Aspatore Special Report
2008

*1 COMMENTARY ON COUNTRYWIDE SETTLEMENTS

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Bank of America has announced that it has settled lawsuits filed by attorneys general relating to high risk loans made by Countrywide Financial, which Bank of America acquired in July 2008. The settlement, which takes effect in December 2008, follows on the heels of the $700 billion congressional bailout. Unlike the bailout, the settlement is intended to directly assist borrowers. Under the settlement, Bank of America will provide up to $8.7 billion to borrowers in 11 states. Not all borrowers will qualify. Rather, the settlement is intended to modify those subprime and pay-option adjustable rate mortgages that were originated by Countrywide between January 1, 2004 and December 31, 2007. In order for borrowers of these loans to qualify for loan modification, they must generally be 60 or more days delinquent or face an impending interest rate adjustment that, once adjusted, will cause them to fall into delinquency, meet certain income requirements, owe at least 75% of the current value of their home and occupy the property. Qualifying borrowers will be eligible for loan modification that ranges from extension of the introductory interest rate, reduction in the principal balance of the loan, and rate reductions.

It is unclear whether Bank of America will face further lawsuits from attorneys general in other states over what has been described by at least one attorney general as “predatory lending practices” or whether pending lawsuits against Bank of America will be halted. As for borrowers, it is estimated that the Bank of America settlement will benefit nearly 380,000 borrowers who obtained loans from Countrywide Financial. Under the settlement, Bank of America will cease foreclosure proceeds for those borrowers who will likely qualify. Unfortunately, it is unclear what will happen to borrowers obtained similar loans from Wachovia and Washington Mutual, who were recently taken over by Wells Fargo and JP Morgan, respectively.

Like the bailout, the settlement between Bank of America and attorneys general evidences the dismal state of the economy. And, like the bailout, the settlement with Bank of American will no more correct the down-slide of the economy. Indeed, in the week after the bailout was approved by Congress, the Dow Jones Industrial Average fell for seven straight days. In all, the Dow has lost nearly 20% in the course of seven consecutive trading days. This prompted a half-point cut interest rate cut by the Federal Reserve and an announcement by the Fed that the central banks will pump unlimited dollars into the financial system in order to stem the tide of further bank failures.

The fiscal rescue efforts such as the congressionally approved bailout and the Bank of America settlement represent no more than a band-aid placed on a large gapping wound in the U.S. economy. Government aided financial rescues of the likes of Freddie Mac, Fannie Mae, and AIG, while perhaps necessary in order to forestall a depression, will not stop the continued down-fall of the U.S. economy. Consumer confidence is low and continues to sink. Foreclosures continue to rise and 401k accounts have plummeted.

***2** We have not yet reached the bottom of the trough. Best estimates place the turnaround of the economy sometime in 2010 or perhaps as late as 2011. The rebound will be signaled by the improvement in the housing market. Increases in new construction starts and the sale of existing home inventory are necessary in order to lead us out of the current depression. The building, buying, and selling of homes is what drives the U.S. economy. Not until this occurs will consumer spending increase. Without consumer spending, no amount of financial rescue efforts will cure our current economic woes.

Looking back a year ago, no one would have predicted the fall of Wall Street institutions like Bear Stearns and Lehman Brothers. No one would have predicted that AIG would be rescued by the federal government or that the FDIC would take over giant Washington Mutual. Unfortunately, no one can predict what will happen in the next 12 to 18 months. If the capital and credit markets continue to restrict, it is not out of the realm of possibility to see additional investment banks, financial institutions, banks, and Fortune 100 companies, not to mention small businesses, out of business and consumers pushed to financial ruin. If this results, the $700 billion bailout will be a small drop in a very large fiscal pond. What happens over this period will determine the course of the United States in matters ranging from our dependence on foreign manufacturing to our ability to preserve democracy in other parts of the world. We are rowing upstream against a strong current and have only one paddle left. Our next move must be decisive and surgical. A band-aid solution will not solve the problem.

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