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HSBC's $550 Million Dollar Mortgage Bond Settlement

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After peaking in 2006, housing prices in the United States began to decline very swiftly – even more so than in the Great Depression. As prices fell 33 percent (they fell 31 percent during the Great Depression), homeowners realized that the value of their homes had become lower than their mortgage debt, and they lost their incentive to pay their mortgage balances. This led to foreclosures and short sales at unprecedented levels. Significantly, lost output—goods and services that we will never see—reached at least 40 percent of 2007 U.S. gross domestic product.

Among the causes was the inflated housing bubble, which resulted from faith put into the misguided belief that "a house's price could not fall," as well as adjustable interest rates (which started low and steadily increased). Under normal circumstances, such rates were affordable for the borrowers. However, with the burst of the house bubble, paying the increased rates became more and more difficult as the income of mortgage borrowers started to rapidly deteriorate.

Financial institutions were on thin ice with their capital already stretched to the limit. According to the Financial Crisis Inquiry Commission: *"[A]s of 2007, the five major investment banks—Bear Stearns, Goldman Sachs, Lehman Brothers, Merrill Lynch, and Morgan Stanley—were operating with extraordinarily thin capital. By one measure, their leverage ratios were as high as 40 to 1, meaning for every $40 in assets, there was only $1 in capital to cover losses."*

Perhaps the most significant contributors to the crisis were the mortgages sold to Fannie Mae and Freddie Mac, which had borne risks that were allegedly falsified or misrepresented by banks and financial institutions. Fannie Mae and Freddie Mac found themselves faced with a catastrophic crisis that could be alleviated only through the pumping of 188 billion taxpayer dollars.

In 2011, after the shockwaves of the crisis abated, the Federal Housing Finance Agency ("the Agency") filed lawsuits against 18 banks and financial institutions, including HSBC in district court in the Southern District of New York. The Agency alleged false representations regarding the mortgage bonds HSBC sold to Fannie Mae and Freddie Mac. HSBC settled for $550 million just before trial, which had been scheduled for September 29. HSBC could have faced up to 1.6 billion dollars in damages, but will pay $374 million to Freddie Mac and $176 million to Fannie Mae. The Federal Housing Finance Agency also settled with Bank of America Corp., Deutsche Bank AG and Morgan Stanley after filing similar lawsuits.