A.


unsettling settings today. The dirty little myth has transmogrified slightly and now attaches full market crisis fault to minority borrowers, the Community Reinvestment Act and the federal government (through the quasi governmental agencies Fannie Mae and Freddie Mac). No longer is it just Representative Bachmann, pundits and talk radio agitators that push the dirty little myth, but it continues to exist and persist as currently peddled by economists, think tank employees, bloggers and reporters, and family reunion attendees.


359 See Peter Schweizer, A Poisonous Cocktail, FORBES.COM, Oct. 10, 2009, available at http://www.forbes.com/2009/10/03/community-reinvestment-act-mortgages-housing-opinions-contributors-peter-schweizer.html (“The CRA is not about community development; it is, essentially, affirmative action in lending. . . . This is precisely what we need to get away from. Drinking this potent cocktail would be dangerous to our financial health.”).

360 See Right-wing Media Criticize Financial Reform with Regurgitated Myth that Affordable Housing Caused Financial Crisis, MEDIA MATTERS, Apr. 21, 2010, available at http://mediamatters.org/research/201004210051 (showing Rush Limbaugh’s radio program where he blames the Community Redevelopment Act and Fannie Mae and Freddie Mac for the financial crisis, absolving Wall Street of any responsibility for the meltdown); see also Quick Fact: Hannity Falsely Suggests Community Reinvestment Act Caused Financial Crisis, MEDIA MATTERS, April 20, 2010, available at http://mediamatters.org/research/201004200058 (showing Sean Hannity’s Fox News program where he blames the Community Reinvestment Act and the “notion that everybody in America had a right to a house” as the primary cause of the financial market crisis).

Economist Thomas Sowell argues that the Community Reinvestment Act was a primary progenitor of the financial market crisis because it required banks to carefully track the loans it was extending to borrowers including memorializing race, gender and age. To Sowell and many others, this act of tracing lending according to race, gender and age allowed federal government regulators to exert enormous pressure on banks that did not appear to lend equally to all potential borrowers. According to Sowell, this act of pressuring banks to loan to all community borrowers where the banks did business had the effect of forcing or mandating that banks lower lending standards in order to increase its lending to minority and low income borrowers. Government policy, since George H.W. Bush, strongly promoted home ownership, and the Community Reinvestment Act tracked lending statistics making banks develop lax lending standards in order to meet governmental policy initiatives, thus allowing the banks greater ability to gain regulatory approval of various activities that were unavailable if the bank was deemed discriminatory in its lending practices. Thus, according to Sowell, banks began devising crafty and mischievous lending devices like adjustable rate mortgages, interest only mortgages and no down-payment mortgages in order to lend to minorities and low income borrowers. Accordingly, the Community Reinvestment Act and social welfare governmental intrusion represent the true roots of the financial market fiasco. Based primarily on Sowell’s interpretation of the meltdown and the role played by government, in particular the Community Reinvestment Act, most of the media and pundits that gravitate toward such messaging, have seized upon this narrow line of reasoning and have distilled it down to a single explosive message: minority borrowers caused the financial market crisis because the government through the Community Reinvestment


368 See THOMAS SOWELL, THE HOUSING BOOM AND BUST (2009)
Act forced banks to adopt quotas by requiring them to loan to poor borrowers of color—affirmative action in lending.

From this massive mutation, the dirty little myth has grown, appeared on headline news programs and dominated dinner table discussions. That news agencies, financial institutions, and corporate America, had the audacity to point a singular market failure finger at minority “subprime” mortgage recipients and governmental intrusion, rather than to accept responsibility for a failure that could have been avoided with market discipline, responsibility and regulation rather than voracity and greed, demonstrates the depth of the mutation and the distortion of those that should accept responsibility (the list is lengthy) but still unfailingly refuse.

B. Nevermind The Truth

The dynamism of American racism has never allowed the truth to impede the desired scapegoating result. As described above the mutation of reality in connection with the financial market crisis borders on the absurd. Yet and still, gathering forces attempt to pin the blame for the financial market crisis on minority borrowers and governmental intrusion.

Is it true that minority borrowers were provided subprime loans through forced lender activity based on the Community Reinvestment Act? Did minority borrowers defaulting on these subprime loans cause the collapse of the financial markets?

Responding to the immediate dirty little mythmakers in the days following the near collapse of the financial markets blaming the Community Reinvestment Act as perpetuating the collapse, Federal Reserve chair Ben Bernanke, in a November 25, 2008 letter to Senator Robert Menendez stated:

> Our own experience with CRA over more than 30 years and recent analysis of available data, including data on subprime loan performance, runs counter to the charge that CRA was at the root of, or otherwise contributed in any substantive way to, the current mortgage difficulties. The available evidence to date does not lend support to the argument that CRA is to blame for causing the subprime loan crisis.

369 See supra notes ____-____ and accompanying text.

370 See Frank Rich, No One Is to Blame for Anything, N.Y. TIMES, Apr. 11, 2010, available at http://www.nytimes.com/2010/04/11/opinion/11rich.html (“[Greenspan] was eager to portray himself as an innocent bystander to forces beyond his control. In his rewriting of history, his clout in Washington was so slight that he was ineffectual at ‘influencing the Congress.’

Further, president of the Federal Reserve Bank of San Francisco Janet Yellen, stated in a March 2008 speech that “studies have shown that the CRA has increased the volume of responsible lending to low- and moderate-income households." In truth, with the guidelines imposed by the Community Reinvestment Act, efforts to open the mortgage pipeline to minority groups has proved successful. Prior to the 1977 Community Reinvestment Act minority borrowers that applied for mortgage loans were often stopped cold by a persistent practice called “red-lining,” wherein lenders would refuse to write mortgages within particular geographical areas, often on the basis of race. Studies show that the Community Reinvestment Act inspired responsible lending, opened homeownership to American citizens previously shut out, and loans written to borrowers through the Community Reinvestment Act default significantly less often than peer loan vehicles and those written by independent mortgage companies.

Despite the hue and cry that the CRA forced lenders to extend subprime mortgages to unqualified minority borrowers, the truth is that the Community Reinvestment Act was enacted more than thirty years ago so its nefarious impact must have laid dormant for more than twenty-five of those years. The CRA requires no quotas or mandatory lending and instead specifies that lenders extend loans in a fair, sound, reasonable and principled fashion. Additionally, more than 50% of the lenders extending subprime loans during

376 See supra Part IV.A.
377 See Interview with Pam Hennes, Compliance Director and Operations Manager, Deerwood Bank, Baxter, MN (conducted March 27, 2010) (describing the requirements of the Community Investment Act and affirmatively disavowing that the CRA mandates any quotas or forces any lending to minority borrowers); see also Elizabeth Laderman and Carolina Reid, CRA Lending During the Subprime Meltdown, Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act, available at http://www.frbsf.org/publications/community/cra/cra_lending_during_subprime_meltdown.pdf (concluding from their empirical study that Community Reinvestment Act loans were significantly less
the run-up to the crisis were finance companies that were not required to comply with the CRA.\textsuperscript{378} In reality, less than 20\% of lenders extending subprime loans were subject to the provisions of the CRA,\textsuperscript{379} with some estimates indicating that lenders beholden to the CRA extended just 6\%-7\% of the subprime loans subject to default risk during the crisis.\textsuperscript{380}

While Thomas Sowell is careful to cabin his criticism of the Community Reinvestment Act by claiming that it only allowed the government to “pressure” banks to loan to poor minorities, many that subscribe to his economic theorizing use his language to argue that the CRA “forced” or “required” banks to write subprime loans to minorities.\textsuperscript{381} This is simply not true. That said, Sowell cherry picks historical facts to support his own ends in describing the CRA’s role in the financial market crisis. When Sowell blames the government for forcing lax lending standards, he does not mention the persistent and gnawing discrimination that led to the adoption of the CRA in 1977. Forcing banks to track lending statistics by race, gender and age allowed bank regulators to determine which banks were continuing to discriminate against minority borrowers in their lending practices. Further, Sowell ignores the private market entry into the subprime mortgage market together with independent and unregulated mortgage brokers who had nothing to do with the CRA, but were insistent on writing subprime loans for profiteering purposes. While banks unquestionably have CRA loans on their books that have defaulted during the market crisis, suggesting that some of those loans were extended that likely should not have been, the truth is that the default rates and percentages are significantly lower than the subprime loans written by independent mortgage companies and are in line with typical default percentages expected with CRA subprime loans.

Thus, not only did the CRA play little to no role in the subprime loan abuse, often minority communities were targeted for predatory lending.\textsuperscript{382} In 2006, 55\% of loans to


\textsuperscript{379} Thomas Edsall, \textit{Conservatives Seek to Shift Blame for Crisis Onto Minority Housing Law}, \textsc{Huffington Post}, Oct. 1, 2008, \textit{available at} http://www.huffingtonpost.com/2008/10/01/conservatives-seek-to-shi_n_131020.html (citing University of Oregon economist Marc Thoma who noted in addition that “subprime loans grew twice as fast in institutions that did not have to meet the conditions of the CRA”).

\textsuperscript{380} \textit{See} Neil Bhutta & Glenn B. Canner, \textit{Did the CRA cause the mortgage market meltdown?}, \textsc{Community Dividend}, Mar. 2009 \textit{at} http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=4136.

\textsuperscript{381} \textit{See supra} notes 342-365 and accompanying text.
African Americans were subprime, despite the fact that many of those borrowers qualified for prime loans. Additionally, statistics indicate that 40% of loans to Latinos were subprime; 35% of loans to American Indians were subprime, while just 23% of loans to whites were subprime. Women also received less favorable loan terms across equal presentations of credit worthiness. Studies indicate that minority borrowers were purposely steered into risky and expensive subprime loans, even when they qualified for better terms. Those lenders that steered minority borrowers into subprime loans were often mortgage brokers that were eager to make a significantly larger profit.

“In two audit studies wherein creditworthy testers approached subprime lenders, whites were more likely to be referred to the lenders’ prime borrowing division than were similar black applicants. Further, subprime lenders quoted the black applicants very high rates, fees, and closing costs not correlated with risk.” A classic discrimination study by the Reinvestment Coalition found that black and Latino individuals that posed as borrowers received significantly poorer treatment and were offered costlier, less-attractive loans more often than whites — despite the fact that minority testers had been given more attractive financial profiles, including stronger credit standings and lengthier employment tenures. This study rebuts mortgage companies’ claims that lending patterns are determined solely by risk characteristics. “John Taylor, the coalition’s president, told a Congressional hearing last year, that minority borrowers were paying a ‘race tax.’ While lenders are required to report to the federal government such things as race, gender, census tract, amount of loan and income, they omit credit score data.”


386 See Creola Johnson, The Magic of Group Identity: How Predatory Lenders Use Minorities to Target Communities of Color, 17 GEORGETOWN J. ON POVERTY LAW & POL’Y 165 (2010); see also supra Part II.B.2 (describing predatory lending as a major cause of the market meltdown).


390 Id.
Therefore, in guarding the most important statistic used in making loans, mortgage lenders provide for themselves a ready shield against charges of discrimination and predatory lending.  

In further debunking the myth that minority borrowers caused the market crisis and that the CRA was at the root of this failure, nearly 60% of all subprime loans in the 2005-07 period were extended to white borrowers and more than 40% of all subprime loans were extended to white borrowers that qualified as “affluent.”

While the mortgage crisis has been recharacterized by the right as the fault of minority borrowers and governmental intervention through the CRA and Fannie and Freddie, the reality is just the opposite. Predatory lending and subprime mortgage abuse is far more responsible for minority involvement in the subprime markets than the Community Reinvestment Act. There are no facts that support the dirty little myth. It is just that – a myth. Minority borrowers are no more responsible for the financial market crisis than are Brazilian surfers, Tongan princes or Japanese lawyers.

As one journalist stated “what we’re witnessing is the disastrous collision of greed, fear, and ignorance at the intersection of Wall Street and Main Street. Some banking kingpins got rich peddling junk.” The once staid mortgage-lending business became the playground for high-flying investment bankers, who were not ready to settle for modest profits. Instead, they turned mortgage lending into a gambling scheme, introducing high risk and huge profits. “The system became corrupted by high salaries and the


394 See SIMON JOHNSON & JAMES KWAK, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN 144-46 (2010) (describing the very limited exposure to subprime loans Fannie and Freddie had on their books during the securitization bonanza years, based primarily on charter limitations and requirements that they purchase only “conforming loans,” by in large); see also JOSEPH E. STIGLITZ, FREEFALL: AMERICA, FREE MARKETS AND THE SINKING OF THE WORLD ECONOMY 10-12 (2010) (describing conservative blaming of Fannie, Freddie and the Community Reinvestment Act as “sheer nonsense.”).


396 See id.
need to sustain those high salaries, by shoddy lending practices, by self-dealing with the bond regulators.”

The truth of the financial market crisis lies above in Part II. The causation and failures were divers and complex. The dirty little myth is unsupportable. So, why was the myth floated in the face of little evidentiary support? What motivated this blatant misrepresentation that continues to percolate?

IV. Racial Coding

When the United States capital markets nearly collapsed in 2008 and came close to causing a global financial meltdown, it is incredibly revealing that a stunning portion of the nation’s citizenry pointed the finger of blame at minority Americans. While at first astonished by this audacious misdirection, the blaming has now settled into a familiar trope that must necessarily be recognized and challenged.

As if existing in parallel universes at the darkest moments of the near global meltdown, the United States was preparing to elect its first non-white male president of the United States. In near lockstep, the country was paralyzed by fear of potential economic failure yet amazed that an African American stood poised to become the most powerful individual in the world. In a truly schizophrenic moment, millions of Americans denigrated minority borrowers as the cause of the financial market crisis while millions of Americans flocked to their election precincts to vote for a candidate that held promise

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401 See supra Part III.
to ring in a post-racial America.\(^{402}\) The irony of this dual, simultaneous construction cannot be ignored.

To many, the election of Barack Obama as president signaled a new era for American politics and symbolically represented a coming of age for a country with a tortured racial history.\(^{403}\) At the very moment that our nation was touted as “coming of age” we regressed into our familiar historical hostility toward our minority citizenry.\(^{404}\) For a nation that has purportedly progressed to a post-racial place, the dirty little myth smacks of the racial hatred and propaganda that marks so many chapters of our nation’s history.\(^{405}\) Can we as a country make a legitimate claim of true racial progress, racial healing and post-racial understanding if we continue to condemn the least powerful and those least responsible for the ills that beset our nation?

A. Code Talk

Many now argue that the financial market crisis owes its entire genesis to the Community Reinvestment Act and the quasi governmental GSEs, Fannie Mae and Freddie Mac. Perhaps recognizing the political inexpediency of blaming “minorities,” the dirty little myth has now morphed into a more insidious characterization of minority blaming in code. Fox News pundits and politicians Coulter, Beck, Cavuto, Bachmann, Buchanan and Limbaugh, while maintaining powerful sway over a certain segment of the U.S. population, are easily dismissed by thoughtful observers. This group was explicit in its condemnation of minority Americans and illegal aliens as the cause of our nation’s subprime sickness.\(^{406}\) The absurdity of the dirty little myth can be easily swept aside as


\(^{404}\) See supra Part III.A.

\(^{406}\) See supra notes ___-___ and accompanying text.
mere talk radio or Fox News spin and only housed in the far right reaches of the tea-party political spectrum.

But what has dangerously evolved from the early Buchanan, Coulter, Limbaugh, Bachmann screeds against “minority” borrowers and “affirmative action” for homeowners, is now a fairly consistent drumbeat from economists, think tanks, bloggers, market insiders and citizen commentators, that articulate as the true downfall of the economy the Community Reinvestment Act and the pre-meltdown activities of Fannie Mae and Freddie Mac. This blaming of governmental welfare, while not expressly racial, is simply traditional coding for race. Using the Community Reinvestment Act, Fannie and Freddie as the primary agents of the economic collapse simply names in code minority Americans and “welfare” affirmative action as the prime progenitor of the global meltdown. And this coding persists with remarkable intensity amongst a wide swath of Americans.

Racial coding has a long tradition in the United States. That it persists in the purportedly post-racial Obama era belies the very positioning of post-racialism and post-racialists. Racial coding entails engaging issues “such as crime and welfare, widely viewed now as ‘coded’ issues” that play upon race—or more centrally, upon white American’s negative views of black American—without explicitly raising the race card. By embracing coded issues, politicians and pundits are able to exploit white American’s racial animosity and resentment toward minority Americans while diminishing the appearance of race hatred or race baiting.

Classic examples of code talk or racial coding in fairly recent U.S. history include the political invocations of the “welfare queen,” the Willie Horton advertisements in the 1988 Bush/Dukakis presidential campaign, and the “Harold, call me” advertisements in

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407 See supra notes ___-___ and accompanying text; see also Aaron Pressman, Community Reinvestment Act Had Nothing to do With Subprime Crisis, BUSINESS WEEK, Sept. 29, 2008, available at http://www.businessweek.com/investing/insights/blog/archives/2008/09/community_reinv.html (in reviewing the more than 400 comments to this piece reveals the vitriol that dozens of commentators have toward the Community Reinvestment Act and blame it (and minorities) for causing the financial crisis).


the 2006 Harold Ford, Jr., Tennessee Senate campaign, amongst so many others examples.

The “welfare queen” entered American tradition during the Reagan years, wherein poor African American women in urban centers were coded as welfare recipients reliant on government largesse and as gaming the system by bearing scads of unruly babies in order to receive greater governmental assistance.410 The racial coding of “welfare queen” has become so imprinted on America’s consciousness that mere mention of the term immediately brings to mind inner-city black women who lazily wait for first of the month welfare checks to arrive by mail.411 Of course, as described above,412 racial coding requires a suspension of the truth. The “welfare queen” largely does not exist, particularly in urban centers.413 Most Americans on welfare in the United States are poor whites. Nevertheless, the racial coding allows white Americans to disdainfully condemn poor African American mothers as a blight and unworthy of assistance or compassion.

Willie Horton entered American tradition during the 1988 George H.W. Bush presidential campaign against Michael Dukakis, wherein a political commercial aired by the Bush campaign used a black rapist and murderer (Horton) who had been granted a weekend prison release from a Massachusetts penitentiary to symbolize Dukakis’s purported softness on crime.414 While the advertisement was ostensibly about crime and Dukakis’s support of prison release programs, it ultimately was racially coded to present the black male criminal trope and was meant to induce fear in white Americans.415 The commercial is roundly considered the primary reason that President Bush was able to overcome double digit down in the polls and played expertly into America’s fear of the


411 See id.

412 See supra Part III.B.


black male criminal. Of course, as described above, racial coding requires a fabrication and distortion of the truth. Michael Dukakis had no connection to Willie Horton and violent crimes in the United States are carried out far more often by white perpetrators than black. Nevertheless, racial coding allows race baiting to be perpetrated without explicit reference to race based on white America’s resentments toward minority citizens.

“Harold, call me” entered American politics during the 2006 Tennessee Senate campaign between African American candidate Harold Ford, Jr and white candidate Bob Corker, where the Republican National Committee released an anti-Harold Ford commercial featuring a scantily clad white woman who winks into the camera and implores Harold Ford to “call me.” While the advertisement was ostensibly about Ford being unprepared or wrong on the politics, it was ultimately racially coded to present the black male/white female interracial relationship taboo that continues in many corners of the United States and was meant to induce fear in white Tennesseans. The commercial was aired in the last weeks of an exceptionally close Senate campaign and is roundly considered as “a very serious appeal to a racist sentiment.” Again, as described above, racial coding requires a fabrication and distortion of the truth. Racial coding allows race baiting to be perpetrated without explicit reference to race based on white American’s continuing resentments toward minority citizens.

This racial coding, blaming the minority poor, continues unabated in “post-racial” America. Following the tradition of the “welfare queen,” Willie Horton, and “call me Harold,” politicians and pundits seized upon the Community Reinvestment Act and governmental housing policy “affirmative action” through Fannie Mae and Freddie Mac to code race and disseminate racial hostility in a wide ranging misdirection from the true underlying causes of the financial market crisis. The countless politicians, commentators, economists and citizens who blame the Community Reinvestment Act for the financial market crisis literally suspend reality in order to code minority citizens as responsible for the economic collapse. The Fannie and Freddie finger pointers are engaging in classic race baiting. The code talk creates subterfuge and massive misdirection in connection with the reality of the meltdown. While capitalism and neoclassical economics should be critically interrogated in light of the colossal failures in the private financial sector that


precipitated the crisis, we are instead fervently engaged in propping up these two systems that failed us so spectacularly.420

B. Coming of Age?

Post-racialism is a deeply loaded term. Taken lightly post-racialism can mean simply that our nation has transcended the “color line” and that truly all people are created equal and treated fairly in this country. Surely if an African American can become president, race is no longer an issue worthy of discussion. On a much deeper level, post-racialism can be used as a tool to perpetuate white privilege and lend additional power to entrenched elites.

Professor Sumi Cho describes one outcome or effect of post-racialism as a “result of adoption of a post-racial construct ‘whether intended or not, [it] is the ultimate redemption of whiteness: a sociocultural process by which whiteness is restored to its full pre-civil-rights value.’”421 In embracing a post-racial conceptualization, Professor Cho argues that the full value of white privilege is captured for whites as unjust enrichment is disaggregated from racist complicity based on the occurrence of the “big event” of racial transcendence.422 The election of Barack Obama as president fully realizes the equality dream for minority citizens and returns whiteness to its comfortable place of dominance and privilege. Racial remedies and racial discourse are off the table in a post racial world and those that engage in continuing racial discussion are agitators seeking to place race where it no longer belongs.423 The nation has rebooted. Equal opportunity is freely available and as a consequence white privilege reigns supreme.

The irony of the survival of the dirty little myth in a purported post-racial nation is that the myth of minority fault for economic collapse serves as subterfuge for the deeply cynical purpose of maintaining “capitalism” and American corporatocracy as a wealthy white tradition. Surely scapegoating minority borrowers as guilty for bringing the global financial markets down is reprehensible, but when done to prop up the very systems that actually failed the nation, simply because those systems are the playground of the white privileged and powerful, is truly diabolical.

The financial market crisis can teach us many lessons. One of the most poignant is that post-racialism is a dream—a worthy dream, but still a distant one. Predatory lenders

420 See generally JOHNSON & KWAK, supra note 2.


targeted African American and Latino borrowers at alarming rates. Minority borrowers were steered into riskier and costlier loans despite credit scores that situated them comfortably within prime loan territory and were eligible for far less costly and risky mortgages. Once the subprime mortgage market collapsed, dozens of commentators and now millions of Americans, including economists, legislators, think tank employees, citizens and neighbors place the blame for the financial market crisis squarely at the feet of African American and Latino homeowners. In a dreadful distortion, millions of Americans now blame minority borrowers and through racial coding the Community Reinvestment Act, Fannie and Freddie as the literal crisis scapegoats. If we had truly arrived at a post-racial, colorblind place, then this dirty little myth could not exist to be spread like a racist virus.

The financial market crisis has laid bare our true place, and it is not post-racial. The dirty little myth indicates that we are as far away from a truly post-racial America as we have ever been.

V. Conclusion

The financial market crisis of 2008 literally invites interrogation of sacred economic traditions in the United States. A near total collapse of the global capital markets signals genuine problems with American capitalism and the neoclassical economics modeling so prevalent today. Yet, we are largely failing the invitation to critically examine the underlying economic principles our markets are currently based upon. One reason that we are failing the invitation to challenge our classic capitalist underpinnings is because many of the entrenched elite in the United States have misdirected our attention. When a massive failure in the private markets nearly collapses the economy, one simmering reason offered up for the underlying cause is minority borrowers in many of our city’s urban centers. Many in this country have fully embraced this classic racist misdirection.

The genuine underlying causes of the financial market crisis of 2008 have been painstakingly outlined above. The reasons and causes are complex, difficult and wide ranging. Very few market players are innocent when it comes to the subprime mortgage industry collapse. Individuals and corporations must be held responsible for their roles, including Wall Street, commercial banks, investment banks, corporate executives, CEOs, regulators, legislators, individual borrowers, lenders, mortgage brokers, credit rating agencies and governmental entities. All must recognize its role in the meltdown and honestly explore how it needs to change to better protect U.S. shareholders and investors. The parties least culpable for the near global meltdown and in need of absolution the least are minority borrowers. And in particular, minority borrowers that took out loans through the Community Reinvestment Act.

This classic racial coding must be summarily rejected if we ever hope to reach our twin goals of genuinely safeguarding our nation’s capital markets and arriving at a truly post-racial positioning in America.