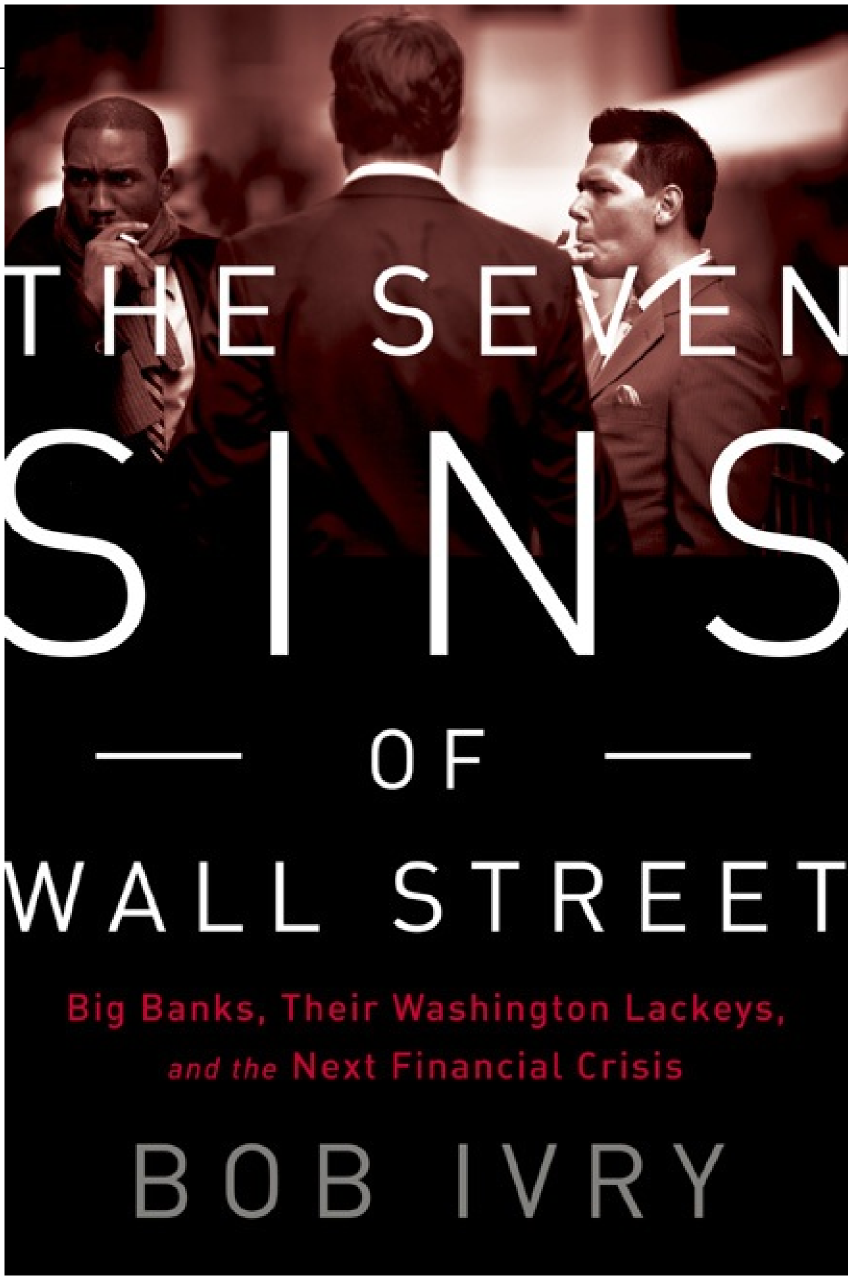
THE SEVEN
SINS
OF
WALL STREET
Big Banks, Their Washington Lackeys,
and the Next Financial Crisis
BOB IVRY

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For Janelle

CONTENTS

Ladies and gentlemen, the six largest American banks, listed in alphabetical order:

Bank of America
Home: Charlotte, North Carolina
Scouting report: Hits below its weight. Kryptonite: mortgage servicing
TARP borrowing: $45 billion
Peak Federal Reserve borrowing: $91.4 billion on February 26, 2009
Total assets, 2006: $1.36 trillion
Total assets, 2013: $2.17 trillion
Percentage change: +60

Citigroup
Home: New York
Scouting report: Can't get out of its own way
TARP borrowing: $45 billion
Peak Federal Reserve borrowing: $99.5 billion on January 20, 2009
Total assets, 2006: $1.59 trillion
Total assets, 2013: $1.88 trillion
Percentage change: +18

Goldman Sachs
Home: New York
Scouting report: Biological imperative: money
TARP borrowing: $10 billion
Peak Federal Reserve borrowing: $69 billion on December 31, 2008
Total assets, 2006: $759 billion
Total assets, 2013: $959 billion
Percentage change: +26

JPMorgan Chase
Home: New York
Scouting report: Performance-enhancing drugs suspected
TARP borrowing: $25 billion
Peak Federal Reserve borrowing: $68.6 billion on October 1, 2008
Total assets, 2006: $1.34 trillion
Total assets, 2013: $2.39 trillion
Percentage change: +78

Morgan Stanley
Home: New York

Scouting report: Smallest of the six and getting smaller
TARP borrowing: $10 billion
Peak Federal Reserve borrowing: $107 billion on September 29, 2008
Total assets, 2006: $960 billion
Total assets, 2013: $801 billion
Percentage change: –16

Wells Fargo
Home: San Francisco
Scouting report: Quietly eating its competitors’ lunch
TARP borrowing: $25 billion
Peak Federal Reserve borrowing: $45 billion on February 26, 2009
Total assets, 2006: $492 billion
Total assets, 2013: $1.44 trillion
Percentage change: +193

THE COST OF DOING BUSINESS

My daughter called me from school one day and said, "Dad, what's a financial crisis?" And without trying to be funny, I said, "It's something that happens every five to seven years."

—Jamie Dimon, chief executive officer of JPMorgan Chase, January 13, 2010

WHEN REBECCA BLACK BOUGHT THE THREE-BEDROOM house at 698 Hazelwood Road in southwe Memphis in May 2005 and moved in with her two teenage sons, it was a quiet communit Children played in the street, and neighbors tended their yards. She could afford the $57,000 mortgag if she skipped oil changes for the car and served the boys store-brand groceries.

Then trouble came.

Her next-door neighbor died, and his family lost the house. Across the street, there were tw foreclosures. One morning, the abandoned house three doors down had gang graffiti spray-painted o the side. A girl in the neighborhood pulled a gun on her son.

In 2010, it was Black's turn to go. She'd gotten one of those 2–28 mortgages that slowly strangl so many borrowers—two years of a low, fixed interest rate followed by twenty-eight years of risin payments—and she'd reached her limit. "I was crazy about that house, and so proud of it," said Blac a US Army veteran. "I just didn't have enough money." She got a letter from her mortgage compar saying it was starting the foreclosure process, and rather than hear a knock on the door one mornin from a sheriff's deputy ordering her to get out, Black packed whatever she could fit into her Chev Astro and left the home she loved so well. By 2011, the property two doors down had sold for $3,00 and Black was in bankruptcy.

If homes are living things, sustaining their inhabitants and contributing to the vitality of the communities, then Hazelwood Road is dying. On nine of the fifteen parcels on Black's side of th street, houses sit empty or have been bulldozed flat, or the lots have reverted to a tangle of sumac ar poison ivy.

I visited Hazelwood Road in the hottest part of 2012, four years after bad mortgages triggered meltdown in the world's most resilient economy. The biggest banks were reporting record profits, ar government agencies were trumpeting statistics showing that a robust recovery from the worst ha times since Dorothea Lange's "Migrant Mother" was just around the corner. And though Hazelwoo Road was never a paradise—a place where Black could buy a three-bedroom house for $57,00 couldn't be described as anybody's ideal of "location, location, location"—conditions there indicate that something essential about America had shifted in the aftermath of the 2008 financial crisis. A economic and political apartheid had emerged. Perhaps fairness had been an illusion and upwa mobility just a dream before things went to hell. Still, hope for advancement was that much tough for most people to sustain after 2008. And just as the crisis was no accident but rather a trag convergence of stupidity, poor oversight, and, more than anything, a neighbor-versus-neighbor wagin of financial warfare, so too were its consequences a result of calculation. Washington, in the form o the ~~federal government and the Federal Reserve, the country's bank for banks, had sacrificed~~ th common good for the profit of the few. By coddling the biggest banks—by rewarding their mischi rather than at least laying down roadblocks of disincentives for them to quit their misconduct- Washington made certain that the country continued down a path of self-aggrandizement that led to perversion of American capitalism and the slow demolition of democracy.

THE LARGEST FINANCIAL INSTITUTIONS ARE LIKE WATER—they find the lowest point. Just about all the lo behavior by the biggest banks and their Washington fellow travelers described in these pages occurre after the 2008 financial crisis. It's my aim not to relitigate the bailouts but to illustrate their legac I've divided the book into seven chapters, each corresponding to one of Catholicism's seven dead sins. Wall Street's seven sins—size, secrecy, regulatory capture (when government superviso identify more with the industry they police than with the people they're supposed to protec excessive pride, complexity, impunity, and a predatory greed weaponized for the war fought by th rich against the poor and middle class—have us pointed toward the second avoidable econom cataclysm of the baby boom era. I've written this in the hope that recognizing the danger we're in wi be an essential step toward correcting our course. It won't be easy. We've dug ourselves a deep hol The digging out might be the most urgent challenge facing this generation of Americans.

After Rebecca Black left Hazelwood Road, one of her old neighbors complained about a snake th got into her kitchen. Memphis city workers mowed Black's grass. Vandals roamed the neighborhoo ripping out copper plumbing, appliances, anything left behind, so the city workers nailed plywoo over Black's old windows and doors. For the plywood and the yard work at 698 Hazelwood, Rebec Black got a bill for $520. She hadn't lived there for more than a year, but she got the tax bill too. H lender, a division of JPMorgan Chase called EMC Mortgage, never took ownership. The house w technically still hers.

Out of this misery and confusion, we expect the US economy to sprout wings and fly. We know th healthy flow of credit stoking a go-go real estate market is the surest way to a sustained recovery. S we examine graphs of home prices, home sales, and construction starts, trying to ignore the unskiab downward slopes of 2006 to 2009. We point instead to the wormy tail ends of 2012 and 2013 so th we can declare the nightmare over. We suspect, but seldom say, that the evidence is telling us that th line on the graph is really a fuse. It leads to a suicide bomb of our own design. We're stuck between desire for all these houses to sell and a fear that too many mortgages given to too many borrowers lil Rebecca Black will push us back to the brink. Yet so few people are better off financially than the were before the 2008 crisis, and we've learned so few of the lessons that the near-death experien could have taught us, that it feels as if it'll take another terrifying plummet to get the people in charg to do something meaningful to repair this broken system.

One foreclosed borrower, Harry Subers, once told me that the mortgage industry had done mo damage to America than Osama bin Laden. We cleaned up Ground Zero and built on the ashes. Whe it comes to struggling home owners, we've cut the grass. But the grass keeps growing, and the snak have come back. Rebecca Black and the 7 million other mortgage borrowers who've lost their hom to foreclosure since 2008 have become a forgotten footnote, a buzzkill best ignored on the way greater profits for the lucky few, their futures written off as the cost of doing business.

This was the actual, if unstated, policy of the US government and the Federal Reserve since th first subprime mortgage borrower quit paying. The Treasury Department did seem to understand th without a housing recovery the US economy would never shake its funk. How do you bail out th ~~lenders and then let the borrowers twist? This is how. In 2009, Treasury earmarked $50 billion~~ to hel failing home owners. By October 2012, the department had spent $5.5 billion, with another $5 billio committed. That might seem like a staggering bounty, until you compare it to assistance for the bank which in 2008—the depths of the financial crisis—collectively got $1.2 trillion of loans from th Federal Reserve on a single day. Overnight borrowing by JPMorgan Chase, Rebecca Black's lende peaked on October 1, 2008, at $68.6 billion. Jamie Dimon, the lender's chief executive officer, got $2 million in compensation for 2011.

All Rebecca Black got was the landscaping bill.

America needs strong banks. But banks need a strong America too. In the wake of the last crisi only one side of that ledger was fortified. We need to bring the teeter-totter closer to equilibrium. As first step toward recovery, in the psychic as well as the economic sense, let's own up to what reall happened in 2008: a bloodless coup. We call it a financial crisis, but it was really a leveraged buyou of the United States. Washington occupied Wall Street, and Wall Street captured Washington. Sure there was some rhetorical sniping in both capitals about fat cats and overregulation and a bit ludicrous whining when one Wall Street billionaire compared changing the tax code to Na Germany's 1939 invasion of Poland, as if taxing income as income (35 percent) instead of investme gains (15 percent) was the first step on the road to Stalingrad. (The whiner was Stephen Schwarzma of Blackstone Group, and he later apologized. But the tax law wasn't changed; it remains Schwarzman's favor.) Park Avenue and Pennsylvania Avenue realized that they wore the sam clothes, golfed the same courses, let the same $38 burgers congeal half-eaten on their plates, sent the children to the same schools, and shared the same lawyers. In some cases, they *were* the same lawyer You were unlikely, if not unable, to break laws if you wrote them. Five years after the financial cris —five years!—central bankers still hadn't quit printing money to bolster the banking system. N super political-action committee could compete with the $85 billion a month the Federal Reserve w sending the big banks by buying their Treasury bonds and mortgage securities. Like the Europea aristocrats fighting on opposite sides in World War I, depicted by filmmaker Jean Renoir in *Th Grand Illusion*, they skirmished when appearances warranted but always, when the chance aros clinked glasses to mutually advantageous goals—in this case, clearing all obstacles on the road to th kind of wealth that would have made Croesus demur. At the same time, most Americans worke harder but watched their incomes stagnate or fall. The people, in the Abraham Lincoln sense of th word, had been cut out of postcrisis prosperity. Those riding high atop the reinvigorated politica financial complex in the 2010s forgot the lesson taught by Henry Ford a century before: the way to g rich and stay rich is to make sure your fellow citizens have the means to buy your product.

In the years leading up to the Great Bubble Burst of 2008, unprecedented wealth had preceded th unprecedented loss of wealth. In the next crisis, no such luck. Ordinary folks had sunk most of the money into their homes, and the real estate bust took a giant chomp out of those small fortunes. home owners regained some of what they had lost as home prices inched back upward, they weren very well going to fall for the same trick again. And if they were, what crazy lender would float the a loan? For the banks, there was plenty of money to be made elsewhere. Thanks to the Feder Reserve, side betting on price fluctuations, also known as derivatives trading, was a lot less risky an tons more lucrative than handing over $57,000 mortgages to millions of small-time credit risks suc as Rebecca Black.

In the months and years after the financial crisis, the top people in Wall Street and Washingto had engineered a closed loop that ensured their feet never touched the dirty ground. Wall Street woul originate the mortgages, and Washington would buy them. (The government was involved in nine every ~~ten home loans in 2013.) The Treasury would sell debt, and Wall Street would buy it, then~~ sell back to the Federal Reserve. (This was called “quantitative easing.”) The Federal Reserve would pri money, and Wall Street would use it to push up prices on stocks and all sorts of commodities (leadir to record highs in corn, cotton, silver, gold, and the S&P 500). Bankers traded derivatives, thos poorly understood bets that blew up local governments and sewer projects from Newport Beach Birmingham, without anyone in the outside world catching a glimpse of the details. (The secreti market expanded to its biggest size after the crisis.) Ordinary people only got in the way—they we unreliable bill payers, they clogged up the customer help lines, they demanded payback from pensio plans they’d contributed to, they yelped antiquated socialistic notions about everyone being in th same boat, and they interrupted shareholder meetings and congressional hearings with the caterwauling—so they were simply disappeared from the equation.

Bankers were an easy target for the rest of the country’s disapproval, but they saw the kind treatment they received in Washington and responded. It was impossible for them not to feel entitle Their partners in the political capital rolled out the red carpet for them at every opportunity. Th Federal Reserve swelled its balance sheet to $4 trillion, just to transfer cash to them. The Treasury an the Fed reworked their “stress tests,” just to make sure their firms passed. Lawmakers invited them hearings to chastise them and ended up asking them for investment advice. While many America undoubtedly had a hand in pushing the US economy to the brink of ruin in 2008, banking was one the few professions for which the government guaranteed a profit in the aftermath. Nothing in the ru book prohibited Washington from funneling cash to strapped home owners rather than flush bank But in the feedback loop of the New York–Washington–New York *Acela Express* train route, strappe home owners existed only if one deigned to squint out the railcar’s tinted windows. The little people failures were best written off as the cost of doing business. Bring in the accountants to wave the magic wands, and let’s move a little faster down the track.

Wall Street paid for some of this largesse, through campaign contributions, sponsorships, an grants from its foundations, paid speaking gigs, and jobs and consultancies aplenty once the nobili of public service smacked hard against the reality of putting the kids through college. But wh bedazzled regulators at hello—what was a more direct cause of regulatory capture—was simply th prestige that men making millions of dollars could bring when they visited Capitol Hill. Washington, the American conviction that money equaled honey had gone too far. Sacrificed a Mammon’s altar was any notion of the common good, or restraint, or that people who work shouldn be poor, or that children need to eat, or that college students and the jobless can use temporary he from their country that will repay multiples in the future. There were individual exceptions, to be sur but most of the time, if you wanted to stick it to Wall Street, you had no one from either th Democratic or the Republican Party to vote for. Practically the only bipartisanship shown on Capit Hill in the 2010s entailed members of both parties bellying up to the same pay window, brought to yo by the financial services industry. Lincoln’s ideal of popular government had perished from the earth

Bankers and those in their employ loved to tout the 2008 bailouts as a moneymaker for the U Treasury. Banks had paid back the Troubled Asset Relief Program, also known as TARP, and returne $20 billion in interest, they said—as if the country should go through it all again as a way of turning profit. But the legacy of the financial crisis wasn’t stronger banks. It was a weaker country. We paid price beyond dollars for rescuing the behemoth financial institutions. Keep the $20 billion, I say, an give us back our government. Make banking boring again. Obey the spirit of the law. Buy a mor compass with your millions. Quit ripping us off. And lawmakers, policymakers, and their staff, qu making it easier for bankers to do whatever they feel like doing.

WHEN MATTHEW WINKLER HIRED ME AS A REPORTER FOR Bloomberg News's newly constituted re
estate coverage team in October 2006, I'd been a film critic, a book reviewer, and a newspaper featu
writer—the kind who writes about a snowstorm on Monday, New Jersey Devils hockey o
Wednesday, and the death of a seven-year-old girl from the flu on Sunday. I knew only one thin
about real estate: a housing bubble that had given home owners like me a wild ride was about to en
I'd bought a home in northern New Jersey in June 2005 with the intention of moving to a bigger pla
as soon as I could. Almost immediately I saw articles and TV news reports that made me cross m
fingers in hope that the mad price rise would last two more years, two more years, please give me tw
more years. Going on a decade later, top bankers, respected regulators, and relied-upon credit rate
claim they had no knowledge of a bubble. That no one did. That "market forces" caused lenders to lo
money in the bust. That they were shocked—shocked!—to find that garbage mortgages had bee
peddled. That they were victims of the credit crunch and not partly to blame for it. I became
financial reporter not long before this load of crap started to get unloaded from the bullshit train. N
wonder I was suspicious of what bankers told me. If I'd been aware of the real estate bubble as
civilian in 2005, surely the generals of finance knew about it too. The list of those pleadin
cluelessness could fill the economics faculty at an Ivy League university. It included two Feder
Reserve chairmen and the chief executives of the majority of the biggest Wall Street firms.

As my editor on the real estate team, Rob Urban, used to say, "All they had to do to know abo
the boom and bust was read their Bloombergs."

I had patient teachers at Bloomberg News. Rob had covered Enron and the Russian debt crisis
the late 1990s and knew a scam when he smelled one. He confirmed for me, over and over, that m
being new to finance didn't mean I didn't see what I saw. I pestered Christine Harper, the chi
financial correspondent, and she invited me along on her meetings with bankers. From her I learn
that an undercurrent, deep below the surface, affects the ebb and flow of money. And it usually has
do with personalities. And somehow I fell in with Mark Pittman. I'd met him on my first day
Bloomberg News. He sat next to an old colleague of mine, Shannon Harrington, and when I found m
way through the rows of desks to say hi to Shannon, there was this hulking linebacker of a guy in h
late forties with a heavy-metal haircut—shaved close on the sides and long enough on top to
gathered into a ponytail in back. Pittman, a corporate bond reporter at the time, showed me that t
truth, or a reasonable facsimile, lurks not in what people say but in what they do. For that, you need
documents, regulatory filings, spreadsheets, and prospectuses. The exciting work he did was built
hours of wrecking his eyesight poring over hieroglyphs.

"Where it impacts regular folks, you gotta do something about it," Pittman said. "Make sure t
rules are fair."

HOW'S THIS FOR FAIR? FROM JUNE 2009, THE END OF THE recession, middle-class income declined whi
the biggest banks made more money than ever before. Still, bankers agitated for loosening rules th
might prevent another implosion on the grounds that regulation would crimp their profits. The iro
is, without the help of regulators, taxpayers, and lawmakers, they would have lived more like the re
of the country—struggling to stretch their paychecks to the end of every month and saddled wi
credit scores that made it unlikely they'd ever be able to borrow anything but hedge clippers from t
neighbors.

Without Washington as its midwife, a new Gilded Age, with its strong whiff of the robber baron of ~~the 1890s, would never have been born. Bankers' rights expanded immeasurably after the~~ crisi Today, some of them don't pay taxes at the same rate that the rest of Americans do; they can use cas from customer deposits to roll the dice in the derivatives casino; they can mix trading oil with th business of drilling for, shipping, refining, and selling it; they can continue to defraud the same U government that bailed them out; and they face scant consequences for the fibs they tell investors federal investigators. In 1997, the humor site The Onion made a joke about VIP citizenship availab to those who qualified as privileged. It was funny, but it was also prophetic.

The heart of the predicament was the unprecedented growth of the biggest banks. Before the crisi at the end of 2006, JPMorgan Chase, Bank of America, Citigroup, and Wells Fargo had $5.2 trillion i assets on their books. In 2012, they had $7.8 trillion. That's a 50 percent increase. In 2012, Wel Fargo, by itself, wrote one of every three residential mortgages in America. Usually, growth is a goo thing. But this was unnatural and out of control. The big boys had gotten so freakishly huge that they coughed in New York, financiers felt a breeze in Singapore.

Even the highly touted 2010 law called the Dodd-Frank Wall Street Reform and Consume Protection Act, which was supposed to provide a way for regulators to put a large bank to slee without bailouts, only added multiple layers of bureaucracy to the oversight of financial firms. didn't end the phenomenon of banks being perceived as too big to be allowed to fail. In fact, enshrined that very idea, bestowing that official designation on selected firms with the euphemis "systemically important financial institution," or SIFI. Bond buyers, the people who put their mone on the line, gave the biggest banks borrowing discounts simply because they believed the governme would step in if they faltered.

Though it would have made more sense for Congress to mandate that the biggest banks shrink split into manageable, acceptably profitable entities whose problems would affect only the employees, shareholders, and creditors and not taxpayers—a plan endorsed in concept by a half doze current and former Federal Reserve branch presidents, a couple of Bank of England bigwigs, senato from both political parties, and both men who created the "financial supermarket" Citigroup—th Obama administration opposed and defeated attempts to get such rules enacted.

REBECCA BLACK MOVED INTO A ONE-BEDROOM APARTMENT in a Memphis senior citizen's complex, living space less than one-third as big as her home on Hazelwood Road. Because of her bankruptc she couldn't get a better deal than 12 percent on her car loan. "Money you don't even have, they wa it," she said. Her embarrassment over losing the house curdled into a shrugging defeatism. "I don want anybody taking care of me," she told me with an incongruous smile. "I'd rather be gone," sh said, meaning dead. Such sentiment, attained at a high cost, was rare in Gimme-Now Nation.

Her brand of rugged individualism, if not her surrender, could be detected in the publ pronouncements of the bank chieftains and their supporters, many of whom championed free mark Darwinism for everyone but themselves. Their actions betrayed a willful denial of the fact that the owed their ongoing existence to people like Rebecca Black, whose mortgage payments made the rich, whose tax payments kept them afloat and furnished them with cheap loans, whose toleran made it possible for them to enjoy wealth the world had never seen—and whose support for anoth round of taxpayer bailouts, should the big banks screw up again, was less than zero. That ought scare the hell out of the rest of us as we careen toward the next financial crisis, which, according Jamie Dimon of JPMorgan Chase, is due any day.

We must survive the next upheaval in order to wrestle back control of our financial and politic institutions, to ensure that they serve society rather than society serving them. To make sure Wa Street will not write off the failure of America as its cost of doing business.

ONE

GLUTTONY

Size: Sherry Hunt and the Champions of Responsible Finance

THE TECHIES AT CITIMORTGAGE'S O'FALLON, MISSOURI, headquarters were told to drop what the were doing and gather outside. They filed out of the fluorescent light of the building and into th sun, where they lined up on the sidewalk at the edge of the vast parking area of the suburban offic campus—three attached buildings with *Truman Show* landscaping between a golf course and cluste of townhouses, two megamalls west of St. Louis. Together they watched as a cortege of three blac Cadillac Escalades made its way from the Interstate 40 access road to Technology Drive, then turne toward them and drove through the parted sea of parked cars. The Escalades stopped. Doors opene The techies began to applaud. One of them gave a high-pitched whoop. Out of the back seat of th middle Escalade stepped a man, lean and slender necked, with wire-frame glasses and a shock of whi in his dark hair. He acknowledged the warm greeting by ducking his delicate chin, flashing a smil and giving a quick, self-conscious wave. With the other hand he buttoned the top button of his su jacket. He was Vikram Pandit, Citigroup's chief executive officer, boss of all bosses, come from Ne York to review the troops.

When he'd disappeared inside the building, the techies quit clapping and filed back to the cubicles.

Perhaps it was too much to expect Pandit, buckled inside the SUV or circling above the O'Fallo offices in Citi's jet, his polished feet touching the sidewalk only long enough to be showered wi ginned-up adulation, to know what was really going on at CitiMortgage. A thousand miles separate the cherrywood conference rooms of the bank's Midtown Manhattan command center from th concrete and reflective glass of CitiMortgage headquarters in Missouri. Connecting the mother sh with the far-flung outpost was a corporate ladder whose every rung was populated with go-getters wl lived to please those above them and step on those below. The only glimpses New York had into wha O'Fallon was up to were periodic reports on the quality of the home loans CitiMortgage w processing. The reports told Pandit how well this spark was moving the piston of Citi's moneymakin machine. From soon after Pandit was chosen to lead the bank in December 2007 until the winter 2012, the reports conveyed the message to the top that the mortgage factory was well greased an purring. Performance was improving every day.

Mortgages keep America's banks in the black. For decades, they promised steady profits fo relatively low risk. Even when they're short of cash for other things, the great majority of hom owners pay their mortgages on time every month. Nobody likes to see an eviction notice stapled to th front door. It's no coincidence that the biggest banks in the country are also the biggest residenti lenders. And as far as loan factories go, Citigroup's was among the biggest of the big. In 2012, th 3,200 CitiMortgage workers in O'Fallon were joined by 2,800 more in Irving, Texas, and anoth

1,000 in Ann Arbor, Michigan, with 2,200 more spread among four other facilities. They processe ~~millions of mortgages every year. Big banks like Citi not only pay hundreds of employees~~ to se mortgages directly to customers out of storefront branches but also buy premade mortgages fro outside brokers, other loan companies, and other banks. Among its many tasks, the O'Fallon offic makes sure these mortgages are kosher, that every precaution is taken to ensure that borrowers won quit paying. If the mortgage papers are in order, chances are the mortgages are too. And if th mortgages are in order, they'll probably be repaid. The stakes are high. Before the financial crisis o 2008, CitiMortgage was buying as much as $90 billion a year of home loans from outside sources. the years since the crisis, with about half the brokers and mortgage companies having gone belly u that number has shrunk, and for a time there was mounting pressure from top executives to feed th hungry beast. Mortgages pay the banks' bills.

After the financial crisis of 2008, residential lending pretty much stopped. No financial fir wanted to risk advancing money to American home buyers, who had turned into deadbeats in recor numbers. With little fanfare, taxpayers stepped in and became the nation's mortgage bankers. Sinc then, the taxpayers' role has only grown. In 2013, Fannie Mae, Freddie Mac, or the Federal Housin Administration (FHA), the three government-controlled mortgage companies, either bought guaranteed about nine of every ten mortgages in the country. In a scenario that repeated itself man times during the crisis and after, private debt was transformed into public obligation: when Citigroup borrower in Springfield USA quit paying, Washington picked up the tab. Only when th government could prove the loans were fraudulent or had missing paperwork to begin with—a cost and resource-sapping undertaking that can take years—could it force banks like Citigroup to cover th government's insurance losses.

That makes cutting corners on mortgages potentially damaging to the whole country. And as lon as there have been mortgages, corners have been cut. It's a lot easier to identify the home loans wi messed-up paperwork before they quit paying. In the industry, messed-up paperwork is called "defect," and defects come in different flavors—a signature left off an important document, ridiculous appraisal, a mismatch between a borrower's income on the mortgage application and on th tax records. Other more serious problems may also indicate fraud: bank statements on which th bank's name is misspelled, tax forms where Wite-Out has been smeared over a number, borrower who list employers that don't exist, borrowers whose identities can't be confirmed.

Here's the crazy thing: whereas Fannie and Freddie double-check samplings of the mortgages the guarantee against defects, the Federal Housing Administration does not. Or, at least it didn't in an meaningful way from 2009 to 2012. The FHA, part of the cabinet-level Housing and Urba Development Department, expanded the number of loans it guaranteed from $700 billion in 2007 $1.1 trillion in 2012. And it delegated all quality control to the lenders. From at least 2009 till 201 government mortgage guarantors simply didn't double-check the mortgages coming in.

In other words, the FHA left it up to the foxes in O'Fallon, Missouri, to make sure taxpayer her didn't get stuck insuring bad loans.

According to O'Fallon, Citigroup was doing a world-class job at making sure all the paperwo was in order and borrowers would most likely repay their loans. Ask executives at the bank's Ne York headquarters how their US mortgage business was doing, and they stood a little taller. "Th quality of our mortgages is among the best, if not the best," they'd crow. I'd watched as CitiMortgage guy tapped a finger on multicolored bar charts that compared Citi with the other bigge lenders—JPMorgan Chase, Wells Fargo, and Bank of America. "See that? We're number one," he sai with pride.

The bar charts were based on data from O’Fallon. The numbers from O’Fallon were increasing ~~encouraging—miraculous even. Here was Citi, a financial gargantuan that lost $36 billion~~ in ju fifteen months back in 2007 and 2008, mostly because of bad mortgages. It received a bailout of $4 billion from the US Treasury Department, was promised another $301 billion from the government prop up its bad investments, and received dozens of overnight loans from the Federal Reserve th peaked at $99.5 billion on a single night in 2009. Those big numbers made Citigroup the most baile out US-based bank. Financial world rock stars such as Sheila Bair, former chairman of the Feder Deposit Insurance Corporation, or FDIC, have intimated that the government and the Federal Reser orchestrated the entire bank bailout extravaganza of 2007 to 2010 in order to save Citigroup, with th checks to the other banks mere window dressing to camouflage the singular insolvency of Ci President Barack Obama told author Ron Suskind that he favored shutting Citi down in the spring 2009 and auctioning off its parts to the highest bidders. Only through the intervention of Treasu Secretary Timothy Geithner did Citi survive in its present form, Suskind found. And here they were i 2012, just thirty-six months removed from their deathbed and a figurative Dr. Kevorkian with his han on the plug, ready to pull, and Pandit and his lieutenant, Sanjiv Das, chief executive of th CitiMortgage division, could brag that everything was peachy. Not perfect, they’d say, but a source delight and the benchmark by which their competitors ought to measure themselves. They were th comeback kids. They’d survived the nightmare of the third week of September 2008, when more tha one high-placed man in American finance made a phone call to his wife, telling her to go to the ATM and withdraw as much cash as she could, because it looked like the ATMs might run dry. And now, i 2012, the quality-assurance reports from O’Fallon were telling the New York executives that the were heroes.

Citi celebrated its two hundredth birthday in 2012, and New York toasted CEO Pandit with gallon of champagne that summer in recognition of the bank’s charitable giving. Lionel Richie and Chak Khan sang for him at a benefit dinner for Harlem’s Apollo Theater. Josh Groban performed at a part for a children’s mentoring organization. The Museum of the City of New York hosted a black-ti dinner where it presented Pandit with a leadership award.

“We are proud to support the great institutions that make New York City, our home for tw hundred years, a better place,” Pandit said about the galas.

O’Fallon had made a mockery of his so-called leadership.

The quality-control reports looked rosy because they were cooked. The truth, in fact, was ugly. Ci was still screwing up. Managers in Missouri simply changed the numbers or had their underlin farther down the corporate ladder apply figurative dabs of Wite-Out to inconvenient findings. The reasons went beyond good old-fashioned sucking up to the boss. It was a matter of livelihoo Compensation was based on the reports. Happy numbers meant more presents under the Christm tree. Besides, what “defect” couldn’t be fixed? Missing paperwork in the mortgage applications cou be found. Questionable appraisals were carefully informed opinions on ever-changing local real esta conditions. The two signatures only looked different. The nonexistent employer listed by the borrow was clearly a simple mistake. A transposed digit, an incorrectly copied address, a dotted lin unsigned: What was the harm?

The government didn’t seem to care. There’s an expression in the finance business attributed t billionaire J. Paul Getty: If you borrow $10,000 from the bank, that’s your problem. But if you borro $10 billion from the bank, that’s the bank’s problem. The US Treasury had sunk all those billions int Citigroup, along with the asset guarantees and those overnight loans from the Federal Reserve, not mention the political capital spent on keeping Citi’s air passages above water. It wanted Citi t succeed. It would guarantee any mortgage Citi shipped over to Fannie, Freddie, and the FHA, n questions asked. As long as Citigroup swore twice a year on its FHA certifications that it had the be interests of the American taxpayer in mind, that was good enough. The government trusted Citigrou It had to. Their fates were intertwined. And besides, 2008 was a long time ago. This was the new Ci —the Citi of responsible finance. Vikram Pandit, in a series of advertisements aimed at winning ov a citizenry—and potential customer base—that was mad as hell about having to bail out a bunch spoiled and ungrateful bankers, said as much. “We’re going to stand for the financial servic company that practices responsible finance—making sure we’re transparent, making sure we’ honest, making sure we manage our shareholders’ money prudently,” Pandit said on a video posted o the Citigroup website. Transparency, honesty, prudence: those were the new watchwords. The cris was over. The economy was recovering. Citigroup had paid back its government loans. People we buying houses and refinancing their mortgages. Defaults were down. All was well. Everybody wa happy.

Until Sherry Hunt.

OF THE HUNDREDS OF VICE PRESIDENTS AT WALL STREET banks, Sherry Hunt might have been th unlikeliest. She was a country girl, born and raised in southwestern Michigan, where her father taug her to fish and her mother showed her where in the woods to find wild mushrooms. She listened Marty Robbins and Buck Owens and came to believe that God had a plan, that everything happens f a reason.

She got married at sixteen and didn’t go to college. When she found herself, a little more than year later, with a baby, living in Alaska, she asked a friend to help her get a job. That’s how sh started processing mortgages, in Fairbanks, Alaska, in 1975.

Over the next thirty years, Hunt moved up the ladder to mortgage-banking jobs in Indian Minnesota, and Missouri. On her days off, when she wasn’t fishing with her second husband, she ro her horse, Cody, in Wild West shows. Sometimes she dressed as Annie Oakley, sometimes a Calamity Jane, firing blanks from a vintage rifle to entertain an audience. She liked the mortga business, liked that she was helping people buy houses. She was good at it. She believed in people, an she also believed they ought to get loans they were likely to pay back.

In November 2004, at the age of forty-seven, Hunt joined CitiMortgage. At first, she felt like mouse in a maze. She wasn’t used to the sea of cubicles stretching out in all directions at the O’Fall headquarters. “You only see people’s faces when someone brings in doughnuts and the smell ge them peeking over the tops of their cubicles,” she joked.

It looked like a great career move. The housing boom was on, and Citi was the country’s sixt largest residential lender at the time and headed upward. She’d made the big time.

Her job was supervising sixty-five mortgage underwriters—the people who check for mortga “defects” and make sure borrowers are able to repay their loans. She and her colleagues inspect home loans Citi wanted to buy from outside sources to make sure they met the bank’s standards. Ci would vouch for the quality of the loans when it sold them to investors or approved them f government insurance.

In the soaring market of the mid-2000s, Citigroup couldn’t process the mortgages fast enoug Investors loved buying bundles of home loans, called mortgage-backed securities, because the received a decent return and were considered low risk by the credit-rating companies. O’Fallon’s jo was to keep the assembly line going to meet the demand. Hunt and her team were expected to keep th process moving. They couldn't check every loan.

~~By 2006, Hunt's group was responsible for overseeing $50 billion of mortgages that Citigrou~~ bought from brokers and independent loan companies. They were finding all sorts of defects in th mortgages: doctored tax forms, missing signatures, phony appraisals, and liar loans, where th borrower's income was obviously picked out of the air so he could qualify for the loan. Hunt trie reporting the defect rate to supervisors, but somehow her warnings never made it past that rung of th corporate ladder, and the flow of defective mortgages never seemed to slow.

CitiMortgage wasn't the only lender more concerned with quantity than quality. The mortgag bubble was inflating, and everybody was along for the ride. Citigroup was paying bonuses based o the number of mortgages that employees processed. O'Fallon workers bought their boats, their fla screen TVs, and their Disney cruises, just like the borrowers who cashed in on their home equity b refinancing their loans.

By late 2007, Hunt's team was finding flaws or fraud in 60 percent of the loans they checked, a astounding number in an industry that tries to keep problem loans to 5 percent of the output or les The defects put the bank in danger. When Citi packaged the loans into securities for sale witho government guarantees, it promised to make good on any defective ones whose borrowers quit payin The flaws in underwriting were exposing Citi to millions, maybe billions, in so-called buybacks. Hu wasn't just a stickler for meaningless rules. She knew these violations could cost the bank som serious money.

Hunt couldn't convince anyone with any authority to toss a wooden shoe into the mortgag processing machinery—until one day she sent a summary of her findings to Richard Bowen, supervisor in CitiMortgage's Irving, Texas, office.

Bowen was a deeply religious man, a former Air Force Reserve Officer Training Corps cadet Texas Tech University in Lubbock, and a certified public accountant. He comes across as somethin of a Boy Scout, so it's a mild shock when he mutters an obscenity, which he's apt to do when he talk about mortgage defects. Bowen took a look at what Sherry Hunt sent him and came to the san conclusion she had: these bad mortgages were putting Citigroup at risk.

Bowen tried his best to raise alarms. But he didn't get anywhere.

On the morning of November 3, 2007, with his wife telling him to hurry up or they would be la for a wedding they were attending, Bowen shot off an e-mail from his home computer to top Citi bra in New York. It went to the bank's chief financial officer, Gary Crittenden, and to Citi's senior ris officer, who was in charge of making sure perils such as flawed home loans didn't cost the bank, an to the bank's chief auditor. But Bowen's main target was Robert Rubin, who at one time had been th Michael Jordan of the economy—popular and successful with an untouchable resume. Rubin ha headed Goldman Sachs, the New York investment bank, before becoming President Bill Clinton Treasury secretary. *Time* magazine, in a 1999 cover photo, called Rubin, Federal Reserve Chairma Alan Greenspan, and Clinton economic adviser Larry Summers "The Committee to Save the World Rubin was instrumental in convincing Clinton to support legislation allowing banks to comming gambling activities with customer deposits, which had been a no-no since the Great Depression. Aft his stint in Washington, Rubin went to work for the biggest beneficiary of that legislation, Citigrou as chairman of the executive committee. Bowen figured Rubin was savvy enough to heed his warnin once he became aware of the problem, so he put the words "Urgent—Read Immediately—Financi Issues" in the e-mail subject line.

"The reason for this urgent e-mail concerns breakdowns of internal controls and resultin significant but possibly unrecognized financial losses existing within our organization," Bowen wrot

"We continue to be significantly out of compliance."

In other words: Danger ahead! Rotten mortgages!

Bowen said he was interviewed by lawyers from an outside firm doing work for Citi and the demoted. He said he went from supervising more than two hundred employees to supervising two. B early 2009, a little more than a year after his e-mail, he no longer worked for Citigroup.

Citigroup denied retaliating against Bowen. Brad S. Karp, chairman of the law firm Paul, Weis Rifkind, Wharton & Garrison in New York, representing Citi, said in a letter to the Financial Cris Inquiry Commission, the panel Congress created to plumb the causes of the 2008 crash, that Citi acte on Bowen's concerns about defective mortgages. He said CitiMortgage fired a supervisor and change its underwriting standards. He didn't provide specifics.

A week after Bowen sent his e-mail, Sherry Hunt and her husband were driving their Toyo Camry, going about fifty-five miles per hour on four-lane Providence Road in Columbia, Missour when a driver in a Honda Civic traveling in the opposite direction hit them head on. Sherry broke foot and her sternum. Her husband broke an arm and his sternum. Doctors used four bones harveste from a cadaver and titanium screws to stabilize his neck.

"You come out of an experience like that with a commitment to making the most of the time yo have and making the world a better place," Hunt said.

Soon after Hunt returned to work, lawyers from Paul, Weiss invited her into a conference room the O'Fallon office and asked her about mortgage defects. At the time, she said, she had no idea it wa related to Bowen's e-mail. But the lawyers' persistent questions and dogged digging for the smalle details gave her an idea. From that time forward, she decided to take notes every day. She kept th notes on a spreadsheet on her home computer. The notes would come in handy when, like Bowen, sh decided that she had to speak up.

CITY BANK RECEIVED ITS CHARTER IN 1812, THE YEAR THAT two New Madrid earthquakes, epicentered Missouri, rang church bells in New York. It was 101 years before the founding of the Federal Reserv Dutch farmers still tilled the soil of the Bronx, and the buttonwood tree at 68 Wall Street, birthplac of the New York Stock Exchange, had yet to be swallowed by BMW of Manhattan. Trade was brisk a the time in Tennessee cotton, Caribbean rum, and African slaves.

The bank's first bailout came twenty-five years later, during the Panic of 1837. In the same wa that billionaire investor Warren Buffett came to the rescue of Goldman Sachs in 2008, tycoon Joh Jacob Astor and a group of wealthy merchants pumped money into City Bank to keep it afloat. Ther was no central bank at the time to dole out overnight loans the contemporary equivalent of $99 billion, though seventy-five years later, Frank A. Vanderlip, an executive of the bank then calle National City Bank of New York, participated in the secret meetings on Jekyll Island, Georgia, tha gave birth to the Federal Reserve.

City Bank was the first to amass $1 billion in assets, and in the 1920s, its chief executive, Charl Mitchell, was referred to as "Billion-Dollar Charlie." Mitchell is best known today for the grilling h received from a special prosecutor investigating the causes of the 1929 crash. Ferdinand Pecor appointed by Congress to conduct hearings in 1933, prodded Billion-Dollar Charlie to reveal his ro in pushing pump-and-dump stock speculation—touting shares of a company and then selling them- which helped inflate the investment bubble.

Pecora also discovered that Mitchell had paid no taxes on his $1 million 1929 compensatio Mitchell resigned.

Billion-Dollar Charlie's personal sacrifice was not in vain. In reaction to the crash of 1929 and th ensuing depression, Congress created the Federal Deposit Insurance Corporation, which guarantee savings accounts, and the Securities and Exchange Commission, tasked with making sure investors g a fair shake. It also passed the Glass-Steagall Act, which forced banks to separate investment bankin —underwriting stocks and bonds, cutting merger and takeover deals, and rolling the dice in hig stakes games of chance—from their taxpayer-guaranteed deposits. It would be nearly forty yea before Citi begged for another bailout.

Bank analyst Mike Mayo lists the years the financial institution, known through the decades City Bank, National City Bank, Citibank, Citicorp, and Citigroup, came close to failing: 1921, 193 1970, 1982, 1991, and 2008. "Citi has been involved in virtually every major financial screwup Mayo said. Citi clamored to fund Enron and underwrote WorldCom. In the early 2000s, Citi's stoc analysts, on whose independent assessments of the relative value of companies' shares investo relied, were convicted of hyping companies that Citi wanted to do business with. The bank lost i private-banking charter in Japan after improprieties there in the mid-2000s led Chief Executiv Officer Chuck Prince to fly to Tokyo to offer his personal apologies. Mayo totaled all of Citi's fine settlements, reserves, or write-downs in the twenty-first century and figured they represented about $ for every $3 it made.

Historians credit Walter Wriston, a former Eagle Scout who led the bank from 1967 to 1984 (an through two bailouts), with bringing innovations to the industry such as the automated teller machin and the negotiable certificate of deposit. But the most significant moment in the recent history banking would come more than a decade later, when Wriston's successor, the patrician John S. Reed picked up the phone to take a call from Brooklyn-raised Sanford I. Weill.

DICK BOWEN'S DEPARTURE FROM CITIMORTGAGE IN EARLY 2009 left Sherry Hunt feeling lonely an isolated. Bowen was a good man, she believed. He'd called Sherry after her car accident, offering h help and prayers. To see a decent man like Bowen treated so shabbily made her angry.

It also scared her. She'd supplied Bowen with much of the data he'd used to blow the whistle o CitiMortgage's quality-control failures, and seeing how he had left the bank, she was terrified she lose her job. She couldn't afford that. She had medical bills and attorney's fees to pay. She decided t lay low.

That didn't last long. On April 1, 2008, Citi demoted her. She went from supervising sixty-fiv people to supervising none. She was now part of the "quality-assurance" team. There, she found plen of dirt to fill up her spreadsheet. "Every time I turned over a rock I found a snake," she said.

One place particularly rife with slithering reptiles was CitiMortgage's Fraud Prevention an Investigation Group. That was where the quality-control team shipped loans they suspected of bein more than just flawed. It was where loans with suspected fraud went.

The FHA rules about this sort of thing are clear. CitiMortgage was supposed to notify the agency it found anything suspicious in a loan guaranteed by government insurance. And it was supposed to d it within a month.

In November 2009, a year after Citigroup's bailout, Hunt came across about 1,000 loans th quality-control team had flagged for possible fraud. Some of them had been in the queue with n action taken for more than two years. Not until July 2011, when the US attorney in Manhattan issued subpoena to the O'Fallon office, did CitiMortgage finally tell the FHA about its secret stash o potentially fraudulent loans.

SANDY WEILL, WITH THE HELP OF A COCKSURE WINGMAN named Jamie Dimon, parlayed a Baltimor ~~based subprime lender into a financial empire that included the Salomon Smith Barney brokerage~~ an the insurance giant Travelers Group. To grow, they needed cash. The easiest and cheapest source wa customer deposits. John Reed's Citicorp could be the wellspring that ka-chinged Weill into the bi time.

Weill's pitch to Reed was simple. Together they could create a financial services supermarke Customers who came for a savings or checking account could get a mortgage and insurance for the home, a credit card to buy clothes and furniture, and a stockbroker to handle their retirement accoun The supermarket would also have an investment banker to make deals and traders to keep the mone rolling in. This Frankenstein monster could compete globally with the biggest banks of Europe an Asia and continue gobbling up smaller competitors.

Reed was game. The only trouble was, they needed to change the law. The sixty-five-year-ol Glass-Steagall Act prohibited risking Grandma's Christmas Club account on the dice games o financial markets. Ironically—and Citi's history does not lack for irony—Glass-Steagall had bee enacted in the wake of Ferdinand Pecora's harsh questioning of the man who'd had Reed's job in th 1920s, National City Bank's Charlie Mitchell.

But Glass-Steagall had been whittled down over the decades. Weill and Reed wanted it to slee with the fishes. They signed their deal to merge Travelers and Citicorp in 1998, creating Citigrou before the law was repealed. They felt confident that with influential friends like Treasury Secretar Bob Rubin to support them, the so-called modernization of the banking industry would prove a n brainer for lawmakers and President Bill Clinton.

The Gramm-Leach-Bliley Act, as the repeal of Glass-Steagall was called, would enhance th stability of the American financial services industry, Clinton said in a statement accompanying h November 1999 signing of the legislation. It's the most important law for the industry since the Gre Depression, Clinton said, and "America's consumers, our communities, and the economy will reap th benefits of this Act."

IN 2009, CITIMORTGAGE EXECUTIVES PUT TOGETHER A COMMITTEE to refute Sherry Hunt's claims o mortgage defects. They called it the Quality Rebuttal team. In meetings they tried to convince Hu that she'd judged some mortgage defects too harshly, that they really weren't as bad as she said the were. For instance, a signed document called a HUD-1 declaration is required for every FHA loan, an according to government guidelines, the loan ought to be rejected for FHA insurance if the docume is missing. The Quality Rebuttal committee insisted a missing HUD-1 declaration didn't make th loan a bad one. The members dug in their heels and wouldn't listen to Hunt, despite her twenty-fiv years' experience with government-guaranteed mortgages. They outvoted her. The loan was approve for FHA insurance. Hunt could only shake her head and make note of it on her spreadsheet.

CitiMortgage even went so far as to create new categories for loans. If a mortgage was defective, was classified by the severity of its defect. That meant that the reports up the ladder would seem eve better—Hey, look, our tier 1 defects are down 58 percent! (So what if tier 2 defects are up, say, 8 percent?)—except that the FHA, Fannie Mae, Freddie Mac, investors in mortgage-backed securitie and anyone else who would sue Citi if there were problems didn't give a rat's patootie whether Ci said a loan had a tier 1, tier 2, or tier 3 defect. They just wanted to know if it would continue payin and if Citigroup had done all it could to assure that it would. CitiMortgage's new classification syste made sense only to CitiMortgage. Its executives could use it to show that they were the comeba