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RACIAL CODING AND THE FINANCIAL MARKET CRISIS

andré douglas pond cummings*

I. INTRODUCTION

The financial market crisis of 2008 has plagued 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

* © 2011 andré douglas pond cummings, 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 assistance, 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; Kyle Schmidt, University of Iowa College of Law, class of 2011; and Devin Daines, West Virginia University 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, with particular thanks to Deborah Post, Henry Richardson, William Rhee, Emma Coleman Jordan, and Atiba Ellis. I am also grateful for the comments that I received during a presentation at the Midwestern People of Color Conference, held at Loyola University Chicago in April 2010, and at faculty colloquia at the University of Iowa College of Law and Southern Methodist University Dedman School of Law. I gratefully acknowledge the West Virginia University College of Law Hodges Research Grant that provided support necessary to draft this Article. Finally, I am deeply appreciative to Lavinia, Cole Kaianuanu, Malia Ao'ilagi, and Maxwell Keavé for constant sunshine and peace. Of course, as usual, the politics and errata of this Article belong exclusively to me.

¹ See *Foreclosure Rate Up 30% From Last February*, CBS NEWS (Mar. 12, 2009), <http://www.cbsnews.com/stories/2009/03/12/national/main4861033.shtml>; STEVEN RAMIREZ, *REIMAGINING CAPITALISM* (forthcoming 2011) (manuscript at introduction) (on file with author) (describing the global impact of the U.S. capital markets meltdown); Alan Zibel, *Foreclosure Rates Up by Smallest Amount in 4 Years*, USA TODAY (Mar. 11, 2010, 12:40 PM), http://www.usatoday.com/money/economy/housing/2010-03-11-foreclosures_N.htm (“Banks repossessed nearly 79,000 homes last month, down 10% from January but still up 6% from February 2009.”); *infra* notes 4, 5.

² See JOSEPH E. STIGLITZ, *FREEFALL: AMERICA, FREE MARKETS AND THE SINKING OF THE WORLD ECONOMY* 12–18 (2010); GARY GORTON, *SLAPPED BY THE INVISIBLE HAND: THE PANIC OF 2007*, at 1–12 (2010); SIMON JOHNSON & JAMES KWAK, *13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN* 3–13 (2010); ROGER LOWENSTEIN, *THE END OF WALL STREET*, at XXI–XXV (2010); BETHANY MCLEAN & JOE NOCERA, *ALL THE DEVILS ARE HERE: THE HIDDEN HISTORY OF THE FINANCIAL CRISIS* 4–37 (2010); SCOTT PATTERSON, *THE QUANTS* 3, 11–12 (2010); RAMIREZ, *supra* note 1 (manuscript at introduction); ROBERT SKIDELSKY, *KEYNES: THE RETURN OF THE MASTER*

thoughtful deconstruction crystallizes, a disturbing trend has forcefully surfaced, wherein dozens of writers, scholars, and thinkers, motivated by politics, limelight, and self-indulgence, have attempted to fix a singular or foundational cause as “the” reason for the market crisis of 2008. In a political environment that favors simplicity and scapegoating, there is a certain toxic danger 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 unabated,⁵ requires a careful and systematic review of causes,

3–28 (2009); ANDREW ROSS SORKIN, *TOO BIG TO FAIL* (2009) (detailing the Lehman Brothers failure from beginning to end); THOMAS SOWELL, *THE HOUSING BOOM AND BUST* 1–29 (2009); Lucian A. Bebchuk et al., *The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000–2008*, 27 *YALE J. ON REG.* 257, 258–61 (2010); 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); Joseph Karl Grant, *What the Financial Services Industry Puts Together Let No Person Put Asunder: How the Gramm-Leach-Bliley Act Contributed to the 2008–2009 American Capital Markets Crisis*, 73 *ALB. L. REV.* 371, 373–77 (2010); Kristin N. Johnson, *Things Fall Apart: Regulating the Credit Default Swap Commons*, 82 *U. COLO. L. REV.* 167, 169–73 (2011); Christopher Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 *U. CIN. L. REV.* 1359, 1359–63 (2010); Steven A. Ramirez, *Subprime Bailouts and the Predator State*, 35 *DAYTON L. REV.* 81, 81–84 (2009); Steven L. Schwarcz, *Markets, Systemic Risk, and the Subprime Mortgage Crisis*, 61 *SMU L. REV.* 209, 209–14 (2008); Steven L. Schwarcz, *Protecting Financial Markets: Lessons from the Subprime Mortgage Meltdown*, 93 *MINN. L. REV.* 373, 373–75 (2008); William K. Black, *Those Who Forget the Regulatory Successes of the Past Are Condemned to Failure*, *ECON. & POL. WKLY.*, Mar. 28, 2009, at 80, 80–86; William K. Black, *The Disastrous Unexpected Consequences of Private Compensation Reforms 2* (Oct. 28, 2009) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1536513; Joseph G. Bunn, *A Justified “Assault upon the Citadel of Privity” and the First Amendment: A Theory of Liability for Investors Seeking Recovery from Credit Rating Agencies* 9–13 (Fall 2009) (unpublished manuscript) (on file with author).

³ See *The Financial Crisis and the Role of Federal Regulators: Hearing Before the H. Comm. on Oversight and Gov’t Reform*, 110th Cong. 11–14 (2008) (statement of Alan Greenspan, former Chairman of the Federal Reserve) (“It was the failure to properly price [subprime securities] that precipitated the crisis.”); Peter J. Wallison, *Barney Frank, Predatory Lender*, *WALL ST. J.*, Oct. 16, 2009, at A19 (blaming Democrats, Fannie Mae and Freddie Mac for the market crisis); Interview by Chris Cuomo, *Good Morning America*, ABC News, with Bill Clinton (Sept. 25, 2008), available at <http://blogs.abcnews.com/politicalradar/2008/09/bill-clinton-do.html> (video at 2:48) (blaming the SEC’s “uptick rule” for the financial market meltdown).

⁴ See Edmund L. Andrews, *Economic Activity Is Slowing across Many Areas, Fed Chairman Says*, *N.Y. TIMES*, Sept. 25, 2008, at C13 (“Mr. Bernanke said Main Street was

impacts, failures, and economic breakdowns.⁶ The foundational causes of the meltdown are numerous. Yet, despite evidence that literally dozens of failures⁷

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.’”); Michael R. Crittenden & 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 off a 1980s-era plan to help save the banking industry and stabilize the economy more broadly.”); Carl Hulse & David M. Herszenhorn, *Behind Closed Doors, Warnings of Calamity*, N.Y. 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.

⁵ See Peter S. Goodman, *Despite Signs of Recovery, Chronic Joblessness Rises*, N.Y. 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.”); *The Cost of the Financial Meltdown: Deficits and Spending*, BBC NEWS, <http://news.bbc.co.uk/2/hi/business/8214272.stm> (last visited Jan. 21, 2011); *Economic News Release: Employment Situation Summary*, U.S. BUREAU OF LABOR STATISTICS, <http://www.bls.gov/news.release/empsit.nr0.htm> (last modified Jan. 7, 2011) (reporting unemployment for January 2010 at 9.7% nationally with an estimated 14.8 million people unemployed); *Failed Bank List*, FDIC, <http://www.fdic.gov/bank/individual/failed/banklist.html> (last updated Jan. 21, 2011) (listing 157 failed banks in 2010).

⁶ See Eliot Spitzer, Frank Partnoy & William Black, Op-Ed., *Show Us the E-Mail*, N.Y. TIMES, Dec. 20, 2009, at WK9 (“The three of us, as experienced investigators and prosecutors of financial fraud, cannot answer these 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.”); Sewell Chan, *Under Pressure, the White House Ponders How to Remake Fannie and Freddie*, N.Y. TIMES, Mar. 24, 2010, at B3 (“Despite growing pressure from Congress to act quickly, the Obama administration is moving tentatively to develop a plan to reshape Fannie Mae and Freddie Mac [T]he Treasury secretary, Timothy F. Geithner, said the administration would ‘take a fresh, cold, hard look at the core problems’ in housing finance”); Brady Dennis, *The AIG E-Mail Trail: Behind the Public Declarations of Optimism in 2007, Months of Internal Discord and Doubt*, N.Y. TIMES, Dec. 30, 2009, at A1 (“While

precipitated the “Great Recession,”⁸ many on the right and on the left attempt to point to individual and singular causes for the economic crisis that seek to establish a particular political purpose or win for them political points in their specific positioning.⁹ Still, thoughtful and honest analysis of the meltdown defies easy blame categorization or simple causation bottoming. A sincere commentator, academic, or politician will 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.¹⁰ Many commentators, however, have continued 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 rejects the general, reckless trend toward simple blame causation which swiftly emerged as interested parties attempted to quantify the financial market crisis as an avoidable event, but for a particular reason, decision, or

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.”); Benjamin M. Friedman, *The Failure of the Economy and the Economists*, N.Y. REV. BOOKS, May 28, 2009, at 42, 42–45.

⁷ See *infra* Parts II.A–C.

⁸ See PAUL KRUGMAN, *THE RETURN OF DEPRESSION ECONOMICS AND THE CRISIS OF 2008*, at 181–91 (2009); STIGLITZ, *supra* note 2, at xi; Niall Ferguson, Op-Ed., *When Will the Recession Be Over?: Our Great Recession*, N.Y. TIMES, Mar. 1, 2009, at WK12; Don Lee, *Unemployment Rate Falls to 9.7%; The Drop Is Tempered by Data Showing the U.S. Lost 8.4 Million Jobs in the Last Two Years*, L.A. TIMES, Feb. 6, 2010, at A1; David Leonhardt, *Casualties of the Recession*, N.Y. TIMES, Mar. 4, 2009, at B1.

⁹ See Wallison, *supra* note 3; Stephen Gandel, *Did Foreigners Cause America’s Financial Crisis?*, TIME (Jan. 15, 2010), <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 the 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.’” (alteration in original)).

¹⁰ See generally *Timeline: A Year of Financial Crisis*, NPR, <http://www.npr.org/templates/story/story.php?storyId=112538025> (last visited Jan. 24, 2011) (detailing the depth and breadth of the financial market crisis through a timeline description).

legislative enactment. Rejecting the simplicity of such an 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 in late 2008. Challenging the most nefarious of the causation explanations for the meltdown, this Article will explore postracialism in the United States and will confront a 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” put forth for the near global meltdown is the “minority borrower” extrapolation that emerged in the very first moments of the September 2008 tumult 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 Capitol Hill, and as doomsday messages were being delivered daily, many pundits on the right named racial “minorities” and lending to “poor minorities” as a root cause for the market collapse.¹¹ This “dirty little myth” played on loop at various news channels and on talk radio programs for weeks and months resonating with those Americans that receive their politics and views from such sources.¹²

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 economic 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 American citizens, 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.¹³ Most agree that Obama was more convincing in that role.¹⁴ Professor Derrick Bell posits that absent the financial market crisis, according to his interest convergence theory,¹⁵ Obama would not have secured the presidency.¹⁶

¹¹ See *infra* Part III.A.

¹² See *infra* notes 359–373 and accompanying text.

¹³ See JOHN HEILEMANN & MARK HALPERIN, *GAME CHANGE: OBAMA AND THE CLINTONS, MCCAIN AND PALIN, AND THE RACE OF A LIFETIME* 377–93 (2010).

¹⁴ See *id.* at 392–93.

¹⁵ See generally Derrick A. Bell, Jr., *Brown v. Board of Education and the Interest Convergence Dilemma*, 93 HARV. L. REV. 518 (1980), *reprinted in* CRITICAL RACE THEORY: THE KEY WRITINGS THAT FORMED THE MOVEMENT 20 (Kimberlé Crenshaw et al. eds., 1995) (Bell’s interest-convergence theory posits that only when white American’s interests are furthered, will the interests of African Americans be considered or protected).

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 Obama as president, the United States officially entered a postracial era.¹⁷ Postracialism, 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.¹⁸ According to postracialists, America has truly arrived at our colorblind ideal. Racism is a relic of a checkered past that has been affirmatively overcome.¹⁹

Notwithstanding the attractiveness of the postracial ideology, these arguments were being made at the very same time that a simmering tale was being floated and adopted by many of the very same citizens that were hailing a new postracial America. While markets were roiling in September and October 2008,²⁰ with

¹⁶ See Derrick A. Bell, Jr., *On Celebrating an Election as Racial Progress*, 36 HUM. RTS. 4 (2009) (“Barack Obama’s election was a dramatic example of Interest Convergence. . . . Facing lost jobs and foreclosed homes, [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.”); HEILEMANN & HALPERIN, *supra* note 13, at 392–93, 632 (“[T]he collapse of the economy hurt the GOP. . . . Obama demonstrated a capacity to withstand pressure and keep his balance.”).

¹⁷ See, e.g., Daniel Schorr, *A New, ‘Post-Racial’ Political Era in America* (NPR broadcast Jan. 28, 2008), available at <http://www.npr.org/templates/story/story.php?storyId=18489466> (arguing that Obama’s presidential campaign signaled a “post racial” era in American politics); John McWhorter, *Racism in America Is Over*, FORBES.COM (Dec. 30, 2008, 2:00 PM), http://www.forbes.com/2008/12/30/end-of-racism-oped-cx_jm_1230_mcwhorter.html (claiming emphatically that racism has ended in America based on Obama’s election); *Race and Ethnicity Poll: ABC News/Washington Post Poll*, POLLINGREPORT.COM (Jan. 12–15, 2010), <http://www.pollingreport.com/race.htm> (finding in a race and ethnicity poll that 71% of White Americans believe that with the election of Obama that African Americans have achieved or will soon achieve racial equality). *But see* Shelby Steele, Op-Ed., *Obama Seduced Whites with a Vision of Their Racial Innocence Precisely to Coerce Them into Acting Out of a Racial Motivation*, L.A. TIMES, Nov. 5, 2008, at A31 (opining that Obama was able to secure the presidency by campaigning as a “post racial” candidate); Mark Dolliver, *How Close Is Post-racial America?*, ADWEEK (Feb. 4, 2010), http://www.adweek.com/aw/content_display/news/e3i4b406c00b9c5b2653a13b5e8fed89d25 (citing a January 2009 ABC News/Washington Post poll indicating that more than 75% of black Americans believed that the election of Obama would improve race relations in the United States, but this view was declining among black Americans by 2010).

¹⁸ See *infra* Part IV.

¹⁹ See Schorr, *supra* note 17; see also andré douglas pond cummings, *Post Racialism?*, 14 IOWA J. GENDER, RACE, & JUST. (forthcoming 2011) (manuscript at 106) (on file with author).

²⁰ See Gary Duncan, *Lehman Brothers Collapse Sends Shockwave Round World*, TIMES ONLINE (Sept. 16, 2008), http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article4761892.ece; Michael J. de la Merced & Andrew Ross Sorkin, *Report Details How Lehman Hid Its Woes*, N.Y. TIMES, Mar. 12, 2010, at A1;

financial Armageddon at the nation's doorstep²¹ and two presidential candidates debating the possible effects and solutions,²² 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 served up as the scapegoat to explain why the global economy was failing.²³ The minority-borrower narrative maintains that because of governmental intrusion into the home lending industry, through the Community Reinvestment Act of 1977 (CRA), Fannie Mae, and Freddie Mac, 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.²⁴ Because lenders had no choice but to provide loans to risky minority borrowers, subprime loans became the avenue of choice for lenders to overreaching minority borrowers and it was because of the then-current failure of black and brown homeowners to pay their mortgages that the subprime mortgage industry collapsed. Thus, as the story

Justin Fox, *Three Lessons of the Lehman Brothers Collapse*, TIME (Sept. 15, 2009), <http://www.time.com/time/business/article/0,8599,1923197,00.html>.

²¹ See Anthony Reuben, *What Would Financial Armageddon Look Like?*, BBC NEWS (Sept. 23, 2008), <http://news.bbc.co.uk/2/hi/business/7631281.stm> (discounting sources that compare the financial crisis to the Great Depression or a financial Armageddon).

²² See HEILEMANN & HALPERIN, *supra* note 13, at 386–92.

²³ See Daniel Gross, *Subprime Suspects*, SLATE (Oct. 7, 2008, 2:08 PM) <http://www.slate.com/id/2201641>; Susan Schmidt & Maurice Tamman, *Housing Push for Hispanics Spawns Wave of Foreclosures*, WALL ST. J., Jan. 5, 2009, at A1; Andy Birkey, *Against All Reason, Bachmann and Others Blame 1977 Fair-Lending Law for Adding to Economic Crisis*, MINN. INDEPENDENT (Sept. 24, 2008, 12:01 PM), <http://minnesota.independent.com/10179/against-all-reason-bachmann-and-others-blame>; Thomas B. Edsall, *Conservatives Seek to Shift Blame for Crisis onto Minority Housing Law*, HUFFINGTON POST (Oct. 1, 2008, 5:34 PM), http://www.huffingtonpost.com/2008/10/01/conservatives-seek-to-shi_n_131020.html; Gary Lapon, *Blaming the Victims of the Crisis*, SOCIALISTWORKER.ORG (Oct. 21, 2008), <http://socialistworker.org/2008/10/21/blaming-victims-of-the-crisis>; Zenitha Price, *Conservatives Blame People of Color for Wall Street Meltdown*, NEW AM. MEDIA (Oct. 3, 2008), http://news.newamericamedia.org/news/view_article.html?article_id=1b7402095164d593deaf2c1115f7ce69; *Coulter on Bailout Lies—“Social Justice” Obamination*, YOUTUBE (Oct. 4, 2008), <http://www.youtube.com/watch?v=awNeOKvx5zo> (showing Ann Coulter, in a Fox News broadcast, blaming Democrats for providing loans to minorities and poor people—unqualified borrowers—for causing the financial market crisis).

²⁴ See SOWELL, *supra* note 2, at 40–43; *Cavuto Suggests Congress Should Have Warned that “Loaning to Minorities and Risky Folks Is a Disaster,”* MEDIA MATTERS FOR AM. (Sept. 19, 2008, 6:28 PM), <http://mediamatters.org/mmtv/200809190021> (describing Fox News reporter Neil Cavuto claiming that minority borrowers are foundationally responsible for financial crisis); *Discussing Financial Crisis, Buchanan Baselessly Blamed Lending in “Minority Communities,”* MEDIA MATTERS FOR AM. (Feb. 20, 2009, 11:37 AM), <http://mediamatters.org/print/research/200902200006> (detailing former Republican Presidential Candidate Patrick Buchanan blaming minorities and the Community Reinvestment Act for the financial market meltdown).

purports, the financial market crisis is ultimately traceable to minority Americans and governmental social welfare.²⁵

With precious little evidence to support this scapegoating, many U.S. citizens have embraced this minority-borrower narrative with vigor.²⁶ And, this percolating resonance continues to survive as proponents of this narrative include some economists,²⁷ conservative think tank employees,²⁸ Wall Street insiders,²⁹ mutual fund presidents,³⁰ pundits,³¹ and average citizens.³² That the minority-borrower

²⁵ See *supra* notes 23–24 and accompanying text.

²⁶ See Jeff Davis, *Minority Subprime Mortgages Have Caused the Financial Crisis*, ALTERMEDIA.INFO (Sept. 23, 2008), 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.”); Larry Keller, *Minority Meltdown: Immigrants Blamed for Mortgage Crisis*, S. POVERTY L. CENTER (2009), <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 Southern Poverty Law Center, “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.*

²⁷ See Stan Liebowitz, *The Real Scandal: How Feds Invited the Mortgage Mess*, N.Y. POST (Feb. 5, 2008, 2:39 AM), http://www.nypost.com/p/news/opinion/opedcolumnists/item_Qjl08vDbysbe6LWDxcq03J; SOWELL, *supra* note 2, at 57–67 (blaming regionalized housing bubbles perpetuated primarily through governmental intrusion in the form of the Community Reinvestment Act, and Fannie Mae and Freddie Mac, as the primary cause of the downfall of the economy).

²⁸ See Peter J. Wallison, *The True Origins of This Financial Crisis*, AM. ENTERPRISE INST. FOR PUB. POL’Y RES. (Feb. 19, 2009), <http://www.aei.org/issue/100001>; John Derbyshire, *PC, Not “Predatory Lenders,”* NAT’L REV. ONLINE (Feb. 5, 2008), <http://corner.nationalreview.com/post/?q=ZGZjYjM2ZjdiZGE2MWJhNzQ4MjhiOTY1NTU1M2M0OWU=>; Adam Weinstein, *Study: Brokers, Minority Borrowers to Blame for Most Mortgage Delinquencies*, DSNEWS.COM (Sept. 2, 2009), <http://www.dsnews.com/articles/study-brokers-minority-borrowers-to-blame-for-most-mortgage-delinquencies-2009-09-02>.

²⁹ See John Carney, *Here’s How the Community Reinvestment Act Led to the Housing Bubble’s Lax Lending*, BUS. INSIDER (June 27, 2009, 9:33 AM), <http://www.businessinsider.com/the-cra-debate-a-users-guide-2009-6>; Edward Pinto, *Acorn and the Housing Bubble*, WALL ST. J., Nov. 13, 2009, at A23; *Squawk Box: Interview with Larry Kudlow* (CNBC television broadcast Apr. 4, 2008), available at <http://www.cnbc.com/id/15840232?video=702180420&play=1> (“The original sub-prime loan, with no money down, no FICA scorekeeping—all that came out of the Community Reinvestment Act and that ought to be repealed or substantially altered.”).

³⁰ See andré douglas pond cummings, Panel Presentation for University of Iowa Journal of Gender, Race & Justice: Post Racialism and the Financial Market Crisis: Race, Gender, and Class at a Crossroad—A Survey of Their Intersection in Employment,

narrative would spring up at the onset of this generation's greatest economic ordeal is disappointing. That this narrative would be embraced by so many with so little to support it, with scant questioning or thought, is demoralizing. The minority-borrower narrative is nothing more than a "dirty little myth," as this Article will show, and that it persists is particularly mystifying in an era where many postracialist Americans are determined to believe that with the election of an African American President Obama that our nation has crossed over into a colorblind, postracial era.³³ Critical race theory, however, provides insight into

Economics, and the Law (Feb. 26, 2010) [hereinafter cummings, Panel: Post Racialism and the Financial Market Crisis], *video available at* <http://podcast.uiowa.edu/law/grj/JGRJ%202010%20Levitt.mov> (describing mutual fund presidents that blame the Community Reinvestment Act and minority borrowers for the poor performance of their mutual funds); andré douglas pond cummings, *Recovery?*, CORP. JUST. BLOG (Feb. 27, 2010, 2:19 PM), <http://corporatejusticeblog.blogspot.com/2010/02/recovery.html> (describing a board meeting wherein Mutual Fund representatives blamed the Community Reinvestment Act for the financial market crisis).

³¹ See Ann Coulter, *Dems' Affirmative-Action Time Bomb Has Detonated*, ST. J.-REG. (Sept. 26, 2008, 12:01 AM), <http://www.sj-r.com/opinions/x1070363616/Ann-Coulter-Dems-affirmative-action-time-bomb-has-detonated> (arguing that absent affirmative action for minority borrowers the financial market crisis of 2008 would have been averted); Davis, *supra* note 26 ("The crash started with the collapse of the subprime mortgage market, which is effectively a code word for blacks and Latinos."); Keller, *supra* note 26 (quoting Rush Limbaugh as blaming illegal immigrants and the Community Reinvestment Act for the financial meltdown); *Limbaugh's "Colorblind" History of Racially Charged Comments*, MEDIAMATTERS FOR AM. (Oct. 13, 2009, 5:18 PM), <http://mediamatters.org/research/200910130049>.

³² Examples of average Americans that blame minorities for the financial market crisis abound on Web 2.0 avenues. See, e.g., *Burning Down the House: What Caused Our Economic Crisis?*, YOUTUBE (Sept. 26, 2008), <http://www.youtube.com/watch?v=TxgSubmiGt8> (video posted by web user claiming that the financial crisis occurred because of the Community Reinvestment Act); *The Democrats and Obama Caused the Financial Crisis of 08 by Supporting Fannie Mae and Freddie Mac*, YOUTUBE (Sept. 23, 2008), <http://www.youtube.com/watch?v=UVVVzEKauzY> (video posted by web user of compiled news reports claiming that Democrats pushed programs to help minorities through government-funded mortgage organizations, which triggered the economic crisis); *Obama Responsible for Economic Crisis Black Caucus Fraud*, YOUTUBE (Oct. 1, 2008), <http://www.youtube.com/watch?v=bh-wwZwpm8U> (video posted by web user claiming Obama caused the economic crisis by ordering "no documentation" loans to minority applicants who then defaulted).

³³ See andré douglas pond cummings, *The Associated Dangers of "Brilliant Disguises," Color-blind Constitutionalism, and Postracial Rhetoric*, 85 IND. L.J. 1277, 1277-78 (2010) (reciting the positions of many Americans believing that the nation has entered a post-racial place); Ward Connerly, *Message from the President*, AM. CIVIL RIGHTS INST., <http://www.acri.org/index.html> (last visited Jan. 26, 2011) ("Race has no place in American life or law."); Shelby Steele, *supra* note 17. For an example of post-racialist thinking articulated before President Obama's election, see generally WARD CONNERLY, *CREATING EQUAL: MY FIGHT AGAINST RACE PREFERENCES* (2000) (showing

how a twenty-first 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 “postracial” United States.³⁴ 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.³⁵ This mutation involves racist embrace of any available mechanism or adjacent expression to subordinate the interests of minorities in the United States, and oftentimes seeks to attach liability in careless ways to any available minority scapegoat.³⁶

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 or governmental intrusion into the mortgage markets.³⁷

To explore the true underlying causes of the financial market crisis in order to challenge the simplicity trend and examine the emergence of the minority-borrower narrative in light of a new postracial 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

that people believed the nation was entering a post racial era even before Obama’s election to the presidency).

³⁴ See DERRICK A. BELL, *FACES AT THE BOTTOM OF THE WELL: THE PERMANENCE OF RACISM* 1–14 (1992); Mari J. Matsuda, *Looking to the Bottom: Critical Legal Studies and Reparations*, 22 HARV. C.R.-C.L. L. REV. 323, 330–31 (1987); Kimberlé Williams Crenshaw, *Race, Reform, and Retrenchment: Transformation and Legitimation in Antidiscrimination Law*, 101 HARV. L. REV. 1331, 1334 (1988); Adrien Katherine Wing, *Space Traders for the Twenty-First Century*, 11 BERKLEY J. AFR.-AM. L. & POL’Y 49, 51–52 (2009); Richard Delgado, *Explaining the Rise and Fall of African American Fortunes—Interest Convergence and Civil Rights Gains*, 37 HARV. C.R.-C.L. L. REV. 369, 370–71 (2002) (book review).

³⁵ See sources cited *supra* note 34; Charles R. Lawrence III, *The Id, the Ego, and Equal Protection: Reckoning with Unconscious Racism*, 39 STAN. L. REV. 317, 335–36 (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 from others? Increasingly, as our culture has rejected racism as immoral and unproductive, this hidden prejudice has become the more prevalent form of racism. The individual’s Ego must adapt to a cultural order that views overtly racist attitudes and behavior as unsophisticated, uninformed, and immoral. It must repress or disguise racist ideas when they seek expression.”). For contemporary examples, see John Meacham, *Southern Discomfort*, N.Y. TIMES, Apr. 11, 2010, at WK12; Spencer S. Hsu, *Miss. County Schools Ordered to Comply with Desegregation Order*, WASH. POST, Apr. 13, 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/04/13/AR2010041302867.html>.

³⁶ See BELL, *supra* note 34; DERRICK BELL, *AND WE ARE NOT SAVED: THE ELUSIVE QUEST FOR RACIAL JUSTICE* 5–8 (1989).

³⁷ See *infra* Part II.

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 and parties anxious to pin blame for political purposes rather than interrogate the true failures that precipitated the meltdown. Part IV will examine postracialism and query whether a nation that accepts minority scapegoating with little objection, can truly be situated as postracial. 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 have now found, 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.³⁸ The neoclassical law and economics theories that drive so much of United States economic policy and legal philosophizing are now being critically interrogated both by longtime critics³⁹ and

³⁸ See JOHNSON & KWAK, *supra* note 2, at 6–13; RAMIREZ, *supra* note 1 (manuscript at introduction) (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); SKIDELSKY, *supra* note 2, at 3–28 (2009); Canova, *supra* note 2, at 369–70 (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 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.”); Timothy A. Canova, *The Failing Bubble Economy: American Exceptionalism and the Crisis in Legitimacy*, 102 AM. SOC’Y INT’L L. PROC. 237, 238 (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*, DISSENT, Summer 2008, at 41, 41 (“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.”).

³⁹ See sources cited *supra* note 38; Douglas M. Branson, *Corporate Governance “Reform” and the New Corporate Social Responsibility*, 62 U. PITT. L. REV. 605, 619 (2001) (“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

surprising new sources.⁴⁰ This examination leads many commentators to freshly conclude that the astonishing rise to prominence of law and economic theory in

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, 173 (2009) [hereinafter Mitchell, *Morals*]; Lawrence E. Mitchell, *The Board as a Path to Corporate Responsibility*, in THE NEW CORPORATE ACCOUNTABILITY (Doreen McBarnet et al. eds., 2007) [hereinafter Mitchell, *Corporate Responsibility*]. Professor Mitchell explains:

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. 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.

Mitchell, *Morals*, *supra*, at 173, 175, 181–82 (citations omitted).

⁴⁰ See RICHARD POSNER, A FAILURE OF CAPITALISM: THE CRISIS OF ‘08 AND THE DESCENT INTO DEPRESSION, at xii (2009) (“We are learning from [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

this country has now proven folly as neoclassical economics is intellectually and morally bankrupt.⁴¹ 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.⁴²

Two surprising commentators are leading this questioning of laissez-faire 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 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

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*, *supra* note 3, at 6–35 (statement of Alan Greenspan, former chairman of the Federal Reserve) (“We are in the midst of a once in a century credit tsunami. . . . [T]hose 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.”).

⁴¹ See sources cited *supra* note 38; JOHNSON & KWAK, *supra* note 2, at 3–13; RAMIREZ, *supra* note 1 (manuscript at introduction) (“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.”); SKIDELSKY, *supra* note 2, at 3–28 (2009).

⁴² See sources cited *supra* notes 38, 40; see also POSNER, *supra* note 40, at 75 (“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 Contributed to the Collapse of the United States Capital Markets*, 83 NEB. L. REV. 979, 984–89 (2005) [hereinafter cummings, *Ain’t No Glory in Pain*] (describing the “deregulation hysteria” that gripped the “Contract with America” Congress in 1994); 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, 469–486 (2007) [hereinafter cummings, *Still Ain’t No Glory in Pain*] (describing the deregulatory enactments of the 1990s and early 2000s that lead to massive market instability).

biggest boosters.”⁴³ Throughout his book, Posner surprisingly rejects many law and economics principles, 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.⁴⁴

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 confessed grave error in aggressively advocating that the U.S. derivatives markets 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.⁴⁵ 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 especially, are in a state of shocked disbelief.”⁴⁶ In addition, Greenspan acknowledged that he relied too much on the “self-correcting power of free markets”⁴⁷ and that careful oversight and regulation could have prevented the “self-destructive power of wanton mortgage lending.”⁴⁸ Greenspan further admitted that the Federal Reserve System and the government allowed the growth of highly risky mortgages and out of control derivatives trading without recognizing the devastating self-destructive potential of those instruments.⁴⁹

Richard Posner and Alan Greenspan conceding significant failure in their foundational economic theories and beliefs should signal to economists,

⁴³ POSNER, *supra* note 40, at 260. 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.

⁴⁴ *See generally id.*

⁴⁵ Edmund Andrews, *Greenspan Concedes Error on Regulation*, N.Y. TIMES, Oct. 23, 2008, at B1.

⁴⁶ *Id.*

⁴⁷ *Id.* Robert Skidelsky, *The Remedist*, N.Y. TIMES, Dec. 14, 2008, at MM21.

⁴⁸ *See Andrews, supra* note 45.

⁴⁹ *See Skidelsky, supra* note 47 (“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 had 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 Frank Rich, No One Is to Blame for Anything*, N.Y. TIMES, Apr. 11, 2010, at WK10 (“[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.’”); Ben Rooney, *Greenspan: ‘I Was Right 70% of the Time,’* CNNMONEY (Apr. 7, 2010, 2:13 PM ET), http://money.cnn.com/2010/04/07/news/economy/Greenspan_financial_crisis_commission/index.htm?hpt=T1.

academics, political leaders, and the broader community that there is 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 frittered around the fringes of the massive failures that brought the global economy to its knees,⁵⁰ 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),⁵¹ marshaled their forces and organized against all formal movement toward new regulation or correction in the aftermath of TARP.⁵² This marshaling of opposition to new and fresh regulation of the financial institutions most embroiled in the market collapse has been truly impressive (and reprehensible).⁵³

Perhaps paralyzed by reelection fear, Congress significantly diluted meaningful regulatory reform—so much so that many argue that it failed to seriously address, in its Dodd-Frank Wall Street Reform and Consumer Protection

⁵⁰ See generally Housing Preservation and Tenant Protection Act, H.R. 4868, 111th Cong. (2010); Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. (2009); Financial Stability Improvement Act, H.R. 3996, 111th Cong. (2009); Private Fund Investment Advisers Registration Act, H.R. 3818, 111th Cong. (2009); Credit Cardholders’ Bill of Rights Act, H.R. 627, 111th Cong. (2009); andré douglas pond cummings, *Consumer Financial Protection Agency*, CORP. JUST. BLOG (Mar. 5, 2010, 2:44 PM), <http://corporatejusticeblog.blogspot.com/2010/03/consumer-financial-protection-agency.html> (describing the legislatively proposed consumer financial protection agency); andré douglas pond cummings, *Financial Reform Legislation*, CORP. JUST. BLOG (Mar. 17, 2010, 2:00 AM), <http://corporatejusticeblog.blogspot.com/2010/03/financial-reform-legislation.html> (describing the Senate version of proposed financial regulatory reform).

⁵¹ See Christopher Swann, *Time to Stand Up to the Banking Lobby*, REUTERS: GREAT DEBATE (July 15, 2009, 9:25 EDT), <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.”).

⁵² See Andrew Ross Sorkin, *So Where’s the Consumer Protection?*, N.Y. TIMES, Mar. 9, 2010, at B1; Paul Krugman, *Financial Reform Endgame*, N.Y. TIMES, Mar. 1, 2010, at A27 (describing the causes of lost momentum toward serious financial reform).

⁵³ See Elizabeth Warren: *It’s Bank Lobbyists vs. American Families in Fight for Financial Reform*, HUFFINGTON POST (Feb. 20, 2010, 1:30 AM), http://www.huffingtonpost.com/2010/02/20/elizabeth-warren-its-bank_n_469939.html (discussing TARP director Elizabeth Warren’s appearance on the Bill Maher show, 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).

Act,⁵⁴ passed in 2010 in response to the financial market crisis,⁵⁵ the necessary reforms that were achingly obvious in the heated aftermath of government bailouts and Wall Street chaos.⁵⁶ Indeed, the Dodd-Frank legislation provides an intimate example of our nation's failure to examine "capitalism" in the United States.⁵⁷ Early commentators have strongly criticized the Dodd-Frank legislation for not authentically addressing most of the underlying causes of the global meltdown.⁵⁸ This has led several prominent economists to predict that a future economic meltdown is a near certainty because of the failure of Dodd-Frank to affect meaningful regulation.⁵⁹

Still, much is now being written and debated about the causes of the financial market crisis of 2008 and the Dodd-Frank Act's response.⁶⁰ 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 2008.⁶¹ Second, a housing market bubble inflated in the early part of the past

⁵⁴ Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). A comprehensive analysis of the Dodd-Frank Act is beyond the scope of this article, although one will be undertaken in future writings.

⁵⁵ See *andré douglas pond cummings*, *Financial Reform: True Change?*, CORP. JUST. BLOG (Aug. 12, 2010, 10:49 AM), <http://corporatejusticeblog.blogspot.com/2010/08/financial-reform-true-change.html> (describing the passage of the Dodd-Frank bill and summarizing its excruciating shortcomings).

⁵⁶ See Krugman, *supra* note 52; David M. Herszenhorn & Edward Wyatt, *G.O.P. Blocks Debate on Financial Oversight Bill*, N.Y. TIMES, Apr. 26, 2010, at A1.

⁵⁷ See Steven Ramirez, *Dodd-Frank: My Final Take*, CORP. JUST. BLOG (Aug. 24, 2010, 1:52 AM), <http://corporatejusticeblog.blogspot.com/2010/08/dodd-frank-my-final-take.html> (summarizing the Dodd-Frank legislation and finding that it mostly fails to address the underlying causes of the financial market crisis).

⁵⁸ See *id.*; Johnson, *supra* note 2, at 234–42 (describing the new Dodd-Frank requirement for clearinghouses and the clearing of over-the-counter derivatives, including credit default swaps, but then identifying the enormous exceptions, né loopholes, that will allow the industry to run much the same way as it had before passage of Dodd-Frank). See generally Matt Taibbi, *Wall Street's Big Win*, ROLLING STONE, Aug. 9, 2010, at 56 (harshly criticizing Congress' treatment of the financial crisis and the enactment of Dodd-Frank).

⁵⁹ See Steven Ramirez, *Dodd-Frank VII: Joseph Stiglitz Says It Will Happen Again*, CORP. JUST. BLOG (July 30, 2010, 4:11 PM), <http://corporatejusticeblog.blogspot.com/2010/07/dodd-frank-vii-joesph-stiglitz-says-it.html> (noting that economist Joseph Stiglitz stated forcefully in an interview that another economic crisis is imminent, in light of the weakness of the Dodd-Frank act).

⁶⁰ See sources cited *supra* note 2.

⁶¹ See *infra* Part II.A; see also Commodity Futures Modernization Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763 (codified as amended in scattered sections of 7 U.S.C.); Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.); Gramm-Leach-Bliley Financial

decade, enabled by lax lender regulation, predatory lending, predatory borrowing, and governmental cover. When the housing bubble burst and the market corrected, the entire housing house of cards collapsed.⁶² 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 leadership, credit default swaps, and balance sheet fraud.⁶³ 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 significant part to the global meltdown. Critically, not one of the causes outlined below implicate race or social engineering as the dirty little myth posits caused the global meltdown. First, an examination of the true causes of the crisis, then an exploration of the dirty little myth and the subsequent racial coding that has emerged.

Modernization Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified as amended at 15 U.S.C. §§ 6801–27 (2006)); Cummings, *Ain't No Glory in Pain*, *supra* note 42, at 984–89.

⁶² See WILLIAM COHAN, HOUSE OF CARDS: A TALE OF HUBRIS AND WRETCHED EXCESS ON WALL STREET (2009) (describing in riveting detail the minute-by-minute collapse of the United States financial market); Hershey Friedman & Linda Friedman, *The Global Financial Crisis of 2008: What Went Wrong?*, in LESSONS FROM THE FINANCIAL CRISIS: CAUSES, CONSEQUENCES, AND OUR ECONOMIC FUTURE 31, 31 (Robert W. Kolb ed., 2010); Rick Brooks & Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy: As Housing Boomed, Industry Pushed Loans to a Broader Market*, WALL ST. J., Dec. 3, 2007, at A1; Bill Brown, *Uncle Sam as Sugar Daddy*, WALL ST. J. MARKETWATCH (Nov. 19, 2008, 10:35 AM EST), <http://www.marketwatch.com/story/moral-hazard-uncle-sam-as-sugar-daddy>; Tyler Cowen, *So We Thought. But Then Again . . .*, N.Y. TIMES (Jan. 13, 2008), http://www.nytimes.com/2008/01/13/business/13view.html?_r=1; *The Downturn in Facts and Figures*, BBC NEWS, <http://news.bbc.co.uk/2/hi/business/7073131.stm> (last updated Nov. 21, 2007, 8:07 GMT).

⁶³ See Adam Ashcraft & Til Schuermann, *The Seven Deadly Frictions of Subprime Mortgage Credit Securitization*, FIN. PROFESSIONALS' POST (Apr. 1, 2010), <http://post.nyssa.org/nyssa-news/2010/04/the-seven-deadly-frictions-of-subprime-mortgage-credit-securitization.html>; Bethany McLean, *The Bank Job*, VANITY FAIR, Jan. 2010, at 82; Zach Carter, *Rating Agencies, Discredited*, AM. PROSPECT (Mar. 20, 2009), http://www.prospect.org/cs/articles?article=rating_agencies_discredited; Jason Cox, *What Is Securitization?*, U. OF IOWA CENTER FOR INT'L FIN. & DEV., http://www.uiowa.edu/ifdebook/issues/financial_crisis/posters/Jason%20Final%20Draft.pdf; Janet Morrissey, *Credit Default Swaps: The Next Crisis?*, TIME (Mar. 17, 2008), <http://www.time.com/time/business/article/0,8599,1723152,00.html>.

A. Deregulation

“We cannot control ourselves. You have to step in and control the Street”
—John J. Mack, CEO, Morgan Stanley⁶⁴

A clear deregulatory trend has driven Congress and regulators for the past two to three decades wherein proponents of 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 Bank (Federal Reserve or Fed) 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.⁶⁵ More than twenty-five years ago, the Fed began to relax lending standards for mortgage providers, loosen interest rates, and slacken capital requirements for large commercial and investment banks.⁶⁶ According to Professor Timothy Canova, in the ultimate “capture” the Fed affirmatively adopted the investment banker’s agenda as far back as the 1970s and since then, the Fed has used that agenda to set policy for commercial and investment banking in the

⁶⁴ Andrew Ross Sorkin, *Extreme Makeover, Wall Street Edition*, N.Y. TIMES DEALBOOK (Apr. 1, 2010, 1:48 AM), <http://dealbook.nytimes.com/2010/04/01/extreme-makeover-wall-street-edition/> (quoting the chairman of Morgan Stanley in an unusually vocal call for needed regulation on Wall Street).

⁶⁵ See Skidelsky, *supra* note 47; RAMIREZ, *supra* note 1 (manuscript at introduction); Timothy Canova, *The Federal Reserve We Need*, 21 AM. PROSPECT, A15, A15–A17(2010) (describing the Federal Reserve of the 1940s and how its policies provided for a robust and stable economic recovery following the Great Depression) [hereinafter Canova, *Federal Reserve*]; Timothy Canova, Symposium Presentation at the Southeast/Southwest People of Color Conference at the University of South Carolina: Equality and Justice in the Obama Era (Mar. 26, 2010) [hereinafter Canova, Symposium Presentation] (notes on file with author).

⁶⁶ See Canova, *supra* note 2, at 370; Timothy A. Canova, *The Transformation of U.S. Banking and Finance: From Regulated Competition to Free-Market Receivership*, 60 BROOK. L. REV. 1295 (1995) [hereinafter Canova, *Transformation*].

United States.⁶⁷ By adopting the private banking interest agenda, the Fed has engaged in a systematic “dereliction of duty”⁶⁸ by promoting standards that increased the profitability of banks at the expense of protecting consumers from lending abuse.⁶⁹

The deregulation trend embraced by the Fed and its wholesale cooptation of the banking lobby agenda led, in large part, to the financial market crisis.⁷⁰ 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. and the Fed during the 1990s and early part of 2000s.⁷¹ 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.⁷²

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.⁷³ Staring into a potential 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.”⁷⁴ 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.”⁷⁵ 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.⁷⁶

⁶⁷ See Canova, *Federal Reserve*, *supra* note 65, at A17; Andrews, *supra* note 45 (“‘This modern risk-management paradigm held sway for decades,’ [Greenspan] said. ‘The whole intellectual edifice, however, collapsed in the summer of last year.’”); Canova, *supra* note 2, at 376; Canova, *Transformation*, *supra* note 66, at 1309–12.

⁶⁸ See Canova, Symposium Presentation, *supra* note 65.

⁶⁹ See *id.*

⁷⁰ See Canova, *Federal Reserve*, *supra* note 65.

⁷¹ See JOHNSON & KWAK, *supra* note 2, at 5, 74, 89, 150, 189.

⁷² See Christian Johnson, *Exigent and Unusual Circumstances: The Federal Reserve and the U.S. Financial Crisis* (Sept. 7, 2010) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1584731; RAMIREZ, *supra* note 1 (manuscript at introduction); *supra* note 65 and accompanying text.

⁷³ See Johnson, *supra* note 72; Peterson, *supra* note 2, at 1360.

⁷⁴ Peterson, *supra* note 2, at 1360–61.

⁷⁵ *Id.* at 1361 (citations omitted).

⁷⁶ See Steven Ramirez, *Dodd-Frank X: Finally Doing Something About Race*, CORP. JUST. BLOG, (Aug. 5, 2010, 5:22 PM), <http://corporatejusticeblog.blogspot.com/2010/08/dodd-frank-x-finally-doing-something.html> (describing the discriminatory and

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.⁷⁷ 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.⁷⁸ With that massive infusion of taxpayer capital and huge loans made available to Wall Street firms from the Fed, 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.⁷⁹

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 money.⁸⁰ The Fed’s failure to provide bailout fund disclosure to the public has been challenged in the courts.⁸¹

Taxpayer bailout funds provided by the U.S. government were used by Wall Street firms to pay hundreds of millions of dollars in executive compensation. Taxpayer bailout funds derived from government largess were 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

predatory lending that many mortgage brokers and banks perpetuated during the housing bubble era).

⁷⁷ See Ramirez, *supra* note 2, at 91, 100; JOHNSON & KWAK, *supra* note 2, at 153–56 (describing the meetings where Treasury Secretary Hank Paulson ordered Wall Street executives to take the government/taxpayer bailout funds at astonishingly low interest rates in order to prop up the balance sheets of Wall Street investment banks).

⁷⁸ See Ramirez, *supra* note 2, at 91, 100 (describing the hoarding of capital by Wall Street firms using taxpayer bailout funds to improve balance sheets and record profits rather than lending to a cash-strapped citizenry).

⁷⁹ See Aaron Lucchetti & Stephen Grocer, *Wall Street on Track to Award Record Pay*, WALL ST. J., Oct. 14, 2009, at A1; Taibbi, *supra* note 58 (“Three hellish years of panic, all done and gone—the mass bankruptcies, midnight bailouts, shotgun mergers of dying megabanks, high-stakes SEC investigations, all capped by a legislative orgy in which industry lobbyists hurled more than \$600 million at Congress.”); Elizabeth Williamson & Brody Mullins, *Firms Keep Lobbying as They Get TARP Cash*, WALL ST. J., Jan. 23, 2009, at A4; Canova, Symposium Presentation, *supra* note 65.

⁸⁰ See Canova, Symposium Presentation, *supra* note 65.

⁸¹ Fox News Network, LLC v. U.S. Dep’t of Treasury, 678 F. Supp. 2d 162, 165 (S.D.N.Y. 2009).

interrogation of the system that enabled the meltdown and without any functional oversight or forced responsibility on Wall Street elites.⁸²

The \$3 trillion loaned by the Fed to Wall Street banks in order to prop up capitalism and free market fundamentalism is an ironic and disturbing oxymoron. The Federal Reserve gave or loaned taxpayer funds to insulate “capitalism,” and Wall Street excess and privilege, sans examination of any sort. Yet, while a specific swath of Americans went very nearly crazy in opposition to passage of Health Care Reform legislation,⁸³ the vitriol for Wall Street and the complete subjugation of taxpayer rights to corporate interests is largely ignored by these same oppositionists. If government intervention is violently opposed in the health care context, why is government intervention in the form of a Wall Street bailout not opposed in the same manner? Why would those that spit on congresspersons, hurl racial epithets at minority members of Congress, scream homophobic slurs at gay Congressional leaders, and telephone 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 rescue of an entrenched system of corporate privilege?⁸⁴

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.⁸⁵ Greenspan declared, “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.”⁸⁶ 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.”

⁸² See andré douglas pond cummings, Symposium Presentation at the Southeast/Southwest People of Color Conference at the University of South Carolina—Equality and Justice in the Obama Era: Economic Justice (Mar. 26, 2010) (notes on file with author); HENRY M. PAULSON, JR., ON THE BRINK: INSIDE THE RACE TO STOP THE COLLAPSE OF THE GLOBAL FINANCIAL SYSTEM 154 (2010) (describing the Treasury Department’s response to the financial crisis as one intended solely to prop up the Wall Street investment banks without any strings attached or alteration in behavior or activity that led to the crisis in the first instance).

⁸³ See Bob Herbert, *An Absence of Class*, N.Y. TIMES, Mar. 23, 2010, at A29.

⁸⁴ See *id.*; Megan Carpentier, *More than Half of Republicans Don’t Believe Banks Are to Blame for the Financial Crisis*, WASH. INDEP. (Mar. 22, 2010, 5:36 PM), <http://washingtonindependent.com/80022/more-than-half-of-republicans-dont-believe-banks-are-to-blame-for-the-financial-crisis> (describing an ABCNews Poll where less than 50% of Republicans polled do not believe that Wall Street banks were the cause of the financial market crisis).

⁸⁵ See *supra* notes 45–49 and accompanying text.

⁸⁶ Rooney, *supra* note 49.

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 2008.⁸⁷ 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.⁸⁸ Glass-Steagall was enacted in 1933 to address the regulatory failures that led to the Great Depression.⁸⁹ It was designed to stamp out commercial speculation, and most perceived evils that Congress viewed at the time as leading to the Great Depression.⁹⁰ 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.⁹¹

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.”⁹² As was

⁸⁷ See James R. Hackney, Jr., *On Markets and Regulation: Richard Posner's Conservative Pragmatist Evolution*, 3 LAW & FIN. MARKETS REV. 540 (2009) (reviewing RICHARD POSNER, *A FAILURE OF CAPITALISM: THE CRISIS OF '08 AND THE DESCENT INTO DEPRESSION* (2009)); JOHNSON & KWAK, *supra* note 2, at 89, 91–92; POSNER, *supra* note 40, at 113; Grant, *supra* note 2, at 373–77.

⁸⁸ See Hackney, *supra* note 87, at 540.

⁸⁹ See Grant, *supra* note 2, at 377.

⁹⁰ *Id.* at 374 n.7 (“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)); JOHNSON & KWAK, *supra* note 2, at 89, 134.

⁹¹ See *id.* at 380.

⁹² See Grant, *supra* note 2, at 371–72; RAMIREZ, *supra* note 1 (manuscript at introduction); David Leonhardt, *Washington's Invisible Hand*, N.Y. TIMES, Sept. 28, 2008, at 32; Louis Uchitelle, *Volcker Fails to Sell a Bank Strategy*, N.Y. TIMES, Oct. 21, 2009, at A1; Paul Krugman, *Army of Ignorance*, N.Y. TIMES (Nov. 10, 2009, 10:26 AM) <http://krugman.blogs.nytimes.com/2009/11/10/armey-of-ignorance/?scp=9&sq=Gramm-Leach-Bliley&st=cse>; Cyrus Sanati, *10 Years Later, Looking at Repeal of Glass-Steagall*, N.Y. TIMES DEALBOOK (Nov. 12, 2009, 2:24 PM), <http://dealbook.blogs.nytimes.com/2009/11/12/10-years-later-looking-at-repeal-of-glass-steagall/?scp=1&sq=Gramm-Leach-Bliley&st=cse>. *But see* Mark A. Calabria, *Did Deregulation Cause the Financial Crisis?*, CATO POL'Y REP., July–Aug. 2009, at 1, 6, available at http://www.cato.org/pubs/policy_report/v31n4/cpr31n4-1.pdf (arguing that Gramm-Leach-Bliley did not play a primary role in the financial market crisis); James L. Gattuso, *Meltdowns and Myths: Did*

feared by the few senators and representatives that opposed passage of Gramm-Leach-Bliley, the banking industry became an industry of enormous “one-stop” financial institutions that engaged in not just consumer banking, but also in insurance activity and speculative investing with consumer deposits.⁹³

Once the firewalls were erased, the consolidation of the banking industry led in part to the market crisis that, but for a government bailout, nearly collapsed every single banking institution, including Citigroup and Bank of America, that had lobbied so aggressively for passage of Gramm-Leach-Bliley.⁹⁴ 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 laissez-faire sway of nearly every financial leader and lobbyist in place at the time.⁹⁵ “This 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.”⁹⁶

Of course, the Fed possesses the power to regulate commercial banks, which it failed to exercise, particularly following passage of Gramm-Leach-Bliley.⁹⁷ Greenspan, believed and preached, as one of his foundational 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.⁹⁸ In this belief, of course,

Deregulation Cause the Financial Crisis?, WEB MEMO (The Heritage Found., Wash., D.C.), Oct. 22, 2008, available at http://s3.amazonaws.com/thf_media/2008/pdf/wm2109.pdf (claiming that Gramm-Leach-Bliley alleviated the financial market crisis rather than caused it).

⁹³ Grant, *supra* note 2, at 384–85.

⁹⁴ See *id.*; JOHNSON & KWAK, *supra* note 2, at 134.

⁹⁵ See Hackney, *supra* note 88, at 540–41 (“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.”); JOHNSON & KWAK, *supra* note 2, at 5–7.

⁹⁶ See Hackney, *supra* note 88, at 541.

⁹⁷ See *id.*

⁹⁸ See Jacob M. Schlesinger & Michael Schroeder, *Greenspan Defends Longer-Term Capital Plan*, WALL ST. J., 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.”); 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 many hedge-fund advisors to oversight for the first time.”); Joseph Rebello & Dawn Kopecki, *Greenspan Urges Congress to Move on Derivatives*, WALL ST. J., Feb. 11, 2000, at C20 (“Federal Reserve

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.”⁹⁹ For a time, Alan Greenspan’s tremendous prestige allowed him nearly unfettered sway, and with it, he blocked deregulation of derivative instruments, refused to use the power of the Fed to stave off the housing bubble by raising interest rates, and failed to rein in reckless lending by more assertively exercising the control that the Federal Reserve holds over commercial banks.¹⁰⁰

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 the early reckless trading in the subprime mortgage-backed securities market (the Commodity Futures Modernization Act enabled investment banks to do most of their damage),¹⁰¹ 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.¹⁰² 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.¹⁰³ No longer consumer lenders only,¹⁰⁴ both Citigroup and Bank of America required a massive infusion of TARP bailout funds in order to stave off certain bankruptcy and collapse because of the investment-related activity that introduced toxic securitized subprime assets onto their balance sheets.¹⁰⁵

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.’); 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.”).

⁹⁹ See POSNER, *supra* note 40, at 281.

¹⁰⁰ See *id.*

¹⁰¹ See Leonhardt, *supra* note 92.

¹⁰² See Grant, *supra* note 2, at 374–76. *But see Gramm-Leach-Bliley Did Not Cause the Financial Crisis*, AM. BANKERS ASS’N (Jan. 2010), <http://www.aba.com/NR/rdonlyres/71949FE8-BA04-40B8-BC61-AF9F612C679A/64916/GrammLeachHelpedoResolvenotCauseTheCreditCrisisJa.pdf>.

¹⁰³ See Grant, *supra* note 2, at 400–01, 406.

¹⁰⁴ See *id.* at 386–87.

¹⁰⁵ See Leonhardt, *supra* note 92; JOHNSON & KWAK, *supra* note 2, at 10–13.

3. *Commodity Futures Modernization Act*

An additional deregulatory decision that precipitated the market collapse was the 2000 promulgation of the Commodity Futures Modernization Act (CFMA).¹⁰⁶ 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.¹⁰⁷ Passed as a rider to an omnibus appropriations bill, against the pointed objection of Brooksley Born, then head of the Commodity Futures Trading Commission, the CFMA prohibited any type of governmental oversight over the trading of derivative investment vehicles.¹⁰⁸ 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.¹⁰⁹

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.¹¹⁰ 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.¹¹¹

¹⁰⁶ See Commodity Futures Modernization Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763 (codified as amended in scattered sections of 7 U.S.C.).

¹⁰⁷ See cummings, *Still Ain't No Glory in Pain*, *supra* note 42, at 536–38.

¹⁰⁸ See *id.* at 529–32; see also JOHNSON & KWAK, *supra* note 2, at 135–37; Anthony Faiola, Ellen Nakashima & Jill Drew, *What Went Wrong*, WASH. POST, Oct. 15, 2008, at A1 (describing the failed campaign of former U.S. Commodity Futures Trading Commission director Brooksley Born to get the Clinton administration to seriously consider regulating over-the-counter derivative trading); Manuel Roig-Fanzia, *Credit Crisis Cassandra*, WASH. POST, May 26, 2009, at C1. 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 (like gold, oranges, or 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 *Derivative*, INVESTORWORDS.COM, <http://www.investorwords.com/1421/derivative.html> (last visited Jan. 26, 2011).

¹⁰⁹ See cummings, *Still Ain't No Glory in Pain*, *supra* note 42, at 531–34; Frank Partnoy, *ISDA, NASD, CFMA, and SDNY: The Four Horsemen of Derivatives Regulation?* 17–18 (Univ. of San Diego Law Sch., Pub. Law & Legal Theory, Working Paper No. 39, 2002), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=293085.

¹¹⁰ See Partnoy, *supra* note 109, at 17–19; cummings, *Still Ain't No Glory in Pain*, *supra* note 42, at 529–34.

¹¹¹ See cummings, *Still Ain't No Glory in Pain*, *supra* note 42, at 529–36; Leonhardt, *supra* note 92 (stating that the CFMA "clearly did contribute to the current crisis"); Roig-

As described in detail *infra*,¹¹² 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.¹¹³ CDOs offered investors rights to receive periodic payments from the cash flows associated with particularized bundles of home mortgages.¹¹⁴ The initiation of Credit Default Swaps (CDSs),¹¹⁵ private insurance-like contracts that act to hedge against the default risk posed by CDOs, introduced an emerging hedging mechanism into the exotic derivatives trading world and evolved into a cottage trading industry.¹¹⁶ 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).”¹¹⁷ 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.¹¹⁸ 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.¹¹⁹ Both the securitized

Fanzia, *supra* note 108 (chronicling Brooksley Born’s opposition to, and ultimately accurate predictions about, the danger of the deregulation of derivatives markets).

¹¹² See *infra* Part II.C.2.

¹¹³ See *infra* Part II.C.2; *What Does Collateralized Debt Obligation Mean?*, INVESTOPEDIA, <http://www.investopedia.com/terms/c/cdo.asp> (last visited Jan. 26, 2011) (“[A collateralized debt obligation is] [a]n investment-grade security backed by a pool of bonds, loans and other assets. CDOs do not specialize in one type of debt but are often non-mortgage loans or bonds.”).

¹¹⁴ See Johnson, *supra* note 2, at 128–29.

¹¹⁵ See *What Does Credit Default Swap Mean?*, INVESTOPEDIA, <http://www.investopedia.com/terms/c/creditdefaultswap.asp> (last visited Jan. 26, 2011) (“[A credit default swap is explained as where] [t]he 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.”).

¹¹⁶ See Johnson, *supra* note 2, at 134–38.

¹¹⁷ See Hackney, *supra* note 87, at 541.

¹¹⁸ See Johnson, *supra* note 2, at 134–38; see generally MICHAEL LEWIS, *THE BIG SHORT: INSIDE THE DOOMSDAY MACHINE* (2010) (describing the evolution of the credit default swap as an insurance hedge against new and innovative securitized subprime loan investment instruments); Interview by Steve Kroft, Correspondent, 60 Minutes, with Michael Lewis, Author, in Cal. (Mar. 14, 2010) [hereinafter 60 Minutes: Michael Lewis Interview].

¹¹⁹ See JOHNSON & KWAK, *supra* note 2, at 3–13.

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 because the CFMA made it so.¹²⁰

The CFMA made trading CDS contracts and CDOs in the shadows possible, thus enabling enormous malfeasance and reckless risk taking by Wall Street banks and corporate leadership.¹²¹ Investment banks and large financial institutions purchased CDOs and securitized subprime mortgage instruments in a frenzied money grab, as the investments were rated as “safe” (Aaa) by compromised credit rating agencies,¹²² and the capital was immediately available based on flawed risk modeling¹²³ designed to show the percentages at which the underlying mortgages would be paid by consumers.¹²⁴ As these unregulated instruments were purchased, traded, passed, sold, and shorted, these large financial institutions were “hedging” by purchasing unregulated insurance contracts, CDSs, which would pay out if the subprime mortgage consumers defaulted and homes were foreclosed upon.¹²⁵ In agreeing to the hedge CDS 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.¹²⁶ CDOs and CDS contracts were then traded and swapped 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

¹²⁰ See Johnson, *supra* note 2, at 157–63; LEWIS, *supra* note 118, at 78.

¹²¹ See *id.*; LEWIS, *supra* note 118, at 78; Michael Lewis Interview, *supra* note 118.

¹²² See *infra* Part II.C.3.

¹²³ See Olufunmilayo B. Arewa, *Risky Business: Credit Crisis and Failure (Part I)*, 104 N.W. U. L. REV. COLLOQUY 398, 403–04 (2010).

¹²⁴ See Gretchen Morgenson, *Credit Rating Agency Heads Grilled by Lawmakers*, N.Y. TIMES, Oct. 23, 2008, at B1; Andrew Ross Sorkin, *Connecticut Sues Moody's and S.&P. Over Ratings*, N.Y. TIMES DEALBOOK (Mar. 10, 2010, 1:15 PM), <http://dealbook.blogs.nytimes.com/2010/03/10/connecticut-sues-moodys-and-s-p-over-ratings/?scp=8&sq=credit%20rating%20agencies&st=cse>; Olufunmilayo B. Arewa, *Trading Places: Securities Regulation, Market Crisis and Network Risk* (Nw. Univ. Sch. of Law Pub. Law & Legal Theory Series, Law & Econ. Paper No. 09-01, 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1324951 (describing the rising power of traders on Wall Street and the necessity to better understand and fundamentally regulate risk and new risk modeling).

¹²⁵ See Houman B. Shadab, *Counterparty Regulation and Its Limits: The Evolution of the Credit Default Swaps Market*, 54 N.Y.L. SCH. L. REV. 689, 705 (2009/10) (describing credit default swaps, counterparty regulation and concluding that little need exists for federal regulation of the credit default swap market); Morrissey, *supra* note 63.

¹²⁶ See William K. Sjostrom, Jr., *The AIG Bailout*, 66 WASH. & LEE L. REV. 943, 988–89 (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); PATTERSON, *supra* note 2, at 11–12.

default occurred.¹²⁷ Further, on these CFMA mandated unregulated markets where CDSs and CDOs were sold, traded, and swapped, they were also short sold, a bet that the underlying instrument would fail.¹²⁸ 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.¹²⁹ President Clinton's financial team during the course of his presidency, including Robert Rubin, Lawrence Summers, and Alan Greenspan,¹³⁰ famously battled furiously against any form of regulation over derivatives and derivatives trading.¹³¹

4. *Private Securities Litigation Reform Act*

A further legislative enactment during the deregulation movement that gripped Congress in the 1990s was the Private Securities Litigation Reform Act (PSLRA).¹³² 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.¹³³ Enacted to combat "strike suits" that were purportedly stifling corporate growth and shareholder earnings, the PSLRA changed the

¹²⁷ See Gretchen Morgenson, *It's Time for Swaps to Lose Their Swagger*, N.Y. TIMES, Feb. 28, 2010, at BU1; Wolfgang Münchau, *Time to Outlaw Naked Credit Default Swaps*, FIN. TIMES, Mar. 1, 2010, at 9; Frank Hardy, *What Are Credit Default Swaps: Unregulated Insurance Policies for Risky, Toxic Investments*, SUITE101.COM (Oct. 19, 2008), http://americanaffairs.suite101.com/article.cfm/what_are_credit_default_swaps; Yves Smith, *So Why Hasn't the Credit Default Swaps Casino Been Shut Down?*, NAKED CAPITALISM (Mar. 1, 2010), <http://www.nakedcapitalism.com/2010/03/so-why-hasnt-the-credit-default-swaps-casino-been-shut-down.html>.

¹²⁸ See Gretchen Morgenson & Louise Story, *Banks Bundled Bad Debt, Bet Against It and Won*, N.Y. TIMES, Dec. 24, 2009, at A1; LEWIS, *supra* note 118, at 77–79; Michael Lewis Interview, *supra* note 118.

¹²⁹ See *Bill Clinton: I Should Have Better Regulated Derivatives*, CNN (Feb. 16, 2009, 3:02 PM EST), <http://www.cnn.com/2009/POLITICS/02/16/bill.clinton.qanda/>.

¹³⁰ See *The Three Marketeers*, TIME, Feb. 15, 1999, <http://www.time.com/time/magazine/article/0,9171,990206,00.html> (describing spookily—in retrospect—the Greenspan, Summers, Rubin financial team as a "Committee to save the world").

¹³¹ See Faiola, Nakashima & Drew, *supra* note 108 (describing the nearly violent reaction that Rubin and Greenspan had when former U.S. Commodity Futures Trading Commission chair Brooksley Born suggested writing a white paper in connection with regulating derivatives); see also JOHNSON & KWAK, *supra* note 2, at 3–13.

¹³² See Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.).

¹³³ See Amy Widman & Joanne Doroshaw, *Legal Abandon: How Limiting Lawsuits Led to the Financial Collapse and What to do About It*, CENTER FOR JUST. & DEMOCRACY, 6–8 (Feb. 2010), <http://www.centerjrd.org/archives/studies/LegalAbandonWpaperF.pdf>.

securities fraud class action scheme in debilitating ways.¹³⁴ 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.¹³⁵

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.¹³⁶

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."¹³⁷

The impact of the PSLRA has been severe. Abner Mikva, former federal judge, U.S. representative, 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 [Securities and Exchange Commission] . . . has observed that what used to be unthinkable is now commonplace in the marketplace."¹³⁸

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.¹³⁹ 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

¹³⁴ See Steven Ramirez, *Arbitration and Reform in Private Securities Litigation: Dealing with the Meritorious as Well as the Frivolous*, 40 WM. & MARY L. REV. 1055, 1055–60 (1999); cummings, *Ain't No Glory in Pain*, *supra* note 42, at 1007–28.

¹³⁵ See cummings, *Ain't No Glory in Pain*, *supra* note 42, at 1005–06; James Cotton, *Another Nail in the Coffin of the Small Investor: The Private Securities Litigation Reform Act of 1995*, 17 TOURO L. REV. 733, 738 (2001); Steven A. Ramirez, *American Corporate Governance and Globalization*, 18 BERKLEY LA RAZA L.J. 47, 57–59 (2000).

¹³⁶ See Ramirez, *supra* note 134 at 1055–60; cummings, *Ain't No Glory in Pain*, *supra* note 42 at 1007–28.

¹³⁷ See Widman & Doroshaw, *supra* note 133, at 2 (quoting cummings, *Ain't No Glory in Pain*, *supra* note 42, at 1009 n.135).

¹³⁸ See *id.* (alterations in original) (quoting Abner J. Mikva, *Share and Shares Alike: Now Let's Fix the 'Reform' of Securities Law*, LEGAL TIMES (Apr. 8, 2002)).

¹³⁹ See cummings, *Ain't No Glory in Pain*, *supra* note 42, at 1065–66.

method to manage a national capital market.”¹⁴⁰ Indeed, La Porta, De Silanes, and Shleifer discovered that markets develop better when civil—not criminal—law is strong.¹⁴¹ 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 Capitol Hill in the 1990s and early 2000s actually took the exact opposite tack of 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”¹⁴² Nearly every financial market legislation enacted by Congress in the 1990s and early 2000s 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 Fed policy, 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 Securities and Exchange Commission (SEC) and federal courts’ failure to regulate hedge funds,¹⁴³ and numerous SEC rules promulgated under its rulemaking authority.¹⁴⁴ 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 shareholders’ ability to recover for securities fraud.¹⁴⁵

¹⁴⁰ See Rafael La Porta, Florencio Lopez-De-Silanes & Andrei Shleifer, *What Works in Securities Laws?*, 61 J. Fin. 1, 1 (2006) (“We examine the effect of securities laws on stock market development in 49 countries. We find little evidence that public enforcement benefits stock markets, but strong evidence that laws mandating disclosure and facilitating private enforcement through liability rules benefit stock markets.”).

¹⁴¹ See Daniel Gross, *So Sue Me*, SLATE (Sept. 23, 2003, 4:54 PM), <http://www.slate.com/id/2088790/>.

¹⁴² Widman & Doroshov, *supra* note 133, at 5.

¹⁴³ See Joshua Hess, Note, *How Arbitrary Really Was the S.E.C.’s “Hedge Fund Rule”?* *The Future of Hedge Fund Regulation in Light of Goldstein, Amaranth Advisors, and Beyond*, 110 W. VA. L. REV. 913 (2008) (describing the SEC’s and federal courts failures to regulate hedge funds).

¹⁴⁴ See Cummings, *Still Ain’t No Glory in Pain*, *supra* note 42, at 469–87 (describing the Telecommunications Act and the Commodities Futures Modernization Act as 1990s deregulation that had a deleterious effect on the capital markets).

¹⁴⁵ See Norman S. Poser, *Why the SEC Failed: Regulators against Regulation*, 3 BROOK. J. CORP. FIN. & COM. L. 289, 309–310 (2008). 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 also ignore the conclusions of an iconic neoclassical economics voice, Judge Posner, who concludes:

The 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 the Glass-Steagall Act . . . and it was decided not to bring the new financial instruments, in particular credit-default swaps, under regulation¹⁴⁶

Of course, proponents of 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 newly deregulated markets,¹⁴⁷ 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 refocus public attention on 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.¹⁴⁸ 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 twenty-first century played a major role in the meltdown as well.

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.

Id. at 296 (citations omitted); Charles R. Schwab, *Restore the Uptick Rule, Restore Confidence*, WALL ST. J., Dec. 9, 2008, at A17; John C. Coffee, Jr., *Analyzing the Credit Crisis: Was the SEC Missing in Action?*, N.Y. L.J. (Dec. 5, 2008), <http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202426495544>.

¹⁴⁶ See POSNER, *supra* note 40, at 270.

¹⁴⁷ See STIGLITZ, *supra* note 2, at 1317.

¹⁴⁸ See *infra* Part III.

B. Housing Bubble

“As long as the music is playing, you’ve got to get up and dance.”
—Charles O. Prince III, CEO Citigroup¹⁴⁹

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. As Professor Christopher Peterson notes:

[i]n 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. As it has become clear that millions of Americans are not capable of repaying loans crafted for them by commission hungry brokers, the liquidity of securities drawn from those loans froze. Currently about 25% of all subprime home mortgages are delinquent with millions more likely to follow. One rating agency predicts that between 40 and 50% of all subprime mortgages originated since 2006 will eventually end in foreclosure.¹⁵⁰

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.¹⁵¹ In other words, negative equity indicates that nearly half of all homeowners that entered subprime mortgages are underwater on their loans, causing many to abandon their homes.¹⁵²

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

¹⁴⁹ Sorkin, *supra* note 64 (quoting the chairman of Citigroup).

¹⁵⁰ Peterson, *supra* note 2, at 1359 (citations omitted); Nick Zieminski, *U.S. Mortgage Delinquencies Set Record*, REUTERS (Sept. 21, 2009, 12:21 PM EDT), <http://www.reuters.com/article/idUSTRE58K29E20090921>.

¹⁵¹ See Jody Shenn, ‘Underwater’ Mortgages to Hit 48%, *Deutsche Bank Says*, BLOOMBERG (Aug. 5, 2009, 15:32 EDT), <http://www.bloomberg.com/apps/news?pid=20601110&sid=ac9y1xr7yNhQ> (explaining that 26% or 14 million properties were mortgaged for more than their value); Gregory Scott Crespi, *The Trillion Dollar Problem of Underwater Homeowners: Avoiding a New Surge of Foreclosures by Encouraging Principal-Reducing Loan Modifications*, 51 SANTA CLARA L. REV. 153–55 (2010).

¹⁵² Les Christie, *Half of Mortgage Brokers Will Be ‘Underwater,’* CNNMONEY (Aug. 6, 2009), http://money.cnn.com/2009/08/06/real_estate/underwaterworld/index.htm?postversion=2009080611&FORM=ZZNR9; Crespi, *supra* note 151, at 153–55; Peterson, *supra* note 2, at 1359–60.

water of swimming pools behind thousands of abandoned suburban homes.¹⁵³

In Detroit, Michigan, more than forty square miles of abandoned housing sits vacant within its city limits as foreclosures and unemployment have wreaked havoc on the city.¹⁵⁴ To appreciate a forty square mile vacancy approximation in Detroit, consider that Manhattan Island in New York City is twenty-three 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.¹⁵⁵ 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.¹⁵⁶

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 billions of dollars of . . . subprime mortgage assets were virtually worthless.”¹⁵⁷ Currently, more than seven hundred banks have been identified by the Federal Deposit Insurance Corporation (FDIC) as “problem” banks in danger of failing.¹⁵⁸ Several contributing factors led to the development of the housing bubble and its subsequent failure.

Factors 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 in 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.

¹⁵³ See Peterson, *supra* note 2, at 1360 (citations omitted).

¹⁵⁴ See Alex P. Kellogg, *Detroit's Smaller Reality*, WALL ST. J., Feb. 27, 2010, at A3.

¹⁵⁵ See Mike Wilkinson, *Nearly Half of Detroit's Workers Are Unemployed; Analysis Shows Reported Jobless Rate Understates Extent of Problem*, DETROIT NEWS, Dec. 16, 2009, at A1; Steven Gray, *In Detroit, Nearly 50% Unemployment Rate?*, DETROIT BLOG (Dec. 16, 2009, 11:01 AM), <http://detroit.blogs.time.com/2009/12/16/in-detroit-nearly-50-unemployment-rate/>.

¹⁵⁶ See Thomas J. Sugrue, *From Motor City to Motor Metropolis: How the Automobile Industry Reshaped Urban America*, AUTOMOBILE IN AM. LIFE & SOC'Y, http://www.autolife.umd.umich.edu/Race/R_Overview/R_Overview1.htm (last visited Jan. 26, 2010); Thomas J. Sugrue, *Motor City: The Story of Detroit*, GILDER LEHRMAN INST. AM. HIST. (Mar. 2007), http://www.gilderlehrman.org/historynow/03_2007/historian6.php.

¹⁵⁷ Peterson, *supra* note 2, at 1360 (citations omitted) (citing COHAN, *supra* note 62, at 4).

¹⁵⁸ See Eric Dash, *At F.D.I.C., Bracing For a Wave of Failures*, N.Y. TIMES, Feb. 24, 2010, at B1 (“Despite resurgent profits and pay at the giants of American finance, many of the nation’s 8,000 banks remain under stress, according to a quarterly report the F.D.I.C. released Tuesday.”).

1. *Lax Lender Oversight*

Before financial deregulation and Gramm-Leach-Bliley, commercial banks wrote mortgages that were primarily based on an individual's demonstrated ability to repay the loan, based upon credit worthiness.¹⁵⁹ Typically, the commercial bank would then hold the mortgage, collecting payments until the mortgage was ultimately paid off by the credit-worthy borrower. Commercial banks were generally careful about how, and to whom, they wrote mortgages, because they held the loan and relied on timely payments to conduct business.¹⁶⁰

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.¹⁶¹ Soon thereafter, securitization of home mortgages was initiated by these government-sponsored enterprises (GSEs) 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."¹⁶²

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,¹⁶³ it ultimately unleashed a shadow system that eventually spun out of control.

While the GSEs, Fannie, Freddie, and Ginnie, typically invested in mortgages with particular middle-class focused policy objectives in mind, mostly 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.¹⁶⁴ 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

¹⁵⁹ See Lissa Lamkin Broome, *The Influence of Enhanced Thrift Institution Powers on Commercial Bank Market Expansion*, 67 N.C. L. REV. 795, 813–814 (1989).

¹⁶⁰ See *id.* at n.74.

¹⁶¹ See Christopher Peterson, *Predatory Structured Finance*, 28 CARDOZO L. REV. 2185, 2194–99 (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).

¹⁶² *Id.* at 2199 (citations omitted).

¹⁶³ *Id.* at 2199–2200.

¹⁶⁴ See MEIR KOHN, FINANCIAL INSTITUTIONS AND MARKETS 623–24 (1994); Christopher Peterson, *Fannie Mae, Freddie Mac and the Home Mortgage Foreclosure Crisis*, 10 LOY. J. PUB. INT. L. 149, 157–58 (2009).

home mortgage lending similarly to the ways the GSEs did with prime mortgages.¹⁶⁵ “Private financiers wanted to mobilize capital to serve this massive potential demand for [mortgage] credit.”¹⁶⁶ Unmet demand in the mortgage market segments that was too risky for the GSEs—including variable rate, home equity, and subprime—left enticing and substantial niches for private investors.¹⁶⁷

It is now beyond dispute that Lehman Brothers,¹⁶⁸ Bear Stearns,¹⁶⁹ Citigroup,¹⁷⁰ Countrywide,¹⁷¹ AIG,¹⁷² and Goldman Sachs,¹⁷³ amongst so many others, stepped into this private mortgage securitization business niche and recklessly pursued these enticing (and enormous) revenue streams by egregiously originating, purchasing, selling, and trading in the unregulated shadow markets of securitized mortgage loans.¹⁷⁴

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.¹⁷⁵ Banks that

¹⁶⁵ See Lewis S. Ranieri, *The Origins of Securitization, Sources of Its Growth, and Its Future Potential*, in A PRIMER ON SECURITIZATION 31, 31 (Leon T. Kendall & Michael J. Fishman eds., 1996); Peterson, *supra* note 164, at 157–58.

¹⁶⁶ See Peterson, *supra* note 161, at 2200 (describing the unmet demand in market segments like “jumbo” mortgages, mortgages with variable interest rates (ARMs), home equity loans, or subprime mortgages).

¹⁶⁷ Claire A. Hill, *Securitization: A Low-Cost Sweetener for Lemons*, 74 WASH. U. L.Q. 1061, 1121 (1996); Peterson, *supra* note 161, at 2200.

¹⁶⁸ Peterson, *supra* note 161, at 2222–25.

¹⁶⁹ Susan Chaplinsky, *Bear Stearns and the Seeds of Its Demise* (Univ. of Va. Darden Bus. Sch., Darden Case No. UVA-F-1574, Oct. 22, 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1418914; COHAN, *supra* note 62, at 208–212.

¹⁷⁰ Eric Dash & Julie Creswell, *Citigroup Pays for a Rush to Risk*, N.Y. TIMES, Nov. 23, 2008, at A1.

¹⁷¹ See JOHNSON & KWAK, *supra* note 2, at 96–97.

¹⁷² Sjoström, *supra* note 126, at 944–45; JOHNSON & KWAK, *supra* note 2, at 96, 126, 128.

¹⁷³ See LEWIS, *supra* note 118, at 77–78; see also 60 Minutes: Michael Lewis Interview, *supra* note 118.

¹⁷⁴ *Factors Affecting Efforts to Limit Payments to AIG Counterparties: Hearing Before the H. Comm. on Oversight and Gov’t Reform*, 111th Cong. (Jan. 27, 2010) (testimony of Thomas C. Baxter Jr., Executive Vice President and General Counsel, Federal Reserve Bank N.Y.), available at <http://www.newyorkfed.org/newsevents/speeches/2010/bax100127.html>; Janice K. McClendon, *The Perfect Storm: How Mortgage-Backed Securities, Federal Deregulation, and Corporate Greed Provide a Wake-Up Call for Reforming Executive Compensation*, 12 U. PA. J. BUS. L. 131, 131–37 (2009); Felix Salmon, *AIG’s Speculative CDS Bets*, SEEKING ALPHA (Dec. 11, 2008), <http://seekingalpha.com/article/110186-aig-s-speculative-cds-bets>; see also *infra* Part II.B.2.

¹⁷⁵ See *infra* Part II.B.2.

closed mortgages through brokers were able to turn around and sell the mortgage on an unregulated secondary market.¹⁷⁶ Often, these loans were then packaged as investment vehicles, CDOs, and again sold in an unregulated market.¹⁷⁷

The mortgage lending market, once one of careful weighing and balancing and where actual concern for the consumer was clear, transformed 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.¹⁷⁸ 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.¹⁷⁹ 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 reckless irresponsibility.

First, banks became detached from the credit-worthiness of borrowers as they could immediately resell mortgages in a secondary market.¹⁸⁰ Second, unregulated mortgage brokers made loans to borrowers that were not qualified and often on a predatory basis.¹⁸¹ Third, many borrowers entered into interest-only loans, many

¹⁷⁶ See *Brokers, Bankers Play Subprime Blame Game*, MSNBC.COM (May 22, 2007, 3:12 PM ET), <http://www.msnbc.msn.com/id/18804054/>.

¹⁷⁷ See ADAM ASCHCRAFT & TIL SCHUERMANN, STAFF REP. NO. 318, FEDERAL RESERVE BANK OF N.Y.: UNDERSTANDING THE SECURITIZATION OF SUBPRIME MORTGAGE CREDIT 2-12 (2008), available at http://www.newyorkfed.org/research/staff_reports/sr318.pdf.

¹⁷⁸ Mitchell, *supra* note 39, at 171-73.

¹⁷⁹ See Mara Der Hovanesian, *Nightmare Mortgages*, BLOOMBERG BUSINESSWEEK, Sept. 11, 2006, at 70 ("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, *Could the Mortgage Crisis and Bank Bailout Have Been Prevented?*, ABOUT.COM, http://useconomy.about.com/od/criticalissues/a/prevent_crisis.htm (last visited Jan. 26, 2011) ("Banks had hired sophisticated 'quant jocks' who wrote computer programs that could repackage these [mortgage-backed securities] 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."); Alistair Barr, *Subprime Crisis Shines Light on Mortgage Brokers*, WALL ST. J. MARKET WATCH (Apr. 10, 2007, 11:30 AM EDT), <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 the borrowers.").

¹⁸⁰ See Amadeao, *supra* note 179.

¹⁸¹ See *id.*; see also *infra* Part II.B.2.

adjustable rate, in order to secure lower monthly payments.¹⁸² 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.¹⁸³ Fourth, and perhaps most important, mortgages were repackaged as mortgage-backed securities and sold in an unregulated market to investors.¹⁸⁴ “Banks had hired sophisticated ‘quant jocks’ who wrote computer programs that could repackage these MBS [mortgage-backed securities] 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.”¹⁸⁵ 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.¹⁸⁶ Further, as hedge funds were left unregulated by the SEC and the buying, selling, and swapping of CDOs and CDSs was conducted in the shadows, banks and hedge funds could engage in highly speculative, outrageously risky trading and betting.¹⁸⁷

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.¹⁸⁸

¹⁸² See Amadeao, *supra* note 179.

¹⁸³ See *id.*

¹⁸⁴ See Arewa, *supra* note 123, at 403.

¹⁸⁵ See Amadeao, *supra* note 179; Arewa, *supra* note 123, at 408.

¹⁸⁶ See Amadeao, *supra* note 179.

¹⁸⁷ See Felix Salmon, *The Magnetar Trade*, FELIX SALMON REUTERS BLOG (Apr. 9, 2010, 16:00 EDT), <http://blogs.reuters.com/felix-salmon/2010/04/09/the-magnetar-trade/> (describing the breathtakingly risky and reckless CDO and CDS positions engaged by Morgan Stanley and the Magnetar Hedge Fund that purportedly lost Morgan Stanley \$9 billion); Hess, *supra* note 143, at 919, 953–54; Jessie Eisinger & Jake Bernstein, *The Magnetar Trade: How One Hedge Fund Helped Keep the Bubble Going*, PROPUBLICA (Apr. 9, 2010, 1:59 PM), <http://www.propublica.org/feature/all-the-magnetar-trade-how-one-hedge-fund-helped-keep-the-housing-bubble>.

¹⁸⁸ Martin H. Bosworth, *Unregulated Lenders Blamed for Mortgage Meltdown*, CONSUMERAFFAIRS.COM (Aug. 12, 2007), http://www.consumeraffairs.com/news04/2007/08/congress_mortgages.html; Peterson, *supra* note 161, at 2222–25.

Predatory lending occurs when a lender deceptively convinces borrowers to agree to unfair and abusive loan terms, or systematically violates terms in ways that are difficult for a borrower to defend against.¹⁸⁹ Subprime loans are those loans most likely to be written through predatory lending practices to borrowers who do not meet prime underwriting borrower guidelines, and are therefore preferred by lenders because profit margins can be significant if a borrower pays out the loan.¹⁹⁰ 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.¹⁹¹ Subprime loans typically carry much higher interest rates than conventional loans.¹⁹²

The development of the subprime lending market and its evolution into an oftentimes predatory market began in the early 1990s when private label securitization conduits became entrenched as an accepted method of financing home mortgages.¹⁹³ During the 1990s, the U.S. witnessed an explosion of a new and aggressive form of “subprime” mortgage lending.¹⁹⁴ Prior to this explosion, “prime” mortgages were generally considered those qualified to be resold to Fannie Mae and Freddie Mac. Both Fannie Mae and Freddie Mac 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.¹⁹⁵ These standards led to stable and homogenized prime mortgage loans, thereby permitting secondary markets to treat prime loans like a commodity instead of a tenuous long-term financial association.¹⁹⁶ In contrast to “prime” mortgages, “subprime” mortgages are typically written for borrowers with

¹⁸⁹ See *Predatory Lending*, INVESTORDICTIONARY.COM, <http://www.investordictionary.com/definition/predatory+lending.aspx> (last visited Jan. 25, 2011).

¹⁹⁰ See *Glossary of Mortgage Loan Terms*, FIN. WEB, <http://www.finweb.com/mortgage/glossary-of-mortgage-loan-terms.html> (last visited June 14, 2011).

¹⁹¹ Ben Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys., Speech at the Federal Reserve Bank of Chicago’s 43rd Annual Conference on Bank Structure and Competition: The Subprime Mortgage Market (May 17, 2007), available at <http://www.federalreserve.gov/newsevents/speech/bernanke20070517a.htm>.

¹⁹² Carol Leonnig, *How HUD Mortgage Policy Fed the Crisis*, WASH. POST, June 10, 2008, at A1.

¹⁹³ See Peterson, *supra* note 161, at 2214.

¹⁹⁴ See Dan Immergluck, *Stark Differences: Explosion of the Subprime Industry and Racial Hypersegmentation in Home Equity Lending*, in HOUSING POLICY IN THE NEW MILLENNIUM CONFERENCE PROCEEDINGS 235, 239–40 (Susan M. Wachter & R. Leo Penne eds., 2001); Cathy Lesser Mansfield, *The Road to Subprime “HEL” Was Paved with Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market*, 51 S.C. L. REV. 473, 475, 525 (2000).

¹⁹⁵ See Peterson, *supra* note 161, at 2214; see also Anand K. Bhattacharya, Frank J. Fabozzi & S. Esther Chang, *Overview of the Mortgage Market*, in THE HANDBOOK OF MORTGAGE BACKED SECURITIES 3, 22 (Frank J. Fabozzi ed., 5th ed. 2001).

¹⁹⁶ See Henry T. Greely, *Contracts as Commodities: The Influence of Secondary Purchasers on the Form of Contracts*, 42 VAND. L. REV. 133, 169–70 (1989).

poor credit histories that did not historically meet the guidelines established by Fannie Mae and Freddie Mac.¹⁹⁷ 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.¹⁹⁸ 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 them to investors for large profits, often disregarding their own underwriting guidelines when writing the subprime mortgages.¹⁹⁹ “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.”²⁰⁰

A steady stream of consumer horror stories and wide-ranging allegations of predatory lending resulted from this “by any means possible” approach to originating subprime loans.²⁰¹ Commentators now point to the powerful connection between predatory lending and securitization signaling that securitization allows lenders with limited capital available to “churn” a significant number of loans.²⁰² 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

¹⁹⁷ See Peterson, *supra* note 161, at 2214.

¹⁹⁸ See Michael D. Larson, *It's Buyer Beware When You're Shopping for a Subprime Loan*, BANKRATE.COM (Feb. 2, 2001), <http://www.bankrate.com/bnm/news/mtg/20000420.asp>; JOHN C. WEICHER, THE HOME EQUITY LENDING INDUSTRY: REFINANCING MORTGAGES FOR BORROWERS WITH IMPAIRED CREDIT 13 (1997) (“In sharp contrast to the prime mortgage market, there are no generally accepted underwriting guidelines for subprime home equity lenders. Individual firms set their own guidelines. . . . For this reason, subprime loans cannot be treated as a standard commodity, again in contrast to loans in the prime market.”); Peterson, *supra* note 161, at 2214–15.

¹⁹⁹ See Jesse Eisinger, *Long & Short: Mortgage Market Begins to See Cracks as Subprime-Loan Problems Emerge*, WALL ST. J., Aug. 30, 2006, at C1 (reporting that in 2004 and 2005, Washington Mutual originated more than \$30 billion in non-conforming mortgage loans without adjusting its own underwriting guidelines to account for rising interest rates during that period); Peterson, *supra* note 161, at 2214.

²⁰⁰ Peterson, *supra* note 161, at 2215.

²⁰¹ See Creola Johnson, *The Magic of Group Identity: How Predatory Lenders Use Minorities to Target Communities of Color*, 17 GEO. J. ON POVERTY L. & POL'Y 165, 171–76 (2010) (illustrating the different methods used to market predatory loans in minority communities); see also Peterson, *supra* note 161, at 2216–17 (“An impressive and growing corpus of empirical research buttresses predatory lending horror stories as much more than mere anecdote. In the legal academy, outrage over the narrative and empirical evidence of predatory mortgage lending has also led to a large body of legal scholarship on the issue.”).

²⁰² See Kurt Eggert, *Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 CREIGHTON L. REV. 503, 546 (2002).

continuing this pattern repeatedly.²⁰³ “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.”²⁰⁴

Scholars believe that the secondary lending market is fully capable of recognizing those loans that include predatory terms and markers.²⁰⁵ Media exposés have exposed 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.²⁰⁶ “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.”²⁰⁷

That predatory lending ran amok in the run-up to the financial market crisis is now well established.²⁰⁸ Mortgage brokers, seeking higher origination fees and profit spreads, fervently sought out borrowers to whom they could sell subprime mortgages.²⁰⁹ 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.²¹⁰

While the law has been very slow to react to the trend of securitizing predatory loans, mortgage lenders, brokers, and servicers moved quickly to

²⁰³ See Peterson, *supra* note 161, at 2220.

²⁰⁴ *Id.* at 2221.

²⁰⁵ See *id.*; Kathleen C. Engel & Patricia A. McCoy, *Predatory Lending: What Does Wall Street Have to Do with It?*, 15 HOUSING POL’Y DEBATE 715, 741–42 (2004).

²⁰⁶ See Peterson, *supra* note 161, at 2221; Diana B. Henriques & Lowell Bergman, *Mortgaged Lives: A Special Report.; Profiting From Fine Print with Wall Street’s Help*, N.Y. TIMES, Mar. 15, 2000, <http://www.nytimes.com/2000/03/15/business/mortgaged-lives-special-report-profiting-fine-print-with-wall-street-s-help.html?pagewanted=1>; Bobbi Murray, *Wall Street’s Soiled Hands*, NATION, July 15, 2002, at 29 (“This whole business is about providing triple-A bonds to funds that you or I would invest in The poor are being used to produce this debt—what you have is a glorified money-laundering scheme.”).

²⁰⁷ Peterson, *supra* note 161, at 2221; Michael Gregory, *The Predatory Lending Fracas: Wall Street Comes under Scrutiny in the Subprime Market as Liquidity Suffers and Regulation Looms*, INVESTMENT DEALERS’ DIGEST (June 26, 2000), <http://www.iddmagazine.com/issues/20000625/4126-1.html>.

²⁰⁸ See Gretchen Morgenson, *Countrywide Suit Settled; Homeowners to Get Aid*, SEATTLE TIMES, Oct. 6, 2008, http://seattletimes.nwsourc.com/html/nationworld/2008231492_mortgages06.html; Tami Luhby, *Predatory Lending Lawsuits on the Rise*, CNNMONEY (Oct. 9, 2009, 7:19 AM ET), http://money.cnn.com/2009/10/08/news/economy/Predatory_lending_lawsuits_increase/index.htm; *States Are Pondering Fraud Suits Against Banks*, N.Y. TIMES DEALBOOK (Nov. 3, 2009, 3:45 AM), <http://dealbook.blogs.nytimes.com/2009/11/03/states-are-pondering-fraud-suits-against-banks/?scp=11&sq=predatory%20lending&st=cse>.

²⁰⁹ See *The Downturn in Facts and Figures*, *supra* note 62; *Brokers, Bankers Play Subprime Blame Game*, *supra* note 176.

²¹⁰ See Editorial, *Mortgages and Minorities*, N.Y. TIMES, Dec. 9, 2008, at A34; Johnson, *supra* note 201, at 187.

actively bargain with a discerning view toward the ultimate end-game destination of the loans they facilitate.²¹¹ In this end-game contingency, mortgage loans, particularly more expensive loans marketed to those with poor credit histories, were to be purchased by investment trusts, bundled into sizeable geographically diverse pools with many other mortgage loans, and then sold as securities to investors.²¹² 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.”²¹³ 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.”²¹⁴

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.²¹⁵ The role of personal borrower culpability for the

²¹¹ See Maura B. O’Connor & James Bryce Clark, *Ten Easy Ways to Make a Loan Nonsecuritizable*, in 2 COMMERCIAL REAL ESTATE FINANCING: WHAT BORROWERS AND LENDERS NEED TO KNOW NOW 11, 15–16 (Joshua Stein, Chair 2001); Jess Lederman, *Techniques for Selling Loans to Conduits*, in THE SECONDARY MORTGAGE MARKET: A HANDBOOK OF STRATEGIES, TECHNIQUES AND CRITICAL ISSUES IN CONTEMPORARY MORTGAGE FINANCE 77, 77–78 (Jess Lederman ed., 1987); Peterson, *supra* note 161, at 2186.

²¹² See Peterson, *supra* note 161, at 2186–87 (“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.”); Jeremy Carter, *Highlights from Securitization News*, 10 J. STRUCTURED FIN. 97, 98 (2005).

²¹³ Peterson, *supra* note 161, at 2186–87.

²¹⁴ See *id.* at 2188.

²¹⁵ See Carrie Bay, *Residential Mortgage Delinquency Rate Surpasses 10%: LPS*, DSNEWS.COM (Feb. 4, 2010), <http://www.dsnews.com/articles/mortgage-delinquency-rate->

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 were written to borrowers that qualified as “affluent” and identified as white.²¹⁶ While some subprime borrowers could be characterized as first-time home purchasers, a large group of affluent white borrowers attempted to take easy advantage of lax lending standards by taking out subprime loans in order to purchase second or third homes to flip them for quick profit, or to purchase apartment buildings they could not afford. 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”²¹⁷ and “Curb Appeal,”²¹⁸ 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.²¹⁹

According to 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.”²²⁰ In a survey 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.²²¹ The study indicated that much of the fraud involved simply 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.²²² “In other words, many of the people now losing their homes committed fraud. And when a mortgage goes into default in its first year,

surpasses-10-lps-2010-02-04 (“[T]he total rate of noncurrent mortgages sits at 13.3 percent.”).

²¹⁶ See Price, *supra* note 23.

²¹⁷ See *Flip This House* (A&E Television 2010); *Flip This House*, A&E SHOWS, <http://www.aetv.com/flipthishouse/> (last visited June 13, 2011).

²¹⁸ See *Curb Appeal* (Home & Garden Television 2010); *Curb Appeal*, HGTV, <http://www.hgtv.com/curb-appeal/show/index.html> (last visited June 14, 2011).

²¹⁹ See *Investment Property or Residential Property?*, MONEYINSTRUCTOR.COM, <http://www.moneyinstructor.com/art/investmentproperty.asp> (last visited Jan. 26, 2011); SOWELL, *supra* note 2, at 24–27; Scott Bernard Nelson, *House-Flipping Still Offers Opportunity*, MSNBC.COM (Apr. 9, 2007, 9:48 AM ET), <http://www.msnbc.msn.com/id/17985804/>; Barry Ritholtz, *Its ALWAYS a Good Time to Buy a House!*, BIG PICTURE (Mar. 14, 2010, 8:47 AM), <http://www.ritholtz.com/blog/2010/03/its-always-a-good-time-to-buy-a-house/>.

²²⁰ Cowen, *supra* note 62.

²²¹ *Id.*

²²² *Id.*

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."²²³

Without doubt, personal borrowers on many levels entered into mortgages that they should not 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, rather than borrowers, actually committed egregious fraud on many loan applications should at least mute those that attempt to place singular blame on borrowers.²²⁴ 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.²²⁵

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, 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.²²⁶

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.²²⁷

²²³ *Id.*

²²⁴ See Barbara O'Neill, *Predatory and High-Cost Sources of Credit*, EXTENSION, http://www.extension.org/pages/Predatory_and_High-Cost_Sources_of_Credit (last updated Dec. 8, 2009); *Don't Be a Victim of Loan Fraud*, U.S. DEP'T OF HOUS. & URBAN DEV., <http://www.hud.gov/offices/hsg/sfh/buying/loanfraud.cfm> (last visited Jan. 26, 2011).

²²⁵ See Wallison, *supra* note 3.

²²⁶ See Peter J. Wallison, *Deregulation and the Financial Crisis: Another Urban Myth*, AM. ENTERPRISE INST. FOR PUB. POL'Y RES. (Oct. 2009), <http://www.aei.org/outlook/100089>.

²²⁷ *Id.*

A few commentators and economists argue that nearly two-thirds of all subprime loans in 2008 were held by government enterprises.²²⁸ 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 the purchase of securitized subprime mortgage-backed instruments.²²⁹

Although Fannie Mae and Freddie Mac entered the private securitized subprime mortgage-backed market late in the game, they entered that market seeking profit.²³⁰ These GSEs are culpable 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. Further, the GSEs guarantee of many types of subprime loans provided cover for those private bankers that recklessly wrote loans destined to fail knowing that the price on some of those junk loans would be guaranteed by the government through its sponsored entities.²³¹

Still, despite attempts favored in some circles to pin singular blame on the government, particularly Fannie Mae and Freddie Mac, for the market crisis, 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.²³²

Further examples of governmental cover include newspaper reports indicating that the U.S. Department of Housing and Urban Development (HUD) played a role in encouraging Fannie and Freddie's entrée into the subprime mortgage market.²³³ HUD, eager to see homeownership more available to low-income families, urged

²²⁸ See *id.* But see JOHNSON & KWAK, *supra* note 2, at 146 (allowing that a “grain of truth” exists in the argument that Fannie Mae and Freddie Mac bought up large percentages of the junk loans being written by private mortgagers, thereby driving the market, but debunking the argument that Fannie and Freddie’s “guarantee” played a primary role in the foreclosure fiasco).

²²⁹ See Steven Ramirez, Symposium Presentation at West Virginia University: Understanding the Financial Market Crisis: Fannie Mae, Freddie Mac and the Community Reinvestment Act (Oct. 29, 2008) (notes on file with author) (referring to securitized subprime mortgage-backed securities as “mortgage smoothies”); Peterson, *supra* note 164, at 149–52.

²³⁰ See Peterson, *supra* note 164, at 163–67.

²³¹ See Wallison, *supra* note 226.

²³² See JOHNSON & KWAK, *supra* note 2, at 144–46; FED. HOUS. FIN. AGENCY, CONSERVATOR’S REPORT ON THE ENTERPRISES’ FINANCIAL PERFORMANCE – SECOND QUARTER 2010 (2010), available at <http://www.fhfa.gov/webfiles/16591/ConservatorsRpt82610.pdf> (providing evidence that Fannie Mae and Freddie Mac leaned against the housing bubble by staying out of the mortgage-backed securities investment game during most of the build-up, and played a minor role during the raucous subprime days by guaranteeing fewer of the subprime mortgages in 2007 and 2008); Peterson, *supra* note 164, at 167–70; Ramirez, *supra* note 229.

²³³ Leonnig, *supra* note 192.

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.”²³⁴ Department policy allowed HUD to neglect examining borrowers’ ability to make payments on loans that Freddie and Fannie characterized as “affordable.”²³⁵ 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.²³⁶ Based on this late game reckless overleveraging in subprime loans, Fannie and Freddie collapsed under the weight of millions of loan defaults, and as a result, required governmental seizure and bailout.²³⁷

A number of important factors precipitated the collapse of Fannie Mae and Freddie Mac. First, taking its lead from Clinton and Bush II administrations, which both heavily promoted homeownership, Fannie and Freddie recklessly entered the subprime mortgage market, both in guaranteeing and securitizing subprime mortgages and selling them to investors, and in buying up subprime loans, which sustained and incentivized a robust market for the freewheeling writing of subprime loans.²³⁸ 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 their executives. Fannie and Freddie’s reckless pursuit of profit must be considered against their newfound status as privatized entities. During the subprime bubble and breakdown, Fannie and Freddie acted as private firms—private firms with an implicit governmental guarantee of their 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 commentators have gone so far as to actually pin the housing crisis and the severe recession triggered by it on Fannie and Freddie, rather than on foreclosure of privately originated and securitized subprime mortgages or risky speculation in the CDOs and CDS derivatives.²³⁹ While it is 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

²³⁴ *See id.*

²³⁵ *See id.*

²³⁶ *Id.*

²³⁷ *See Peterson, supra note 164, at 151, 169.*

²³⁸ *See McLEAN & NOCERA, supra note 2, at 6–8, 32–35; SOWELL, supra note 2, at 36–45.*

²³⁹ *See Peterson, supra note 164, at 151* (“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.”).

government-sponsored enterprises was simply one of many causes of the meltdown.

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.”²⁴⁰

Unregulated lending, predatory borrowing, predatory lending, and governmental cover all played a role in the collapse of the subprime loan market that 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 the financial crisis causes.²⁴¹ The dirty little myth being analyzed in this Article, 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.²⁴² Still, borrower failure and the role of Fannie and Freddie are merely minor pieces of the meltdown puzzle.

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 Posner²⁴³

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 by the securitized mortgages overturned the table entirely. The profits available to those institutions that traded in securitized mortgage-backed securities overwhelmed most involved to the point of

²⁴⁰ *Id.* at 152.

²⁴¹ See JOHNSON & KWAK, *supra* note 2, at 144–47.

²⁴² See *id.* at 144.

²⁴³ POSNER, *supra* note 40, at 269.

recklessness.²⁴⁴ 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, which 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, despite a higher default rate risk, the 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.

At the outset, a mortgage broker “identifies a potential borrower through a variety of marketing approaches including direct mail, telemarketing, door-to-door solicitation, and television or radio advertising.”²⁴⁵ After contact with a potential borrower is made, the loan broker and loan originator “together identify a loan which may or may not suit the borrower’s needs.”²⁴⁶ Typically, a home mortgage will fund the purchase price of a home, but it might instead consolidate a

²⁴⁴ See Jeanne L. Schroeder, *Wall Street’s Obsession with Bonuses 4–9* (Benjamin N. Cardozo Sch. of Law, Jacob Burns Inst. for Advanced Legal Studies, Paper No. 293, 2010), available at <http://ssrn.com/abstract=1578066>.

²⁴⁵ Peterson, *supra* note 161, at 2208.

²⁴⁶ *Id.*

borrower's other debts or refinance a pre-existing home mortgage.²⁴⁷ 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.²⁴⁸ Once interest rates and pricing terms are set, the consumer formally applies for the mortgage which then typically closes one to two weeks later when the borrower signs all of the necessary paperwork wherein the borrowers become bound to the terms as settled upon.²⁴⁹ At this point, "[s]ome brokers fund the loan directly using their own funds or a warehouse line of credit, while other brokers act as an agent and use the originator's capital to fund the loan."²⁵⁰

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 other similarly situated mortgage loans.²⁵¹ 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, or most commonly, a trust.²⁵² This SPV trust holds no other assets, employs no individuals, and has no function other than owning a pool of mortgage loans.²⁵³ Under the contract that transfers the loans into the pool, the SPV agrees to sell equity pieces, or tranches, of itself to various investors.²⁵⁴ 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."²⁵⁵ Thereafter, the underwriters employ placement agents who work on commission to sell the tranching securities to various investors based on portfolio needs and risk tolerance.²⁵⁶

Prior to engaging the placement agents and selling the securitized mortgage loans, in designing the SPV and its investment tranches, the seller works quite closely with a credit rating agency that is paid by the seller to rate the credit risk of

²⁴⁷ *See id.*

²⁴⁸ *See id.*

²⁴⁹ *See id.* at 2208–09.

²⁵⁰ *See id.* at 2209; Eggert, *supra* note 202, at 538.

²⁵¹ *See id.*; Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133, 142 (1994).

²⁵² *See* Joseph C. Shenker & Anthony J. Colletta, *Asset Securitization: Evolution, Current Issues and New Frontiers*, 69 TEX. L. REV. 1369, 1377–78 (1991); Hill, *supra* note 167, at 1067 n.25, 1098 n.162; Peterson, *supra* note 161, at 2209.

²⁵³ *See* Peterson, *supra* note 161, at 2209.

²⁵⁴ *See* Eggert, *supra* note 202, at 539 n.156; Peterson, *supra* note 161, at 2209.

²⁵⁵ Peterson, *supra* note 161, at 2209.

²⁵⁶ *See id.*

each tranche.²⁵⁷ The credit rating agency is tasked with investigating the credit risk of the underlying mortgages, along with investigating the risks posed from pooling the mortgages together, called respectively, “mortgage risk” and “pool risk.”²⁵⁸ Evaluating mortgage risk requires the credit rating agency to focus on borrower net equity over time, in other words, “the risk that foreclosure on a defaulting mortgage will not recoup invested funds.”²⁵⁹ Evaluating pool risk requires the credit rating agency to examine “factors such as the size of the various loan pool and the geographic diversity of underlying mortgages.”²⁶⁰ 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 of the underlying mortgages because this has ostensibly become the responsibility of the credit rating agencies.²⁶¹ 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.²⁶² This credit enhancement typically entails a “third party guarantee from an insurance company on losses from mortgage default and prepayments.”²⁶³

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, receiving monthly payments, monitoring collateral, and when necessary foreclos[ing] on homes.”²⁶⁴ Occasionally the originator retains the right to service the mortgages, maintaining some connection with homeowners, but typically servicing is outsourced to a

²⁵⁷ See *infra* Part II.C.3; Kenneth P. Morrison, *Observations on Effecting Your First Asset-Backed Securities Offering*, in ACCESSING CAPITAL MARKETS THROUGH SECURITIZATION 41, 44–45 (Frank J. Fabozzi ed., 2001); Peterson, *supra* note 161, at 2209.

²⁵⁸ See Michael F. Molesky, *An Overview of Mortgage Credit Risks from a Rating Agency Perspective*, in THE SECONDARY MORTGAGE MARKET: A HANDBOOK OF STRATEGIES, TECHNIQUES, AND CRITICAL ISSUES IN CONTEMPORARY MORTGAGE FINANCE 317, 318, 324–25 (Jess Lederman ed., 1987); Bunn, *supra* note 2, at 9–13; Peterson, *supra* note 161, at 2209; Georgette C. Poindexter, *Subordinated Rolling Equity: Analyzing Real Estate Loan Default in the Era of Securitization*, 50 EMORY L.J. 519, 544 (2001).

²⁵⁹ Peterson, *supra* note 161, at 2210; Molesky, *supra* note 258, at 317–18, 324–25; Poindexter, *supra* note 258, at 544.

²⁶⁰ Peterson, *supra* note 161, at 2210; Anthony B. Sanders, *Commercial Mortgage-Backed Securities*, in THE HANDBOOK OF MORTGAGE BACKED SECURITIES 661, 667 (Frank J. Fabozzi ed., 5th ed. 2001); Molesky, *supra* note 258, at 317–18, 324–25.

²⁶¹ See Peterson, *supra* note 161, at 2210.

²⁶² See *infra* Part II.C.3; Peterson, *supra* note 161, at 2210.

²⁶³ Peterson, *supra* note 161, at 2210; Robert D. Aicher et al., *Credit Enhancement: Letters of Credit, Guaranties, Insurance, and Swaps (The Clash of Cultures)*, 59 BUS. LAW. 897, 920–21, 930–31 (2004).

²⁶⁴ Peterson, *supra* note 161, at 2210; R.K. Arnold, *Yes, There Is Life on MERS*, 11 PROP. & PROB. 33, 34 (1997).

company specializing in loan servicing.²⁶⁵ 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.²⁶⁶ Further, “[s]ervicing rights also change hands often, ‘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.²⁶⁷ Additionally, securitization deal sellers and trustees typically hire a document custodian to track the voluminous information and paperwork on loans in a pool.²⁶⁸ In recent years, the emergence of a unique company called the Mortgage Electronic Registration System, Inc. (MERS) has played a controversial role in representing originators and sellers and often acting as a foreclosure agent.²⁶⁹ 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.²⁷⁰

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. 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.²⁷¹ 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.²⁷² 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

²⁶⁵ See Elizabeth Renuart, *An Overview of the Predatory Mortgage Lending Process*, 15 HOUSING POL’Y DEBATE 467, 473 (2004); Peterson, *supra* note 161, at 2210.

²⁶⁶ Peterson, *supra* note 161, at 2210; see Richard Levine & Phoebe J. Moreo, *An Investor’s Guide to B Pieces*, in TRENDS IN COMMERCIAL MORTGAGE-BACKED SECURITIES 172, 180 (Frank J. Fabozzi ed., 1998).

²⁶⁷ Peterson, *supra* note 161, at 2211 (quoting Arnold, *supra* note 264, at 35).

²⁶⁸ See Peterson, *supra* note 161, at 2211; Arnold, *supra* note 264, at 34; Peterson, *supra* note 2, at 1362; Poindexter, *supra* note 258, at 539–40.

²⁶⁹ See Arnold, *supra* note 264, at 34; Peterson, *supra* note 2, at 1361; Peterson, *supra* note 161, at 2211.

²⁷⁰ See Peterson, *supra* note 161, at 2208–13.

²⁷¹ See *supra* Part II.B.2; *The Downturn in Facts and Figures*, *supra* note 62.

²⁷² See Cheryl L. Wade, *Let’s Talk About the Lawyers Who Represented Borrowers Who Were Targeted for Predatory Loans*, CORP. JUST. BLOG (Mar. 11, 2010, 10:09 PM), <http://corporatejusticeblog.blogspot.com/2010/03/lets-talk-about-lawyers-who-represented.html>; Scott H. Greenfield, *Mortgage Fraud Costs Lawyer 30 Years of Files*, SIMPLE JUST. BLOG (Feb. 8, 2009, 7:23 AM), <http://blog.simplejustice.us/2009/02/08/mortgage-fraud-costs-lawyer-30-years-of-files.aspx?ref=rss>.

investment vehicle.²⁷³ This process disaggregates the borrower from the lender and commodifies the borrower as a capital stream rather than a consumer.²⁷⁴ 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.²⁷⁵

Once the special purpose vehicles have bundled the mortgages into an investment, then credit rating agencies are employed to assign a risk rating to each securitized tranche.²⁷⁶ That credit rating agencies were misrating the securitized mortgages is now widely understood based on the intimate, conflicted relationship between the underwriting industry and the credit rating agencies that are paid by those the agency is assigned to rate.²⁷⁷ 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.²⁷⁸ 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.²⁷⁹

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 government-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

²⁷³ See Peterson, *supra* note 161, at 2209; Peterson, *supra* note 164, at 156–57.

²⁷⁴ See *supra* Part II.B.2.

²⁷⁵ See Ramirez, *supra* note 229.

²⁷⁶ See *Ex-Moody's Employee Warned S.E.C. on Municipal Bonds*, N.Y. TIMES DEALBOOK (Sept. 30, 2009, 4:05 AM), <http://dealbook.blogs.nytimes.com/2009/09/30/ex-moodys-employee-warned-sec-on-municipal-bonds/>; *Credit Rating Agencies and the Financial Crisis: Hearing Before the H. Comm. on Oversight and Gov't Reform*, 110th Cong. 5–6 (2008), available at <http://house.resource.org/110/org.c-span.281924-1.pdf>.

²⁷⁷ See Bunn, *supra* note 2, at 9–13; *infra* Part II.C.3.

²⁷⁸ See *infra* Part II.C.2.

²⁷⁹ See Louise Story, *Goldman Posts Profit, and Morgan Follows Suit*, N.Y. TIMES, Sept. 17, 2008, at C1; Stephen Foley, *Goldman Star Trader Plans to Go It Alone after Netting Bosses a \$4bn Windfall*, INDEPENDENT, Apr. 18, 2008, at 44; Alejandro Lazo, *Wall Street Begins Quarter with a Bang; Spurred by Financials, Dow Jumps 391*, WASH. POST, Apr. 2, 2008, at D1.

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 that 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 deeply entrenched institution was left desperate as borrowers began to default on subprime loans.²⁸⁰ Each institution that had purchased the securitized subprime mortgage investments had hedged its reckless subprime money grab by entering into credit default swaps contracts primarily purchased through insurers like AIG.²⁸¹

As described briefly above,²⁸² 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 over-the-counter by banks, hedge funds, and other parties. 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.²⁸³ CDS contracts are purported to work similarly to homeowners insurance (which protects against losses from fire, theft, and the like)—but they do not. 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 any party overseeing the trades to ensure the buyer has the resources to cover the losses if the security defaults.²⁸⁴

²⁸⁰ See *The Last Days of Lehman Brothers*, N.Y. TIMES DEALBOOK (Oct. 6, 2008, 8:28 AM EST), <http://dealbook.blogs.nytimes.com/2008/10/06/the-last-days-of-lehman-brothers/?scp=1&sq=Lehman%20Brothers,%20depth%20of%20exposure&st=cs>; Louise Story & Ben White, *The Road to Lehman's Failure Was Littered with Lost Chances*, N.Y. TIMES, Oct. 6, 2008, at B1; John Waggoner & David J. Lynch, *Red Flags in Bear Stearns' Collapse; Uncertainty Could Poison Financial System, Economy*, USA TODAY, Mar. 18, 2008, at A1; Gretchen Morgenson, *A Stock Filing Gone Awry for Bear Stearns*, N.Y. TIMES (June 26, 2007), <http://www.nytimes.com/2007/06/26/business/26bond.html>.

²⁸¹ See INSIDE JOB (Sony Pictures Classics 2010); *American International Group: Examining What Went Wrong, Government Intervention, and Implications for Future Regulation: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 111th Cong. 2 (2009) (statement of Eric Dinallo, Superintendent, New York State Insurance Department), available at http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=8ee655c8-2aed-4d4b-b36f-0ae0ae5e5863; Caroline Salas, *Bear, Lehman, Merrill Trade as Junk, Derivatives Show*, BLOOMBERG (July 31, 2007, 12:26 EDT), <http://www.bloomberg.com/apps/news?pid=20601109&sid=afHmD6FZ2Wpw&refer=home>.

²⁸² See *supra* Part II.A.3.

²⁸³ Johnson, *supra* note 2, at 194; Morrissey, *supra* note 63.

²⁸⁴ Morrissey, *supra* note 63.

AIG had engaged so recklessly in the shadow CDS market, writing 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.²⁸⁵ When Bear Stearns and Lehman Brothers needed insurance payouts for defaulted securitized vehicles, AIG had no ability or capital to repay.

Firms wagering on the ability of the CDS payee to default, through an unregulated short sale, simply added to the economic morass that enabled the financial meltdown.²⁸⁶ That firms could purchase CDS contracts on CDOs that they did not own—not for hedging purposes, but for straight up betting purposes, which is commonly referred to as a naked contract and involves speculating on the potential failure of a particular pool of securitized subprime loans—contributed to the wild unregulated atmosphere that prevailed at the time the capital markets collapsed.²⁸⁷ Subprime mortgage pools were bought up in a frenzy by commercial banks, investment banks, insurance companies, hedge funds, GSEs, and others. These subprime pools were overrated by credit rating agencies and ended up falling precipitously in value as foreclosures mounted on the underlying mortgages in the pools.²⁸⁸ 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 would not, default.²⁸⁹

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.²⁹⁰ ““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’re not playing in the game, but people all over the country are betting on the outcome.””²⁹¹ 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.

²⁸⁵ See Ellen Brown, *Credit Default Swaps: Evolving Financial Meltdown and Derivative Disaster Du Jour*, GLOBAL RES. (Apr. 11, 2008), <http://www.globalresearch.ca/index.php?context=va&aid=8634>; see generally LEWIS, *supra* note 118.

²⁸⁶ See *supra* notes 284–285; Gerald P. Dwyer, *Financial Speculation in Credit Default Swaps*, FED. RES. BANK OF ATLANTA (Mar. 2010), http://www.frbatlanta.org/cenfis/pubscf/vn_speculation.cfm.

²⁸⁷ See Johnson, *supra* note 2, at 206–16; Gerald P. Dwyer, *supra* note 286; Shah Gilani, *The Real Reason for the Global Financial Crisis . . . the Story No One’s Talking About*, MONEY MORNING (Sept. 18, 2008), <http://moneymorning.com/2008/09/18/credit-default-swaps>.

²⁸⁸ Gilani, *supra* note 287.

²⁸⁹ See Johnson, *supra* note 2, at 210–12; Dwyer, *supra* note 286; Gilani, *supra* note 287.

²⁹⁰ Gilani, *supra* note 287.

²⁹¹ Morrissey, *supra* note 63 (quoting Andrea Pincus, partner at Reed Smith LLP); see also Johnson, *supra* note 2, at 206–10 (describing the speculative nature of entering into naked credit default swap contracts).

CDS investors were left wondering if the parties holding the CDS insurance after multiple trades had the financial wherewithal to meet their contractual obligations in the event of mass defaults.²⁹² This 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. Trading of these instruments occurred on shadow markets, where capital reserve requirements and clearing were unnecessary and in some instances legislatively prohibited.²⁹³ CDSs had been traded and shorted to the point that the CDO holder often had no clue as to where the CDS currently resided or what the underlying firm's capitalization or prospects to pay looked like.²⁹⁴ 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.²⁹⁵ 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.

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.²⁹⁶ 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.²⁹⁷

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

²⁹² See Gilani, *supra* note 287.

²⁹³ See *supra* Part II.A.2.

²⁹⁴ See Johnson, *supra* note 2, at 206–16.

²⁹⁵ Gilani, *supra* note 287; Johnson, *supra* note 2, at 210–12.

²⁹⁶ See Peterson, *supra* note 161, at 2208–11; JOHNSON & KWAK, *supra* note 2, at 94, 128–29, 140, 149.

²⁹⁷ See generally Michael J. de la Merced, *Findings on Lehman Take Even Experts by Surprise*, N.Y. TIMES, Mar. 13, 2010, at B1 (finding that examiner Anton R. Valukas's report on the demise of Lehman "provided plenty of material for civil regulatory action at the least with his findings of 'materially misleading' accounting and 'actionable balance sheet manipulation.'"); Grace Wong & Aaron Smith, *What Killed Lehman*, CNNMONEY.COM (Mar. 15, 2010, 10:29 AM EST), http://money.cnn.com/2010/03/12/news/companies/lehman_examiner/index.htm?hpt=T1 (describing the failures at Lehman Brothers that precipitated its bankruptcy filing, including "'repeatedly exceed[ing] its own internal risk limits and controls'").

instruments early in the twentieth century, and continue today, by giving letter grades to debt vehicles in connection with the likelihood of the instrument's default or failure to pay.²⁹⁸ 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.²⁹⁹

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 as 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.³⁰⁰ 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.³⁰¹ 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).³⁰² 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.³⁰³ Fourth, the credit rating agencies overrelied on outdated risk modeling and dissimilar historical data which negatively impacted the accuracy of the ratings that they provided.³⁰⁴ 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

²⁹⁸ See *Ratings Definitions*, MOODY'S, <http://v3.moody's.com/ratings-process/Ratings-Definitions/002002> (last visited Jan. 26, 2011).

²⁹⁹ See *id.*; Bunn, *supra* note 2, at 9–13.

³⁰⁰ See Anna Katherine Barnett-Hart, *The Story of the CDO Market Meltdown: An Empirical Analysis* 3–7, 16–26 (Mar. 19, 2009) (unpublished B.A. thesis, Harvard College), available at <http://www.hks.harvard.edu/m-rcbg/students/dunlop/2009-CDO-meltdown.pdf>. As Barnett-Hart explained, "Overall, the credit ratings of CDOs have been an utter disaster." *Id.* at 26.

³⁰¹ See SEC, SUMMARY REPORT OF ISSUES IDENTIFIED IN THE COMMISSION STAFF'S EXAMINATIONS OF SELECT CREDIT RATING AGENCIES 7–10 (2008), available at <http://www.sec.gov/news/studies/2008/craexamination070808.pdf>; Bunn, *supra* note 2, at 9.

³⁰² See Bunn, *supra* note 2, at 9–10; Barnett-Hart, *supra* note 300, at 17; AMERICAN CASINO (Table Rock Films 2009).

³⁰³ See SEC, *supra* note 301, at 13–20; Bunn, *supra* note 2, at 9; AMERICAN CASINO, *supra* note 302.

³⁰⁴ See SEC, *supra* note 301, at 35; Bunn, *supra* note 2, at 9–10.

during the rating process in order to prevent losing an important underwriting client.³⁰⁵

These failures and pressures set the table for the ratings disaster that eventuated. Nearly “80 percent of \$1.4 trillion in subprime debt issued between 2005–2007 was [wrongly represented as] triple-A rated securities.”³⁰⁶ 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 or fraudulent 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.³⁰⁷ Credit rating agencies are culpable in large part for igniting the subprime mortgage bond market.

4. Regulatory Capture

Arthur Levitt, former chair of the SEC, stated, “As an overheated market needed a strong referee to rein in dangerously risky behavior, the commission too often remained on the sidelines.”³⁰⁸ 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.”³⁰⁹ Not only was there a relaxation of enforcement, there was also a reduction in SEC staff.³¹⁰ 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.³¹¹

Regulators, a favorite target of many in postcrisis 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. The SEC was presented with evidence on five or six occasions that Madoff was engaged in a scheme that could not possibly be sustained if the numbers were run carefully.³¹²

³⁰⁵ See SEC, *supra* note 301, at 31; see also Bunn, *supra* note 2, at 10.

³⁰⁶ See Aaron Unterman, *Innovative Destruction: Structured Finance & Credit Market Reform in the Bubble Era*, 5 HASTINGS BUS. L.J. 53, 66 n.36 (2009) (citing DAVID GREENLAW ET AL., *LEVERAGED LOSSES: LESSONS FROM THE MORTGAGE MARKET MELTDOWN* 17 (2008)).

³⁰⁷ See AMERICAN CASINO, *supra* note 302.

³⁰⁸ Eric Lichtblau, *Federal Cases of Stock Fraud Drop Sharply*, N.Y. TIMES, Dec. 25, 2008, at A1.

³⁰⁹ *Id.*

³¹⁰ See *id.*

³¹¹ See *id.*

³¹² See SEC OFFICE OF INSPECTOR GEN., INVESTIGATION OF FAILURE OF THE SEC TO UNCOVER BERNARD MADOFF’S PONZI SCHEME 1 (2009) (Case No. OIG-509) (submitted by Inspector General H. David Kotz), available at <http://www.sec.gov/news/studies/2009/oig-509-exec-summary.pdf> (“The OIG investigation did find . . . that the SEC received

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.”³¹³ 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.³¹⁴ The SEC drew significant fire for its failure to properly regulate and investigate Bernie Madoff.³¹⁵

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.³¹⁶ Others 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.³¹⁷ The financial market crisis minefield is littered with failed regulators, beginning with the SEC and carving a wide swath through the Federal Reserve Bank, the FDIC, the Commodity Futures Trading Commission (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

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.”); Binyamin Appelbaum & 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, at D1.

³¹³ See Binyamin Appelbaum & David S. Hilzenrath, *SEC Ignored Credible Tips About Madoff, Chief Says*, WASH. POST, Dec. 17, 2008, at D1. (“Our initial findings have been deeply troubling,” [SEC Chairman Christopher] 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.”).

³¹⁴ See *supra* notes 312–313; Kara Scannell, *Madoff Chasers Dug for Years, to No Avail: Regulators Probed at Least 8 Times over 16 Years; Congress Starts Review of SEC Today*, WALL ST. J., Jan. 5, 2009, at C1

³¹⁵ See Stephen Labaton, *SEC Knew Him As Foe and Friend*, N.Y. TIMES, Dec. 18, 2008, at B1; Gregory Zuckerman, *The Madoff Fraud Case: Fees, Even Returns and Auditor All Raised Flags*, WALL ST. J., Dec. 13, 2008, at A7; Jesse Westbrook et al., *Madoff Tipster Markopolos Cites SEC's "Ineptitude"*, BLOOMBERG (Feb. 4, 2009, 12:03 EST), <http://www.bloomberg.com/apps/news?pid=20601103&sid=axvJfch6PDjs>.

³¹⁶ See Poser, *supra* note 145, at 309 (“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 . . . particularly in connection with the recent SEC enforcement failures.”); see generally HARRY MARKOPOLOS, *NO ONE WOULD LISTEN: A TRUE FINANCIAL THRILLER* (2010) (describing his multiple attempts to get the SEC to investigate Bernie Madoff, to no avail); Paul Krugman, Op-Ed., *The Madoff Economy*, N.Y. TIMES, Dec. 19, 2008, at A45.

³¹⁷ See Westbrook, *supra* note 315.

were spending working hours viewing pornography on their government issued computers.³¹⁸ 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 Abucus 2007-AC1 investment vehicle structured in consultation with client John Paulson,³¹⁹ it continues to receive withering criticism for its myriad shortcomings.

5. *Balance Sheet Fraud*

Despite the machinations of the Sarbanes-Oxley Act,³²⁰ 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,³²¹ accounting fraud continues to be perpetrated by some of the nation’s most important financial institutions.³²² 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 accounting fraud engaged by some of Wall Street’s most important players.³²³ As the gravity of the subprime crisis failures became apparent to Lehman Brothers, company executives engaged in accounting fraud to secret the losses from the public and present a picture of vitality to the investing community.³²⁴ The very fraud that Sarbanes-Oxley was

³¹⁸ See Daniel Wagner, *SEC Porn Probe: Staffers Watched Porn as Economy Crashed*, HUFFINGTON POST (Apr. 22, 2010, 11:44 PM EST), http://www.huffingtonpost.com/2010/04/23/sec-porn-probe-staffers-w_n_548931.html#.

³¹⁹ See Press Release, SEC, SEC Charges Goldman Sachs with Fraud in Structuring and Marketing of CDO Tied to Subprime Mortgages (Apr. 16, 2010), available at <http://www.sec.gov/news/press/2010/2010-59.htm>; Alistair Barr, *Goldman Charged with Fraud over Paulson CDO Trade*, MARKETWATCH (Apr. 16, 2010, 3:00 PM EDT), <http://www.marketwatch.com/story/goldman-charged-with-fraud-over-paulson-cdo-trade-2010-04-16>.

³²⁰ See generally Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, (codified as amended in scattered sections of 18 U.S.C.) (legislation that introduced major changes to the regulation of financial practice and corporate governance).

³²¹ See Cummings, *Ain't No Glory in Pain*, *supra* note 42, at 1061 (“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 . . .”).

³²² See Jacob Goldstein, *Repo 105: Lehman's 'Accounting Gimmick' Explained*, NPR (Mar. 12, 2010, 11:55 AM), http://www.npr.org/blogs/money/2010/03/repo_105_lehmans_accounting_gi.html; *Ex-Lehman C.F.O. Criticizes Repo 105*, N.Y. TIMES DEALBOOK (Mar. 12, 2010, 1:02 PM), <http://dealbook.blogs.nytimes.com/2010/03/12/ex-lehman-c-f-o-criticizes-repo-105/>.

³²³ See Goldstein, *supra* note 322; *Ex-Lehman C.F.O. Criticizes Repo 105*, *supra* note 322.

³²⁴ See Goldstein, *supra* note 322; *Ex-Lehman C.F.O. Criticizes Repo 105*, *supra* note 322.

supposed to cover—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.”³²⁵ Indeed, reports indicate that Bank of America may have also used that accounting mechanism to conceal bad assets in order to prop up its balance sheet during the same crisis period.³²⁶

Further, if not outright fraudulent, recent reports indicate that 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.³²⁷

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.³²⁸

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.

In February 2002, Greenspan underscored how simple it was for chief executive officers 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.”³²⁹ 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.

³²⁵ See Goldstein, *supra* note 322; *Ex-Lehman C.F.O. Criticizes Repo 105*, *supra* note 322.

³²⁶ See John Hempton, *Repo 105’s Antecedents: Ken Lewis*, BRONTE CAPITAL (Mar. 20, 2010, 12:03 PM), <http://brontecapital.blogspot.com/2010/03/repo-105s-antecedents-ken-lewis.html>; *BofA: Our Accounting Followed the Rules*, N.Y. TIMES DEALBOOK (Mar. 24, 2010, 10:12 AM), <http://dealbook.blogs.nytimes.com/2010/03/24/bofa-our-accounting-was-within-the-rules/>; Ryan Chittum, *Audit Notes: Hapless SEC, Murdoch’s Mega-Losses, BofA Repo 105*, COLUM. JOURNALISM REV. (Mar. 23, 2010, 8:05 PM), http://www.cjr.org/the_audit/audit_notes_hapless_sec_murdoc.php.

³²⁷ See Kate Kelly et al., *Big Banks Mask Risk Levels: Quarter-End Loan Figures Sit 42% Below Peak, Then Rise as New Period Progresses*, WALL ST. J., Apr. 9, 2010, at C1.

³²⁸ *Id.*

³²⁹ Ron Suskind, Op-Ed., *The Crisis Last Time*, N.Y. TIMES, Sept. 25, 2008, at A29.

6. CEO Primacy

Commentators now argue that corporate law in the United States has evolved to a point where the chief executive officer (CEO) reigns supreme as nearly untouchable in the modern marketplace.³³⁰ 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.³³¹ 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.³³² According to Professor Steven Ramirez, “CEOs of public companies have the unique privilege of picking their own nominal supervisors—the board of directors.”³³³

The CEO in the United States has the power to appoint the board of directors that “oversees” his performance,³³⁴ to maneuver board members off of the board if they challenge his decisions,³³⁵ to establish his compensation through the board committee that he appoints,³³⁶ to make reckless decisions that are protected by the business judgment rule,³³⁷ to exercise nearly unfettered power (as the duty of care and duty of loyalty have been judicially emasculated to the point of near nonexistence),³³⁸ and to escape private shareholder lawsuits (as class action

³³⁰ Steven Ramirez, *The Special Interest Race to CEO Primacy and the End of Corporate Governance Law*, 32 DEL. J. CORP. L. 345, 345 (2007) (“Corporate governance law in the United States is deeply flawed.”).

³³¹ See Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 679 (2007); Ramirez, *supra* note 330, at 345–46.

³³² See Thomas W. Joo, *A Trip Through the Maze of “Corporate Democracy”*: *Shareholder Voice and Management Compensation*, 77 ST. JOHN’S L. REV. 735, 758–60 (2003).

³³³ Ramirez, *supra* note 135, at 55 (describing the proxy rules that essentially allow the CEO and management to determine who leads a corporation and to establish significant obstacles for shareholders who wish to nominate persons for the board of directors); Steven Ramirez, *The End of Corporate Governance Law: Optimizing Regulatory Structures for a Race to the Top*, 24 YALE J. ON REG. 313, 332 (2007) [hereinafter Ramirez, *The End of Corporate Governance Law*].

³³⁴ Ramirez, *supra* note 135, at 56 (“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.”).

³³⁵ 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).

³³⁶ See Ramirez, *The End of Corporate Governance Law*, *supra* note 333, at 333, 340.

³³⁷ See Marc I. Steinberg, *The Evisceration of the Duty of Care*, 42 SW. L.J. 919, 923 (1988); Steven Ramirez, *The Chaos of Smith*, 45 WASHBURN L.J. 343, 344 (2006).

³³⁸ See Bebchuk, *supra* note 331, at 732; Ramirez, *The End of Corporate Governance Law*, *supra* note 333, at 329, 335.

securities fraud actions have been congressionally neutered to a near terminal state).³³⁹ 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.³⁴⁰

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 firms 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.³⁴¹ Short-term profit, tied into 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.³⁴²

Nearly all the corporate executives that steered their companies into the subprime mortgage morass walked away with bonuses and compensation, not jail time.³⁴³ In the ultimate irony, some of the compensation paid to these reckless executives came from the very TARP bailout funds that were needed to keep the overleveraged firms afloat.³⁴⁴ While corporate executives that recklessly capsized their firms avoid jail time and any significant consequence for their actions, many minority borrowers, who are underhandedly blamed by some for causing the crisis, find themselves saddled with subprime mortgages that were delivered to them predatorily.³⁴⁵

D. Summation

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

We foolishly believed that the firms had a strong culture of self-preservation and responsibility and would have the discipline not to be

³³⁹ See *supra* Part II.A.4. (describing the Private Securities Litigation Reform Act); Ramirez, *supra* note 134, at 1055–60.

³⁴⁰ Ramirez, *The End of Corporate Governance Law*, *supra* note 333, at 336–37.

³⁴¹ See McClendon, *supra* note 174, at 134, 138–39.

³⁴² See generally LEWIS, *supra* note 118 (describing the near insane pursuit of profits by Wall Street executives and the role that subprime mortgage securitization played in that dogged pursuit).

³⁴³ See Ramirez, *supra* note 2, at 91, 100 (describing the hoarding of capital by Wall Street firms using taxpayer bailout funds to improve balance sheets and post record profits rather than lending to a cash-strapped citizenry).

³⁴⁴ See Canova, Symposium Presentation, *supra* note 65.

³⁴⁵ See Johnson, *supra* note 201, at 176.

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.³⁴⁶

The "Group of 20,"³⁴⁷ meeting shortly after the U.S. Government acted in a desperate attempt to keep its primary financial institutions from collapsing by passing TARP,³⁴⁸ released its "Declaration of the Summit on Financial Markets and the World Economy" on November 15, 2008, 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 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.³⁴⁹

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, the Obama administration, congressional leaders, and market regulators have a critical responsibility to 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

³⁴⁶ Stephen Labaton, *Agency's '04 Rule Let Banks Pile Up New Debt and Risk*, N.Y. TIMES, Oct. 3, 2008, A1 (quoting Duke Law Professor James Cox).

³⁴⁷ See *About G-20*, G20.ORG, http://www.g20.org/about_what_is_g20.aspx (last visited June 15, 2011) ("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.")

³⁴⁸ Troubled Asset Relief Program (TARP) of 2008, Pub. L. 110-343, §§ 101-36, 122 Stat. 3765, 3767-3800.

³⁴⁹ See *Declaration Summit on Financial Markets and the World Economy*, G20.ORG (Nov. 15, 2008), http://www.g20.org/Documents/g20_summit_declaration.pdf.

investors.³⁵⁰ As “Main Street” citizens continue today to suffer from rugged unemployment statistics, continued tightening of credit, continued depression of housing prices, and destroyed retirement and college savings accounts, congressional leaders, academics, and economists must seriously examine the true causes of the meltdown, across the board, and adopt new, fresh, and sensible regulation, of which the Dodd-Frank Act does not qualify, that protects the American investor and citizen.³⁵¹ 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 minority-borrower narrative that has been disseminated and adopted by a curious swath of American citizens and commentators. The dirty little myth, in the penultimate misdirection, attempts to pin ultimate blame for the financial market crisis on minority borrowers, through the Community Reinvestment Act, Fannie Mae, and Freddie Mac.

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 mostly white male Wall Street executives, a mostly white male Congress, 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.³⁵² This mutation was on clear display in the days, weeks, and months following the financial market meltdown of 2008, as the minority-borrower narrative spread like a virus throughout the nation. That minority-borrower myth has not subsided in the months that have passed. Today, the minority scapegoating has transmogrified into

³⁵⁰ See U.S.A. Patriot Act, Pub. L. No. 107-56, 115 Stat. 272 (2001) (codified in scattered sections of 8 U.S.C., 15 U.S.C., 18 U.S.C., 22 U.S.C., 31 U.S.C., 42 U.S.C., 49 U.S.C., 50 U.S.C.); Private Securities Litigation Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.); Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 18 U.S.C.); TARP, §§ 101–36.

³⁵¹ See andré douglas pond cummings, *Momentum Builds for Reform*, CORP. JUST. BLOG (Apr. 9, 2010, 3:09 AM), <http://corporatejusticeblog.blogspot.com/2010/04/momentum-builds-for-reform.html>.

³⁵² See andré douglas pond cummings, *A Furious Kinship, Critical Race Theory and the Hip Hop Nation*, 48 LOUISVILLE L. REV. 499, 500–07 (2010) (describing the evolution of critical race theory).

a racial coding blame game where now rather than pointing specifically at minority borrowers, it is the Community Reinvestment Act, Fannie Mae, and Freddie Mac that are blamed by many, in racial code, for causing the meltdown of 2008.

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 particular news sources, various commentators, and Web 2.0.³⁵³ 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.³⁵⁴ 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 minority-borrower myth, against the will of the lenders.³⁵⁵

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 visibly shaken.³⁵⁶ 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.³⁵⁷ Thereafter a strange dance materialized where the Bush II 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

³⁵³ See Edsall, *supra* note 23; Lapon, *supra* note 23; *Fox News Blames Black People for Financial Meltdown*, YOUTUBE (Sept. 22, 2008), <http://www.youtube.com/watch?v=q9O1hpeO-qQ&feature=related>; *Coulter on Bailout Lies – “Social Justice” Obomination*, *supra* note 23.

³⁵⁴ See sources cited *supra* note 353.

³⁵⁵ See Birkey, *supra* note 23; *Morning Joe* (MSNBC television broadcast Feb. 20, 2009), available at <http://mediamatters.org/research/200902200006> (interview by Joe Scarborough with Patrick Buchanan).

³⁵⁶ See Jeanne Sahadi, ‘Sobering Moment,’ CNNMONEY (Sept. 20, 2008, 9:13 AM), http://money.cnn.com/2008/09/19/news/economy/what_lawmakers_heard/index.htm?postversion=2008091922.

³⁵⁷ See *id.*; PAULSON, *supra* note 82, at 266; Jeannine Aversa, *Dire Warnings Fail to Sway Senators on Big Bailout*, HUFFINGTON POST (Sept. 23, 2008, 10:44 PM), http://www.huffingtonpost.com/2008/09/23/bush-team-congress-haggle_n_128501.html.

up the U.S. economy by bailing out Wall Street financial institutions whose leadership had driven them to the point of utter collapse.³⁵⁸

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 repay³⁵⁹ all made possible by the Community Reinvestment Act, Fannie Mae, and Freddie Mac seemed absurd to many, but found unbelievable traction.³⁶⁰ Neal Cavuto on Fox News stated “loaning to minorities and risky folks is a disaster.”³⁶¹ Ann Coulter, in an article she authored, stated in the headline, “They Gave Your Mortgage to a Less Qualified Minority.”³⁶² Representative 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.’”³⁶³ In fact, according to the myth, the overzealous enforcement by the 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.”³⁶⁴ This is simply false.³⁶⁵

Former presidential candidate Pat Buchanan on MSNBC’s Morning Joe stated flatly, “[T]he Feds leaned on banks and threatened some of these banks [saying] ‘[y]ou’ve got to make more loans,’ . . . and pushed them out

³⁵⁸ See John Gress, *Obama Looking at \$850 Billion Jolt to the Economy*, USA TODAY, Dec. 17, 2008, http://www.usatoday.com/news/washington/2008-12-17-stimulus_N.htm; see generally JOHNSON & KWAK, *supra* note 2 (describing the breathtaking account of governmental largesse in bailing out Wall Street banks).

³⁵⁹ See Edsall, *supra* note 23; Gross, *supra* note 23.

³⁶⁰ 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.” *Community Reinvestment Act*, FED. FIN. INSTITUTIONS EXAMINATION COUNCIL, <http://www.ffiec.gov/cra/> (last modified Apr. 14, 2011, 2:03 PM).

³⁶¹ See Lapon, *supra* note 23; *Fox News Blames Black People for Financial Meltdown*, *supra* note 353.

³⁶² Edsall, *supra* note 23; *Coulter on Bailout Lies – “Social Justice” Obamination*, *supra* note 23.

³⁶³ See Birkey, *supra* note 23; *Michelle Bachmann: Poor Minorities Responsible for Economic Crisis*, YOUTUBE (Sept. 26, 2008), <http://www.youtube.com/watch?v=4DHuxHyafyM>.

³⁶⁴ Lapon, *supra* note 23.

³⁶⁵ See *infra* notes 400, 402 and accompanying text; Interview with Pam Hennes, Compliance Dir. and Operations Manager, Deerwood Bank, in Baxter, Minn. (Mar. 27, 2010) (describing the requirements of the Community Reinvestment Act and affirmatively disavowing that the CRA mandates any quotas or forces any lending to minority borrowers); Robert Gordon, *Did Liberals Cause the Sub-Prime Crisis?*, AM. PROSPECT (Apr. 7, 2008), http://www.prospect.org/cs/articles?article=did_liberals_cause_the_sub_prime_crisis; Aaron Pressman, *Community Reinvestment Act Had Nothing to Do with Subprime Crisis*, BLOOMBERG BUSINESSWEEK (Sept. 29, 2008), http://www.businessweek.com/investing/insights/blog/archives/2008/09/community_reinv.html.

. . . 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.”³⁶⁶ To which Joe Scarborough responded, “And that’s what happened. Banks made bad loans. They sold it to Fannie and Freddie.”³⁶⁷ While many reputable sources were quick to discredit the claim³⁶⁸ and denounce Buchanan, Scarborough, Cavuto, and Coulter,³⁶⁹ the myth had been unleashed and it began to creep into households and mindsets across the country.³⁷⁰ Politicians, pundits, and economists served up minority borrowers and governmental social steering as the primary cause of a near global meltdown.

Not surprisingly, 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.³⁷¹ 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.³⁷² Despite overwhelming evidence that the private sector’s profligation was at the root of the subprime

³⁶⁶ See *Morning Joe*, *supra* note 355.

³⁶⁷ See *id.*

³⁶⁸ See Letter from Ben Bernanke, Chairman, U.S. Fed. Reserve, to Robert Menendez, U.S. Senator (Nov. 25, 2008) [hereinafter Letter from Ben Bernake], available at <http://menendez.senate.gov/pdf/112508ResponsefromBernankeonCRA.pdf>.

³⁶⁹ See Edsall, *supra* note 23; Lapon, *supra* note 23.

³⁷⁰ See Carpentier, *supra* note 84 (describing an ABC News Poll where less than 50% of Republicans polled did not believe that Wall Street banks were the cause of the recession); see also *Three-Quarters Say the Banks Still Need to Make Amends*, ABC WORLD NEWS (Mar. 22, 2010), <http://abcnews.go.com/images/PollingUnit/1106a2The%20Banks.pdf> (“There also are partisan gaps in criticism of the banks more broadly—nearly two-thirds of Democrats and independents alike assign them significant blame for the recession, but just under half of Republicans agree. And there’s a similar gap in views of whether banks and related institutions have a responsibility to help Americans who are still struggling with the economy. Seventy-nine percent of 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.”).

³⁷¹ See Cheryl Wade, Professor of Law, St. John’s Sch. of Law, Panel Address at the University of Utah S.J. Quinney College of Law Symposium: The Financial Crisis: Regulatory & Corporate Governance Critiques & Reforms (Sept. 25, 2009), available at <http://www.ulaw.tv/videos/financial-crisis-symposium---morning-session/791>; see also Keller, *supra* note 26 (“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.’” (alteration in original)).

³⁷² See *Rush Limbaugh Show: There’s a Big Idea at Stake in the Democrat-Caused Financial Crisis* (Premier Radio Networks broadcast Sept. 22, 2008), http://www.rushlimbaugh.com/home/daily/site_092208/content/01125108.guest.html.

securitization frenzy,³⁷³ Limbaugh suspended the truth to perpetuate his own peculiar mythmaking.

The minority-borrower narrative 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,³⁷⁴ 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 in the panic-stricken period that gripped Congress and the nation in September and October 2008,³⁷⁵ it found traction at America's dinner tables and some boardrooms and now continues to rear its head in unsettling settings today.³⁷⁶ 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.³⁷⁷ No longer is it just Representative Bachmann, pundits, and talk radio agitators that push the dirty little myth³⁷⁸—it continues to exist and persist as currently peddled by economists,³⁷⁹ think tank employees,³⁸⁰ bloggers and reporters,³⁸¹ and family reunion attendees.

³⁷³ See *supra* Part II.C.

³⁷⁴ See Gross, *supra* note 23.

³⁷⁵ See PAULSON, *supra* note 82, at 250–77 (detailing the initiation of TARP).

³⁷⁶ See cummings, Panel: Post Racialism and the Financial Market Crisis, *supra* note 30 (describing mutual fund presidents that blame the Community Reinvestment Act and minority borrowers for the miserable performance of their mutual funds); Pressman, *supra* note 365 (providing more than two hundred reader comments to the online Pressman article, which reveal the vitriol that hundreds of commentators have toward the Community Reinvestment Act, and that they blame it—and minorities—for causing the financial crisis).

³⁷⁷ See, e.g., Peter Schweizer, *A Poisonous Cocktail*, FORBES.COM (Oct. 5, 2009, 12:01 AM EST), <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.”).

³⁷⁸ See *Right-Wing Media Criticize Financial Reform with Regurgitated Myth that Affordable Housing Caused Financial Crisis*, MEDIAMATTERS (Apr. 21, 2010, 3:23 PM EST), <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*, MEDIAMATTERS (Apr. 20, 2010, 11:14 PM EST), <http://mediamatters.org/research/201004200058> (showing Sean Hannity's Fox News program where he

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.³⁸² 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.³⁸³ Accordingly, Sowell argues that 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.³⁸⁴ Government policy since George H. W. Bush has 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.³⁸⁵ 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

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).

³⁷⁹ See Thomas J. DiLorenzo, *The Government-Created Subprime Mortgage Meltdown*, LEWROCKWELL.COM (Sept. 6, 2007), <http://www.lewrockwell.com/dilorenzo/dilorenzo125.html>; SOWELL, *supra* note 2, at 36–37, 39, 41, 95–109; Stan Liebowitz, *Anatomy of a Train Wreck: Causes of the Mortgage Meltdown*, in HOUSING AMERICA: BUILDING OUT OF A CRISIS 287, 317–19 (2009); Howard Husock, Op-Ed, *Housing Goals We Can't Afford*, N.Y. TIMES, Dec. 11, 2008, at A41; Thomas J. DiLorenzo, *The CRA Scam and Its Defenders*, LUDWIG VON MISES INST. (Apr. 30, 2008), <http://mises.org/daily/2963>; Liebowitz, *supra* note 27.

³⁸⁰ See Wallison, *supra* note 28.

³⁸¹ See Noel Sheppard, *IBD: Carter More to Blame for Financial Crisis than Bush or McCain*, NEWSBUSTERS (Sept. 20, 2008, 3:29 PM), <http://www.newsbusters.org/blogs/noel-sheppard/2008/09/20/ibd-carter-more-blame-financial-crisis-bush-or-mccain>; Jeff Jacoby, *Frank's Fingerprints Are All Over the Financial Fiasco*, BOS. GLOBE, Sept. 28, 2008, at D9; Derbyshire, *supra* note 28; Weinstein, *supra* note 28.

³⁸² See generally SOWELL, *supra* note 2, at 36–37, 39–41 (describing the role that Sowell believes the Community Reinvestment Act and governmental intrusion played in the financial market crisis and mortgage market collapse); see also *Thomas Sowell on the Housing Boom and Bust*, YOUTUBE (Jan. 26, 2010), <http://www.youtube.com/watch?v=5GoAGuTibVY> (showing Sowell's conviction that lax lending standards pushed by various government programs and entities led to a regionalized housing bubble and a mortgage industry collapse).

³⁸³ See SOWELL, *supra* note 2, at 36–45.

³⁸⁴ See *id.*

³⁸⁵ See *id.* at 41–42.

roots of the financial market fiasco.³⁸⁶ 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 Act forced banks to adopt quotas by requiring them to loan to poor borrowers of color—i.e., affirmative action in lending.³⁸⁷

Extending the myth of governmental social engineering as a primary cause of the financial market crisis, in 2009, Congress established a commission, styled the Financial Crisis Inquiry Commission (FCIC) that was charged with drilling down into the root causes of the financial market crisis.³⁸⁸ The FCIC was ordered to conduct an exhaustive investigation, and upon completion, submit a report to Congress that would identify all of the causes and failures that precipitated the meltdown.³⁸⁹ This bipartisan commission, after conducting hundreds of hours of interviews, began fracturing. In December 2010, the four Republican members of the ten-member FCIC forced a vote in advance of the official report due date where they demanded that the following terms be banned from the final version of the official report: "Wall Street," "shadow banking," and "deregulation."³⁹⁰ When the Republican committee members' proposal to ban these terms was rejected by the five Democratic members and the one Independent member, the Republican commissioners defected from the FCIC and became determined to issue their own report, called the "Financial Crisis Primer."³⁹¹

The nine-page Republican Financial Crisis Primer, with precious little factual support, bewilderingly ignores Wall Street's role in the financial market crisis, refuses to mention deregulation, credit default swaps, and reckless decision making by Wall Street executives, and instead, focuses fundamentally on the role of Fannie Mae, Freddie Mac, and the goal of homeownership in poor communities as the

³⁸⁶ See *id.* at 146–47.

³⁸⁷ E.g., Schweizer, *supra* note 377.

³⁸⁸ See Fraud Enforcement & Recovery Act of 2009, Pub. L. No. 111-21, § 5, 123 Stat. 1617, 1625–31 (2009).

³⁸⁹ *Id.*

³⁹⁰ See Brady Dennis & Zachary A. Goldfarb, *Financial Crisis Probe Ends with Partisan Vote on Report*, WASH. POST, Jan. 8, 2011, at A07; Kathleen Parker, Editorial, *Washington's Weasel Words*, WASH. POST, Dec. 19, 2010, at A21; Shahien Nasiripour, *Financial Crisis Panel in Turmoil as Republicans Defect; Plan to Blame Government for Crisis*, HUFFINGTON POST (Dec. 15, 2010, 12:17 AM), http://www.huffingtonpost.com/2010/12/14/financial-crisis-panel-wall-street_n_796839.html.

³⁹¹ See *Republican Commissioners on the Financial Crisis Inquiry Commission Financial Crisis Primer Questions and Answers on the Causes of the Financial Crisis*, BIG PICTURE (Dec. 16, 2010, 7:06 AM), available at <http://www.ritholtz.com/blog/2010/12/republican-commissioners-on-the-financial-crisis-inquiry-commission-financial-crisis-primer-questions-and-a-answers-on-the-causes-of-the-financial-crisis/>.

primary causes of the financial market crisis.³⁹² No longer is the mythmaking reserved for pundits and an occasional economist—now the Republican commissioners have issued a report that whitewashes Wall Street’s role in the crisis, effectively rewriting history.³⁹³

From this massive mutation, the minority-borrower narrative has grown, appeared on headline news programs, and dominated dinner table discussions.³⁹⁴ 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 private market discipline, responsibility, and regulation, in place of voracity and greed, demonstrates the depth of the mutation and the distortion of those who should accept responsibility (the list is lengthy), but still unfailingly refuse.³⁹⁵

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 minority borrower and governmental social engineering mythmakers in the days following the near collapse of the financial markets blaming the Community Reinvestment Act (CRA) 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,

³⁹² See Paul Krugman, Op-Ed., *Wall Street Whitewash*, N.Y. TIMES, Dec. 17, 2010, at A39.

³⁹³ See *id.*; Michael Powell, *Obama the Centrist Irks a Liberal Lion*, N.Y. TIMES, Jan. 8, 2011, at B1 (“If you widen the lens, the public is being sold a lie—that our [economic] problems owe to unions and the size of government and not to fraud and deregulation and the vast concentration of wealth. Obama’s failure is that he won’t challenge this Republican narrative, and give people a story that helps them connect the dots and understand where we’re going.”).

³⁹⁴ See *supra* notes 352–386 and accompanying text.

³⁹⁵ See Rich, *supra* note 49 (“[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.’”).

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.³⁹⁶

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.”³⁹⁷ In truth, with the guidelines imposed by the Community Reinvestment Act, efforts to open the mortgage pipeline to minority groups have proved successful.³⁹⁸ 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.³⁹⁹ Studies show that the CRA inspired responsible lending and opened homeownership to American citizens previously shut out, and that loans written to borrowers through the CRA default significantly less often than peer loan vehicles and those written by independent mortgage companies.⁴⁰⁰

Despite the hue and cry that the Community Reinvestment Act forced lenders to extend subprime mortgages to unqualified minority borrowers,⁴⁰¹ the truth is that the CRA was enacted more than thirty years ago, so its evil impact must have

³⁹⁶ See Letter from Ben Bernanke, *supra* note 368.

³⁹⁷ See Janet Yellen, President, Fed. Reserve Bank of S.F., Opening Remarks at the 2008 National Interagency Community Reinvestment Conference (Mar. 31, 2008), available at <http://www.frbsf.org/news/speeches/2008/0331.pdf>.

³⁹⁸ See Schmidt & Tamman, *supra* note 23.

³⁹⁹ See *id.*

⁴⁰⁰ See Roberto Quercia et al., *The Community Reinvestment Act: Outstanding, and Needs to Improve*, in REVISITING THE CRA: PERSPECTIVES ON THE FUTURE OF THE COMMUNITY REINVESTMENT ACT (Fed. Reserves of S.F. and Bos. 2009), available at http://www.frbsf.org/publications/community/cra/cra_outstanding_needs_improve.pdf; Elizabeth Laderman & Carolina Reid, *CRA Lending During the Subprime Meltdown*, in REVISITING THE CRA: PERSPECTIVES ON THE FUTURE OF THE COMMUNITY REINVESTMENT ACT, *supra*, 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 likely to be in foreclosure than loans originated by independent mortgage companies, and finding that CRA standards and localized lending led to lower cost loans and significantly fewer defaults); Lei Ding et al., *Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models 20–21* (Nov. 30, 2009) (Univ. N.C. Ctr. for Cmty. Capital, Working Paper) available at <http://www.ccc.unc.edu/documents/Risky.Disaggreg.11.09.Final.pdf>; Memorandum from the Bd. of Governors of the Fed. Reserve Sys., Div. of Research and Statistics, to Sandra Braunstein, Dir., Consumer & Consumer Affairs Div. 5–6 (Nov. 21, 2008), available at http://www.federalreserve.gov/newsevents/speech/20081203_analysis.pdf.

⁴⁰¹ See *supra* Part III.A.

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.⁴⁰² Additionally, more than 50% of the lenders extending subprime loans during the run-up to the crisis were finance companies that were not required to comply with the CRA.⁴⁰³ In reality, less than 20% of lenders extending subprime loans were subject to the provisions of the CRA,⁴⁰⁴ with some estimates indicating that lenders beholden to the CRA extended just 6% to 7% of the subprime loans subject to default risk during the crisis.⁴⁰⁵

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.⁴⁰⁶ This is simply untrue. 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.⁴⁰⁷

⁴⁰² See Interview with Pam Hennes, *supra* note 365 (describing the requirements of the Community Investment Act and affirmatively disavowing that the CRA mandates any quotas or forces any lending to minority borrowers).

⁴⁰³ Edsall, *supra* note 23; Gordon, *supra* note 365; Pressman, *supra* note 365.

⁴⁰⁴ Edsall, *supra* note 23 (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”).

⁴⁰⁵ See Neil Bhutta & Glenn B. Canner, *Did the CRA Cause the Mortgage Market Meltdown?*, FED. RES. BANK OF MINNEAPOLIS (Mar. 2009), http://www.minneapolis.fed.org/publications_papers/pub_display.cfm?id=4136.

⁴⁰⁶ See *supra* notes 359–383 and accompanying text.

⁴⁰⁷ See David Goldstein & Kevin G. Hall, *Private Sector Loans, Not Fannie or Freddie, Triggered Crisis*, MCCLATCHY NEWSPAPERS (Oct. 12, 2008) <http://www.mcclatchydc.com/2008/10/12/v-print/53802/private-sector-loans-not-fannie.html>; *The Community Reinvestment Act: A Welcome Anomaly in the Foreclosure Crisis*, TRAIGER & HINCKLEY LLP (Jan. 7, 2008), http://www.traigerlaw.com/publications/traiger_hinckley_llp_cra_foreclosure_study_1-7-08.pdf; *The Community Reinvestment Act of*

Thus, not only did the CRA play little to no role in the subprime loan abuse, often minority communities were targeted for predatory lending.⁴⁰⁸ In 2006, 55% of loans to African Americans were subprime, despite the fact that many of those borrowers qualified for prime loans.⁴⁰⁹ 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.⁴¹⁰ Women also received less favorable loan terms across equal presentations of credit worthiness.⁴¹¹

Studies indicate that minority borrowers were purposely steered into risky and expensive subprime loans, even when they qualified for better terms.⁴¹² Those lenders that steered minority borrowers into subprime loans were often mortgage brokers that were eager to make a significantly larger profit.⁴¹³ For instance, “[i]n 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.”⁴¹⁴ In addition, 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.⁴¹⁵ 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.”⁴¹⁶ 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.⁴¹⁷

1977: *Not Guilty*, TRAIGER & HINCKLEY LLP (Jan. 26, 2009), http://www.traigerlaw.com/publications/The_community_reinvestment_act_of_1977-not_guilty_1-26-09.pdf.

⁴⁰⁸ See Johnson, *supra* note 201, at 176–82.

⁴⁰⁹ See Editorial, *supra* note 210.

⁴¹⁰ See *id.*

⁴¹¹ See *id.*

⁴¹² See Johnson, *supra* note 201, at 176–82; see also *supra* Part II.B.2 (describing predatory lending as a major cause of the market meltdown).

⁴¹³ See Editorial, *supra* note 210; Johnson, *supra* note 201, at 176–82.

⁴¹⁴ Devah Pager & Hana Shepherd, *The Sociology of Discrimination: Racial Discrimination in Employment, Housing, Credit, and Consumer Markets*, 34 ANN. REV. SOC. 181, 190 (2008), available at http://www.princeton.edu/~pager/annualreview_discrimination.pdf.

⁴¹⁵ See Editorial, *supra* note 210.

⁴¹⁶ *Id.*

⁴¹⁷ *Id.*

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 to 2007 period were extended to white borrowers and more than 40% of all subprime loans were extended to white borrowers that qualified as “affluent.”⁴¹⁸

While the mortgage crisis has been recharacterized by some as the fault of minority borrowers and governmental intervention through the Community Reinvestment Act, Fannie, and Freddie,⁴¹⁹ the reality is primarily just the opposite.⁴²⁰ The financial market crisis has landed heaviest on communities of color.⁴²¹ Predatory lending and subprime mortgage abuse is far more responsible for minority involvement in the subprime markets than the CRA. Because minority communities and borrowers were targeted predatorily for subprime loans, foreclosures have devastated urban communities.⁴²² There are few, if any, facts that support the minority-borrower narrative and governmental social engineering myth. It is just that—a myth. Minority borrowers are no more responsible for the financial market crisis than are Brazilian surfers, Tongan princesses, or Japanese lawyers.

As one journalist stated, “[w]hat 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.”⁴²³ The once staid mortgage-lending business became the playground for high-flying investment bankers, who were not ready to settle for modest profits.⁴²⁴ Instead, they turned mortgage lending into a gambling scheme, introducing high risk and huge profits.⁴²⁵ “The

⁴¹⁸ Price, *supra* note 23.

⁴¹⁹ See Phil Gramm, *Deregulation and the Financial Panic: Loose Money and Politicized Mortgages Are the Real Villains*, WALL ST. J., Feb. 20, 2009, at A17.

⁴²⁰ See JOHNSON & KWAK, *supra* note 2, at 144–46 (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 loans that met strict underwriting standards and size limits); see also STIGLITZ, *supra* note 2, at 10–12 (describing conservative blaming of Fannie, Freddie and the Community Reinvestment Act as “sheer nonsense”).

⁴²¹ See Devona Walker, *How Ruthless Banks Gutted the Black Middle Class and Got Away with It*, ALTERNET (Sept. 4, 2010), <http://www.alternet.org/story/148068/>; Michelle Chen, *No End in Sight for Foreclosures in Communities of Color*, HUFFINGTON POST (Oct. 25, 2010), http://www.huffingtonpost.com/michelle-chen/no-end-in-sight-for-forec_b_626421.htm.

⁴²² See Chen, *supra* note 421; Walker, *supra* note 421.

⁴²³ See Caitriona Palmer, *Greed that Led to Financial Meltdown*, INDEPENDENT.IE (Mar. 22, 2008), <http://www.independent.ie/business/world/greed-that-led-to-financial-meltdown-1324810.html>.

⁴²⁴ See *id.*

⁴²⁵ See *id.*; Andy Serwer & Allan Sloan, *How Financial Madness Overtook Wall Street*, TIME (Sept. 18, 2008), <http://www.time.com/time/business/article/0,8599,184212300.html>.

system became corrupted by high salaries and the need to sustain those high salaries, by shoddy lending practices, by self-dealing with the bond regulators.⁴²⁶

The truth of the financial market collapse lies above in Part II. The causation and failures were divers and complex.⁴²⁷ The dirty little myth is unsupportable.⁴²⁸

So, why was the myth floated in the face of little evidentiary support? What motivates 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.⁴²⁹ 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 nonwhite 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 to ring in a postracial America.⁴³⁰ 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

⁴²⁶ See Palmer, *supra* note 423.

⁴²⁷ See Serwer & Sloan, *supra* note 425.

⁴²⁸ See Eric Alterman & George Zornick, *Think Again: Meltdown: The Blame Game*, CENTER FOR AM. PROGRESS (Oct. 16, 2008), http://www.americanprogress.org/issues/2008/10/thinkagain_fannie.html (describing the "deeply misleading" arguments seeking to blame Fannie Mae, Freddie Mac, the Community Reinvestment Act, and minority borrowers as the primary cause of the financial market crisis); Goldstein & Hall, *supra* note 407; Ellen Seidman, *Don't Blame the Community Reinvestment Act*, AM. PROSPECT (Aug. 7, 2009), http://www.prospect.org/cs/articles?article=dont_blame_the_community_reinvestment_act; *The Community Reinvestment Act: A Welcome Anomaly in the Foreclosure Crisis*, *supra* note 407; *The Community Reinvestment Act of 1977: Not Guilty*, *supra* note 407.

⁴²⁹ See *supra* Part III.

⁴³⁰ See Senator Barack Obama, Address at Phila., Pa.: A More Perfect Union (Mar. 18, 2008), available at <http://my.barackobama.com/page/content/hisownwords>; Steele, *supra* note 17; Courtney E. Martin, *The Power of the "Post-Racial" Narrative*, AM. PROSPECT (Feb. 2, 2010), http://www.prospect.org/cs/articles?article=the_power_of_the_postracial_narrative; Schorr, *supra* note 17. Obama himself campaigned in a post-racial fashion, positioning himself as a product of a different era, apart from the civil rights battles of old. See McWhorter, *supra* note 17.

a tortured racial history.⁴³¹ At the very moment that our nation was touted as “coming of age” we regressed into our familiar historical hostility toward our minority citizenry.⁴³² For a nation that has purportedly progressed to a postracial place, the dirty little myth smacks of the racial hatred and propaganda that marks so many chapters of our nation’s history.⁴³³ Can we as a country make a legitimate claim of true racial progress, racial healing, and postracial understanding if we continue to condemn the least powerful and those least responsible for the ills that beset our nation?

A. Code Talk

As described above, many now argue that the financial market crisis owes its entire genesis to the Community Reinvestment Act and the quasi-government-sponsored entities, Fannie Mae and Freddie Mac. Perhaps recognizing the political inexpediency of pointedly blaming “minorities,” the dirty little myth has now morphed into a more insidious characterization of minority blaming in code. News pundits and politicians Coulter, Beck, Cavuto, Bachmann, Limbaugh, and Buchanan, 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.⁴³⁴ The absurdity of this dirty little myth can be easily swept aside as 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, and Bachmann screeds against “minority” borrowers and “affirmative action” for homeowners, is now a fairly consistent drumbeat from some 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.⁴³⁵ This blaming of governmental welfare, while not expressly racial, is simply traditional coding for race. Portraying the CRA, Fannie, and Freddie as the primary agents of the

⁴³¹ See Ian F. Haney López, *Post-Racial Racism: Racial Stratification and Mass Incarceration in the Age of Obama*, 98 CALIF. L. REV. 1023, 1023 (2010); Peter J. Boyer, *The Political Scene: The Color of Politics*, NEW YORKER, Feb. 4, 2008, at 38; Tim Rutten, *The Good Generation Gap*, L.A. TIMES, Feb. 6, 2008, at 31; Hua Hsu, *The End of White America?* ATLANTIC ONLINE (Jan.–Feb. 2009), <http://www.theatlantic.com/magazine/archive/2009/01/the-end-of-white-america/7208/>.

⁴³² See *supra* Part III.A.

⁴³³ See *Korematsu v. United States*, 323 U.S. 214 (1944); *Plessy v. Ferguson*, 163 U.S. 537 (1896); *Dred Scott v. Sandford*, 60 U.S. 393 (1856).

⁴³⁴ See *supra* notes 359–365 and accompanying text.

⁴³⁵ As described above, Fannie Mae and Freddie Mac played a minor role in the subprime mortgage fiasco by stoking the market with its own private profiteering efforts and in guaranteeing many of the subprime loans that were recklessly written by mortgage brokers and banks. See *supra* Part II.B.4.

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.⁴³⁶

Racial coding has a long tradition in the United States. That it persists in the purportedly postracial Obama era belies the very positioning of postracialism and postracialists. Racial coding entails engaging issues “such as crime and welfare are now widely viewed as ‘coded’ issues” that play upon race—or more centrally, upon white Americans’ negative views of black Americans—without explicitly raising the race card.⁴³⁷ 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.⁴³⁸

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 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.⁴³⁹ 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.⁴⁴⁰ Of course, as described above,⁴⁴¹ racial coding requires a suspension of the

⁴³⁶ See *supra* Part III.A; see also Pressman, *supra* note 365 (providing more than two hundred comments to the online *Business Week* article, which discloses the venom that dozens of commentators hold against the Community Reinvestment Act, and that they blame it—and minorities—for causing the financial crisis).

⁴³⁷ See Martin Gilens, *Race Coding and White Opposition to Welfare*, 90 AM. POL. SCI. REV. 593, 593 (1996); see also THOMAS BYRNE EDSALL & MARY D. EDSALL, CHAIN REACTION: THE IMPACT OF RACE, RIGHTS AND TAXES ON AMERICAN POLITICS 198–214 (1992) (describing the emergence of coded language during the Reagan Administration).

⁴³⁸ See Tim Wise, *Imagine if the Tea Party Was Black*, OPEN SALON (Apr. 26, 2010, 6:56 AM), http://open.salon.com/blog/theone69/2010/04/26/imagine_if_the_tea_party_was_black_by_tim_wise (describing the American racial double standard in connection with racial animosity and racial exploitations); EDSALL & EDSALL, *supra* note 437, at 198; Gilens, *supra* note 437, at 593, 602.

⁴³⁹ See Nathan Tobin, *Disrobing the Welfare Queen*, WIRETAP (July 10, 2000), <http://www.wiretapmag.org/stories/9435/>; Paul Krugman, Op-Ed., *Republicans and Race*, N.Y. TIMES, Nov. 19, 2007, at A23; Franklin D. Gilliam, *The “Welfare Queen” Experiment: How Viewers React to Images of African American Mothers on Welfare*, NIEMANN REP. (Summer 1999), <http://www.niemann.harvard.edu/reportsitem.aspx?id=102223>.

⁴⁴⁰ See sources cited *supra* note 439.

⁴⁴¹ See *supra* Part III.B.

truth. The “welfare queen” largely does not exist, particularly in urban centers.⁴⁴² Most Americans on welfare in the United States are poor whites. Nevertheless, this 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.⁴⁴³ 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 stereotype and was meant to induce fear in white Americans.⁴⁴⁴ The commercial is roundly considered the primary reason that President Bush was able to overcome double-digit deficits in the polls and played expertly into America’s fear of the black male criminal.⁴⁴⁵ Of course, as described above, racial coding requires a fabrication and distortion of the truth. Michael Dukakis had no connection to Willie Horton,⁴⁴⁶ and violent crimes in the United States are carried out far more often by white perpetrators than black.⁴⁴⁷ Nevertheless, racial coding allows race baiting to be perpetrated without explicit reference to race based on white Americans’ 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.”⁴⁴⁸ While the advertisement was ostensibly about Ford being unprepared or wrong on the politics, it was ultimately

⁴⁴² See sources cited *supra* note 439.

⁴⁴³ See Gilens, *supra* note 437, at 593; Jon Hurwitz & Mark Peffley, *Playing the Race Card in the Post-Willie Horton Era: The Impact of Racialized Code Words on Support for Punitive Crime Policy*, 69 PUB. OPINION Q. 99, 100–01 (Spring 2005), available at <http://poq.oxfordjournals.org/cgi/content/abstract/69/1/99>; *Willie Horton 1988 Attack Ad*, YOUTUBE (Nov. 3, 2008), <http://www.youtube.com/watch?v=Io9KMSSEZ0Y>.

⁴⁴⁴ See Gilens, *supra* note 437, at 593.

⁴⁴⁵ See Jake Tapper, *The Willie Horton Alumni Association*, SALON (Aug 25, 2000, 13:31 ET), <http://www.salon.com/news/politics/feature/2000/08/25/horton>.

⁴⁴⁶ See *id.*

⁴⁴⁷ See *Uniform Crime Report: Crime in the United States 2009*, FBI (Sept. 2010), <http://www2.fbi.gov/ucr/cius2009/data/documents/tab43overview.pdf> (“In 2009, 69.1 percent of all individuals arrested were white, 28.3 percent were black, and 2.6 percent were of other races.”).

⁴⁴⁸ *Harold Ford Jr. Not for Tennessee*, YOUTUBE (Oct. 22, 2006), http://www.youtube.com/watch?v=kkiz1_d1GsA; see Peter Wallsten, *GOP Attack Ad Draws Heat for Racial Overtones: The Tennessee Spot Is Denounced as More of the “Southern Strategy,”* L.A. TIMES, Oct. 24, 2006, at A14; *Anti-Harold Ford Ad Draws Racism Charges*, TRUTHDIG (Oct. 24, 2006), http://www.truthdig.com/avbooth/item/200601024_harold_ford_ad/.

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.⁴⁴⁹ 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.”⁴⁵⁰ 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 “postracial” America.⁴⁵¹ Following the tradition of the “welfare queen,” Willie Horton, and “Harold, call me,” 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, as painstakingly described above.⁴⁵² 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.⁴⁵³

B. Coming of Age?

Postracialism is a deeply loaded term. Taken lightly, postracialism 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

⁴⁴⁹ See Sean Alfano, *Rove Protégé Behind Racy Tennessee Ad*, CBSNEWS (Oct. 26, 2006), <http://www.cbsnews.com/stories/2006/10/26/politics/main2125324.shtml>.

⁴⁵⁰ See Alex Johnson, *Tennessee Ad Ignites Internal GOP Squabbling*, MSNBC.COM (Oct. 25, 2006), <http://www.msnbc.msn.com/id/15403071/> (quoting a former Republican senator from Maine who acknowledged the race-baiting nature of the ad).

⁴⁵¹ See Kevin R. Johnson & George A. Martinez, *Discrimination by Proxy: The Case of Proposition 227 and the Ban on Bilingual Education*, 33 U.C. DAVIS. L. REV. 1227, 1269–71 (2000) (identifying the use of “proxy” language as racial coding to enable discriminatory policies against “aliens” and “immigrants” particularly in the context of Mexican Americans).

⁴⁵² See *supra* Part II.

⁴⁵³ See generally JOHNSON & KWAK, *supra* note 2 (describing the intimate relationship between Washington D.C. and Wall Street, and identifying how the Wall Street economy has recently become synonymous with the American economy).

deeper level, postracialism can be used as a tool to perpetuate white privilege and lend additional power to entrenched elites. On a more subtle, contemptible level, racial coding is often used as a mechanism for claiming “colorblindness” as a valued principle but engaging in race baiting and racial fearmongering by playing on the fears of white American’s without explicitly mentioning race.⁴⁵⁴ When those claiming postracialism are the same parties perpetrating instances of racial coding, a particularly reprehensible plane of racism is on display.

Professor Sumi Cho describes one outcome or effect of postracialism as a result of adopting a postracial 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.”⁴⁵⁵ In embracing a postracial 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.⁴⁵⁶ 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 postracial world and those that engage in continuing racial discussion are agitators seeking to place race where it no longer belongs.⁴⁵⁷ 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 postracial 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 disgraceful, 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 postracialism is a dream—a worthy dream, but still a distant one. Predatory lenders 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

⁴⁵⁴ See *supra* Part IV.A.

⁴⁵⁵ Sumi Cho, *Post Racialism*, 94 IOWA L. REV. 1596, 1596–97 (2009).

⁴⁵⁶ See *id.*

⁴⁵⁷ See *id.* at 1597; Haney López, *supra* note 431; Jeffrey J. Rachlinski & Gregory Scott Parks, *Implicit Bias, Election '08, and the Myth of a Post-Racial America* 1–3 (2009) (unpublished manuscript), available at <http://ssrn.com/abstract=1456509>.

minority borrowers and through racial coding the Community Reinvestment Act, Fannie Mae, and Freddie Mac as the literal crisis scapegoats. If we as a nation had truly arrived at a postracial, colorblind place, then this dirty little myth could not exist and proliferate like a racist disease.

The financial market crisis has laid bare our true place, and it is not postracial. The dirty little myth and its accompanying racial coding indicate that we are not close to becoming a truly postracial America.

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 most 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 carefully 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 least in need of absolution are minority borrowers, particularly 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 postracial positioning in America.