TARP OVERSIGHT PANEL: SECURITIZATION MESS MAY (RE)CRASH THE ECONOMY

The TARP Congressional Oversight Panel just released a report dedicated to the foreclosure fraud problem and the securitization mess underlying it. They conclude that the problems may represent a significant problem for the housing market and the financial system more generally.

Here's a great summary of why:

> If documentation problems prove to be pervasive and, more importantly, throw into doubt the ownership of not only foreclosed properties but also pooled mortgages, the consequences could be severe. **Clear and uncontested property rights are the foundation of the housing market. If these rights fall into question, that foundation could collapse.** Borrowers may be unable to determine whether they are sending their monthly payments to the right people. Judges may block any effort to foreclose, even in cases where borrowers have failed to make regular payments. Multiple banks may attempt to foreclose upon the same property. Borrowers who have already suffered foreclosure may seek to regain title to their homes and force any new owners to move out. Would-be buyers and sellers could find themselves in limbo, unable to know with any certainty whether they can safely buy or sell a home. If such problems were to arise on a large scale, the housing market could experience even greater disruptions than have already occurred, resulting in significant harm to major financial institutions. For

> example, if a Wall Street bank were to discover that, due to shoddily executed paperwork, it still owns millions of defaulted mortgages that it thought it sold off years ago, it could face billions of dollars in unexpected losses.
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> [snip]
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> In addition to documentation concerns, another problem has arisen with securitized mortgage loans that could also threaten financial stability. Investors in mortgage-backed securities typically demanded certain assurances about the quality of the loans they purchased: for instance, that the borrowers had certain minimum credit ratings and income, or that their homes had appraised for at least a minimum value. Allegations have surfaced that banks may have misrepresented the quality of many loans sold for securitization. Banks found to have provided misrepresentations could be required to repurchase any affected mortgages. Because millions of these mortgages are in default or foreclosure, the result could be extensive capital losses if such repurchase risk is not adequately reserved.
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> To put in perspective the potential problem, one investor action alone could seek to force Bank of America to repurchase and absorb partial losses on up to $47 billion in troubled loans due to alleged misrepresentations of loan quality. **Bank of America currently has $230 billion in shareholders" equity, so if several similar-sized actions – whether motivated by concerns about underwriting or loan ownership – were to succeed, the company could suffer disabling damage to its regulatory capital. It is possible that widespread**

> **challenges along these lines could pose risks to the very financial stability that the Troubled Asset Relief Program was designed to protect**. Treasury has claimed that based on evidence to date, mortgage-related problems currently pose no danger to the financial system, but in light of the extensive uncertainties in the market today, Treasury‟s assertions appear premature. Treasury should explain why it sees no danger. Bank regulators should also conduct new stress tests on Wall Street banks to measure their ability to deal with a potential crisis. [my emphasis]

There’s a lot of conditional language here, reflecting a general uncertainty about how deep the shitpile is this time around. But the demand that Treasury conduct another stress test of these obviously insolvent banks is a good start.