

In Financial Crisis, No Prosecutions of Top Figures

by Gretchen Morgenson & Louise Story via sal - NYT Saturday, Apr 16 2011, 12:42am
international / injustice/law / other press

(Suckers! Yes, that means YOU!)

It is a question asked repeatedly across America: why, in the aftermath of a financial mess that generated hundreds of billions in losses, have no high-profile participants in the disaster been prosecuted?



GSachs CEO, Lloyd 'better you than me' Blankfein

Answering such a question — the equivalent of determining why a dog did not bark — is anything but simple. But a private meeting in mid-October 2008 between Timothy F. Geithner, then-president of the Federal Reserve Bank of New York, and Andrew M. Cuomo, New York's attorney general at the time, illustrates the complexities of pursuing legal cases in a time of panic.

At the Fed, which oversees the nation's largest banks, Mr. Geithner worked with the Treasury Department on a large bailout fund for the banks and led efforts to shore up the American International Group, the giant insurer. His focus: stabilizing world financial markets.

Mr. Cuomo, as a Wall Street enforcer, had been questioning banks and rating agencies aggressively for more than a year about their roles in the growing debacle, and also looking into bonuses at A.I.G.

Friendly since their days in the Clinton administration, the two met in Mr. Cuomo's office in Lower Manhattan, steps from Wall Street and the New York Fed. According to three people briefed at the time about the meeting, Mr. Geithner expressed concern about the fragility of the financial system.

His worry, according to these people, sprang from a desire to calm markets, a goal that could be complicated by a hard-charging attorney general.

Asked whether the unusual meeting had altered his approach, a spokesman for Mr. Cuomo, now New York's governor, said Wednesday evening that "Mr. Geithner never suggested that there be any lack of diligence or any slowdown." Mr. Geithner, now the Treasury secretary, said through a spokesman that he had been focused on A.I.G. "to protect taxpayers."

Whether prosecutors and regulators have been aggressive enough in pursuing wrongdoing is likely to long be a subject of debate. All say they have done the best they could under difficult circumstances.

But several years after the financial crisis, which was caused in large part by reckless lending and excessive risk taking by major financial institutions, no senior executives have been charged or imprisoned, and a collective government effort has not emerged. This stands in stark contrast to the failure of many savings and loan institutions in the late 1980s. In the wake of that debacle, special government task forces referred 1,100 cases to prosecutors, resulting in more than 800 bank officials going to jail. Among the best-known: Charles H. Keating Jr., of Lincoln Savings and Loan in Arizona, and David Paul, of Centrust Bank in Florida.

Former prosecutors, lawyers, bankers and mortgage employees say that investigators and regulators ignored past lessons about how to crack financial fraud.

As the crisis was starting to deepen in the spring of 2008, the Federal Bureau of Investigation scaled back a plan to assign more field agents to investigate mortgage fraud. That summer, the Justice Department also rejected calls to create a task force devoted to mortgage-related investigations, leaving these complex cases understaffed and poorly funded, and only much later established a more general financial crimes task force.

Leading up to the financial crisis, many officials said in interviews, regulators failed in their crucial duty to compile the information that traditionally has helped build criminal cases. In effect, the same dynamic that helped enable the crisis — weak regulation — also made it harder to pursue fraud in its aftermath.

A more aggressive mind-set could have spurred far more prosecutions this time, officials involved in the S.&L. cleanup said.

“This is not some evil conspiracy of two guys sitting in a room saying we should let people create crony capitalism and steal with impunity,” said William K. Black, a professor of law at University of Missouri, Kansas City, and the federal government’s director of litigation during the savings and loan crisis. “But their policies have created an exceptional criminogenic environment. There were no criminal referrals from the regulators. No fraud working groups. No national task force. There has been no effective punishment of the elites here.”

Even civil actions by the government have been limited. The Securities and Exchange Commission adopted a broad guideline in 2009 — distributed within the agency but never made public — to be cautious about pushing for hefty penalties from banks that had received bailout money. The agency was concerned about taxpayer money in effect being used to pay for settlements, according to four people briefed on the policy but who were not authorized to speak publicly about it.

To be sure, Wall Street’s role in the crisis is complex, and cases related to mortgage securities are immensely technical. Criminal intent in particular is difficult to prove, and banks defend their actions with documents they say show they operated properly.

But legal experts point to numerous questionable activities where criminal probes might have borne fruit and possibly still could.

Investigators, they argue, could look more deeply at the failure of executives to fully disclose the scope of the risks on their books during the mortgage mania, or the amounts of questionable loans they bundled into securities sold to investors that soured.

Prosecutors also could pursue evidence that executives knowingly awarded bonuses to themselves and colleagues based on overly optimistic valuations of mortgage assets — in effect, creating illusory

profits that were wiped out by subsequent losses on the same assets. And they might also investigate whether executives cashed in shares based on inside information, or misled regulators and their own boards about looming problems.

Merrill Lynch, for example, understated its risky mortgage holdings by hundreds of billions of dollars. And public comments made by Angelo R. Mozilo, the chief executive of Countrywide Financial, praising his mortgage company's practices were at odds with derisive statements he made privately in e-mails as he sold shares; the stock subsequently fell sharply as the company's losses became known.

Executives at Lehman Brothers assured investors in the summer of 2008 that the company's financial position was sound, even though they appeared to have counted as assets certain holdings pledged by Lehman to other companies, according to a person briefed on that case. At Bear Stearns, the first major Wall Street player to collapse, a private litigant says evidence shows that the firm's executives may have pocketed revenues that should have gone to investors to offset losses when complex mortgage securities soured.

But the Justice Department has decided not to pursue some of these matters — including possible criminal cases against Mr. Mozilo of Countrywide and Joseph J. Cassano, head of Financial Products at A.I.G., the business at the epicenter of that company's collapse. Mr. Cassano's lawyers said that documents they had given to prosecutors refuted accusations that he had misled investors or the company's board. Mr. Mozilo's lawyers have said he denies any wrongdoing.

Among the few exceptions so far in civil action against senior bankers is a lawsuit filed last month against top executives of Washington Mutual, the failed bank now owned by JPMorgan Chase. The Federal Deposit Insurance Corporation sued Kerry K. Killinger, the company's former chief executive, and two other officials, accusing them of piling on risky loans to grow faster and increase their compensation. The S.E.C. also extracted a \$550 million settlement from Goldman Sachs for a mortgage security the bank built, though the S.E.C. did not name executives in that case.

Representatives at the Justice Department and the S.E.C. say they are still pursuing financial crisis cases, but legal experts warn that they become more difficult as time passes.

"If you look at the last couple of years and say, 'This is the big-ticket prosecution that came out of the crisis,' you realize we haven't gotten very much," said David A. Skeel, a law professor at the University of Pennsylvania. "It's consistent with what many people were worried about during the crisis, that different rules would be applied to different players. It goes to the whole perception that Wall Street was taken care of, and Main Street was not."

The Countrywide Puzzle

As nonprosecutions go, perhaps none is more puzzling to legal experts than the case of Countrywide, the nation's largest mortgage lender. Last month, the office of the United States attorney for Los Angeles dropped its investigation of Mr. Mozilo after the S.E.C. extracted a settlement from him in a civil fraud case. Mr. Mozilo paid \$22.5 million in penalties, without admitting or denying the accusations.

White-collar crime lawyers contend that Countrywide exemplifies the difficulties of mounting a criminal case without assistance and documentation from regulators — the Office of the Comptroller of the Currency, the Office of Thrift Supervision and the Fed, in Countrywide's case.

“When regulators don’t believe in regulation and don’t get what is going on at the companies they oversee, there can be no major white-collar crime prosecutions,” said Henry N. Pontell, professor of criminology, law and society in the School of Social Ecology at the University of California, Irvine. “If they don’t understand what we call collective embezzlement, where people are literally looting their own firms, then it’s impossible to bring cases.”

Financial crisis cases can be brought by many parties. Since the big banks’ mortgage machinery involved loans on properties across the country, attorneys general in most states have broad criminal authority over most of these institutions. The Justice Department can bring civil or criminal cases, while the S.E.C. can file only civil lawsuits.

All of these enforcement agencies traditionally depend heavily on referrals from bank regulators, who are more savvy on complex financial matters.

But data supplied by the Justice Department and compiled by a group at Syracuse University show that over the last decade, regulators have referred substantially fewer cases to criminal investigators than previously.

The university’s Transactional Records Access Clearinghouse indicates that in 1995, bank regulators referred 1,837 cases to the Justice Department. In 2006, that number had fallen to 75. In the four subsequent years, a period encompassing the worst of the crisis, an average of only 72 a year have been referred for criminal prosecution.

Law enforcement officials say financial case referrals began declining under President Clinton as his administration shifted its focus to health care fraud. The trend continued in the Bush administration, except for a spike in prosecutions for Enron, WorldCom, Tyco and others for accounting fraud.

The Office of Thrift Supervision was in a particularly good position to help guide possible prosecutions. From the summer of 2007 to the end of 2008, O.T.S.-overseen banks with \$355 billion in assets failed.

The thrift supervisor, however, has not referred a single case to the Justice Department since 2000, the Syracuse data show. The Office of the Comptroller of the Currency, a unit of the Treasury Department, has referred only three in the last decade.

The comptroller’s office declined to comment on its referrals. But a spokesman, Kevin Mukri, noted that bank regulators can and do bring their own civil enforcement actions. But most are against small banks and do not involve the stiff penalties that accompany criminal charges.

Historically, Countrywide’s bank subsidiary was overseen by the comptroller, while the Federal Reserve supervised its home loans unit. But in March 2007, Countrywide switched oversight of both units to the thrift supervisor. That agency was overseen at the time by John M. Reich, a former banker and Senate staff member appointed in 2005 by President George W. Bush.

Robert Gnaizda, former general counsel at the Greenlining Institute, a nonprofit consumer organization in Oakland, Calif., said he had spoken often with Mr. Reich about Countrywide’s reckless lending.

“We saw that people were getting bad loans,” Mr. Gnaizda recalled. “We focused on Countrywide because they were the largest originator in California and they were the ones with the most exotic mortgages.”

Mr. Gnaizda suggested many times that the thrift supervisor tighten its oversight of the company, he said. He said he advised Mr. Reich to set up a hot line for whistle-blowers inside Countrywide to communicate with regulators.

"I told John, 'This is what any police chief does if he wants to solve a crime,' " Mr. Gnaizda said in an interview. "John was uninterested. He told me he was a good friend of Mozilo's."

In an e-mail message, Mr. Reich said he did not recall the conversation with Mr. Gnaizda, and his relationships with the chief executives of banks overseen by his agency were strictly professional. "I met with Mr. Mozilo only a few times, always in a business environment, and any insinuation of a personal friendship is simply false," he wrote.

After the crisis had subsided, another opportunity to investigate Countrywide and its executives yielded little. The Financial Crisis Inquiry Commission, created by Congress to investigate the origins of the disaster, decided not to make an in-depth examination of the company — though some staff members felt strongly that it should.

In a January 2010 memo, Brad Bondi and Martin Biegelman, two assistant directors of the commission, outlined their recommendations for investigative targets and hearings, according to Tom Krebs, another assistant director of the commission. Countrywide and Mr. Mozilo were specifically named; the memo noted that subprime mortgage executives like Mr. Mozilo received hundreds of millions of dollars in compensation even though their companies collapsed.

However, the two soon received a startling message: Countrywide was off limits. In a staff meeting, deputies to Phil Angelides, the commission's chairman, said he had told them Countrywide should not be a target or featured at any hearing, said Mr. Krebs, who said he was briefed on that meeting by Mr. Bondi and Mr. Biegelman shortly after it occurred. His account has been confirmed by two other people with direct knowledge of the situation.

Mr. Angelides denied that he had said Countrywide or Mr. Mozilo were off limits. Chris Seefer, the F.C.I.C. official responsible for the Countrywide investigation, also said Countrywide had not been given a pass. Mr. Angelides said a full investigation was done on the company, including 40 interviews, and that a hearing was planned for the fall of 2010 to feature Mr. Mozilo. It was canceled because Republican members of the commission did not want any more hearings, he said.

"It got as full a scrub as A.I.G., Citi, anyone," Mr. Angelides said of Countrywide. "If you look at the report, it's extraordinarily condemnatory."

An F.B.I. Investigation Fizzles

The Justice Department in Washington was abuzz in the spring of 2008. Bear Stearns had collapsed, and some law enforcement insiders were suggesting an in-depth search for fraud throughout the mortgage pipeline.

The F.B.I. had expressed concerns about mortgage improprieties as early as 2004. But it was not until four years later that its officials recommended closing several investigative programs to free agents for financial fraud cases, according to two people briefed on a study by the bureau.

The study identified about two dozen regions where mortgage fraud was believed rampant, and the bureau's criminal division created a plan to investigate major banks and lenders. Robert S. Mueller III, the director of the F.B.I., approved the plan, which was described in a memo sent in spring 2008

to the bureau's field offices.

"We were focused on the whole gamut: the individuals, the mortgage brokers and the top of the industry," said Kenneth W. Kaiser, the former assistant director of the criminal investigations unit. "We were looking at the corporate level."

Days after the memo was sent, however, prosecutors at some Justice Department offices began to complain that shifting agents to mortgage cases would hurt other investigations, he recalled. "We got told by the D.O.J. not to shift those resources," he said. About a week later, he said, he was told to send another memo undoing many of the changes. Some of the extra agents were not deployed.

A spokesman for the F.B.I., Michael Kortan, said that a second memo was sent out that allowed field offices to try to opt out of some of the changes in the first memo. Mr. Kaiser's account of pushback from the Justice Department was confirmed by two other people who were at the F.B.I. in 2008.

Around the same time, the Justice Department also considered setting up a financial fraud task force specifically to scrutinize the mortgage industry. Such task forces had been crucial to winning cases against Enron executives and those who looted savings and loans in the early 1990s.

Michael B. Mukasey, a former federal judge in New York who had been the head of the Justice Department less than a year when Bear Stearns fell, discussed the matter with deputies, three people briefed on the talks said. He decided against a task force and announced his decision in June 2008.

Last year, officials of the Financial Crisis Inquiry Commission interviewed Mr. Mukasey. Asked if he was aware of requests for more resources to be dedicated to mortgage fraud, Mr. Mukasey said he did not recall internal requests.

A spokesman for Mr. Mukasey, who is now at the law firm Debevoise & Plimpton in New York, said he would not comment beyond his F.C.I.C. testimony. He had no knowledge of the F.B.I. memo, his spokesman added.

A year later — with precious time lost — several lawmakers decided that the government needed more people tracking financial crimes. Congress passed a bill, providing a \$165 million budget increase to the F.B.I. and Justice Department for investigations in this area. But when lawmakers got around to allocating the budget, only about \$30 million in new money was provided.

Subsequently, in late 2009, the Justice Department announced a task force to focus broadly on financial crimes. But it received no additional resources.

A Break for 8 Banks

In July 2008, the staff of the S.E.C. received a phone call from Scott G. Alvarez, general counsel at the Federal Reserve in Washington.

The purpose: to discuss an S.E.C. investigation into improprieties by several of the nation's largest brokerage firms. Their actions had hammered thousands of investors holding the short-term investments known as auction-rate securities.

These investments carry interest rates that reset regularly, usually weekly, in auctions overseen by the brokerage firms that sell them. They were popular among investors because the interest rates

they received were slightly higher than what they could earn elsewhere.

For years, companies like UBS and Goldman Sachs operated auctions of these securities, promoting them as highly liquid investments. But by mid-February 2008, as the subprime mortgage crisis began to spread, investors holding hundreds of billions of dollars of these securities could no longer cash them in.

As the S.E.C. investigated these events, several of its officials argued that the banks should make all investors whole on the securities, according to three people with knowledge of the negotiations but who were not authorized to speak publicly, because banks had marketed them as safe investments.

But Mr. Alvarez suggested that the S.E.C. soften the proposed terms of the auction-rate settlements. His staff followed up with more calls to the S.E.C., cautioning that banks might run short on capital if they had to pay the many billions of dollars needed to make all auction-rate clients whole, the people briefed on the conversations said. The S.E.C. wound up requiring eight banks to pay back only individual investors. For institutional investors — like pension funds — that bought the securities, the S.E.C. told the banks to make only their “best efforts.”

This shift eased the pain significantly at some of the nation’s biggest banks. For Citigroup, the new terms meant it had to redeem \$7 billion in the securities for individual investors — but it was off the hook for about \$12 billion owned by institutions. These institutions have subsequently recouped some but not all of their investments. Mr. Alvarez declined to comment, through a spokeswoman.

An S.E.C. spokesman said: “The primary consideration was remedying the alleged wrongdoing and in fashioning that remedy, the emphasis was placed on retail investors because they were suffering the greatest hardship and had the fewest avenues for redress.”

A similar caution emerged in other civil cases after the bank bailouts in the autumn of 2008. The S.E.C.’s investigations of financial institutions began to be questioned by its staff and the agency’s commissioners, who worried that the settlements might be paid using federal bailout money.

Four people briefed on the discussions, who spoke anonymously because they were not authorized to speak publicly, said that in early 2009, the S.E.C. created a broad policy involving settlements with companies that had received taxpayer assistance. In discussions with the Treasury Department, the agency’s division of enforcement devised a guideline stating that the financial health of those banks should be taken into account when the agency negotiated settlements with them.

“This wasn’t a political thing so much as, ‘We don’t know if it makes sense to bring a big penalty against a bank that just got a check from the government,’ ” said one of the people briefed on the discussions.

The people briefed on the S.E.C.’s settlement policy said that, while it did not directly affect many settlements, it slowed down the investigative work on other cases. A spokesman for the S.E.C. declined to comment.

Attorney General Moves On

The final chapter still hasn’t been written about the financial crisis and its aftermath. One thing has been especially challenging for regulators and law enforcement officials: balancing concerns for the state of the financial system even as they pursued immensely complicated cases.

The conundrum was especially clear back in the fall of 2008 when Mr. Geithner visited Mr. Cuomo and discussed A.I.G. Asked for details about the meeting, a spokesman for Mr. Geithner said: "As A.I.G.'s largest creditor, the New York Federal Reserve installed new management at A.I.G. in the fall of 2008 and directed the new C.E.O. to take steps to end wasteful spending by the company in order to protect taxpayers."

Mr. Cuomo's office said, "The attorney general went on to lead the most aggressive investigation of A.I.G. and other financial institutions in the nation." After that meeting, and until he left to become governor, Mr. Cuomo focused on the financial crisis, with mixed success. In late 2010, Mr. Cuomo sued the accounting firm Ernst & Young, accusing it of helping its client Lehman Brothers "engage in massive accounting fraud."

To date, however, no arm of government has sued Lehman or any of its executives on the same accounting tactic.

Other targets have also avoided legal action. Mr. Cuomo investigated the 2008 bonuses that were paid out by giant banks just after the bailout, and he considered bringing a case to try to claw back some of that money, two people familiar with the matter said. But ultimately he chose to publicly shame the companies by releasing their bonus figures.

Mr. Cuomo took a tough stance on Bank of America. While the S.E.C. settled its case with Bank of America without charging any executives with wrongdoing, Mr. Cuomo filed a civil fraud lawsuit against Kenneth D. Lewis, the former chief executive, and the bank's former chief financial officer. The suit accuses them of understating the losses of Merrill Lynch to shareholders before the deal was approved; the case is still pending.

Last spring, Mr. Cuomo issued new mortgage-related subpoenas to eight large banks. He was interested in whether the banks had misled the ratings agencies about the quality of the loans they were bundling and asked how many workers they had hired from the ratings agencies. But Mr. Cuomo did not bring a case on this matter before leaving office.

© 2011 The New York Times Company

See:

<http://www.commondreams.org/view/2011/04/15-7>

<http://www.nytimes.com/2011/04/14/business/14prosecute.html>

Cleaves Alternative News. <http://cleaves.lingama.net/news/story-2450.html>