

January 2012

Business Fraud Alert

A Newsletter Covering Developments in Criminal and Civil Enforcement of Anti-Fraud Statutes

January 31, 2012

Justice Department Establishes Residential Mortgage-Backed Securities Working Group¹

At a press conference on January 27, 2012, Attorney General Eric Holder, accompanied by the SEC Director of Enforcement, the Secretary for the Department of Housing and Urban Development, the Assistant Attorney General for the Civil Division, and the New York Attorney General, among others, announced that the formation of a new Residential Mortgage-Backed Securities Working Group (“Working Group”) within the current Financial Fraud Enforcement Task Force (“Task Force”).² The Working Group’s task will be to “streamline and strengthen current and future efforts to identify, investigate, and prosecute instances of wrongdoing in the packaging, selling, and valuing of residential mortgage-backed securities.”³

SEC Director of Enforcement Robert Khuzami noted in his remarks at the press conference that “mortgage products were in many ways ground zero for the financial crisis. The collapse in value of mortgage-backed securities resulted in unprecedented losses, and all of us in law enforcement are dedicated to holding accountable financial institutions that lied and cheated and misled investors.” Attorney General Holder noted that the Working Group would include 15 attorneys at Department headquarters and at United States Attorney’s Offices, and 10 Federal Bureau of Investigation special agents and analysts, with additional staffing to be added in the coming weeks.⁴ Recognizing that not all reckless or unethical conduct in the RMBS industry is criminal in nature, Attorney General Holder also emphasized the availability of civil sanctions and announced that the Department had recently issued civil subpoenas related to the market for RMBS to 11 financial institutions. He promised that “more will follow.”

After the press conference, the Department released a January 27, 2012, memorandum from Attorney General Holder to the Task Force requiring it to form the Working Group. Like the remarks of Mr. Khuzami, the Attorney General’s directive to the Task Force emphasized that the government’s prior investigations and inquiries into the financial crisis had revealed that “the creation, sale, and ultimately massive failure of residential mortgage-backed securities . . . contributed significantly to the collapse of the housing market, damaged the public’s trust and threatened the safety and soundness of our economy.” Accordingly, he directed the Working Group to focus on:

- misrepresentations by originators, sponsors, underwriters, and other market participants concerning the quality of mortgages backing the RMBS;
- failures to transfer ownership of the collateral into the securities;
- failures by trustees to manage adequately the assets within the securitized pools of loans;
- failures by RMBS sponsors to repurchase the problematic loans or remit loan proceeds to RMBS trusts;

- failures by RMBS sponsors to adequately reserve for and/or disclose the potential exposure to liability if obligations to repurchase problematic loans were triggered; and
- harm suffered by American consumers as a result of any of the above.⁵

Prior Federal Enforcement Activity

In November 2009, in the wake of the mortgage and financial crisis, President Obama created the Task Force by Executive Order, and authorized it to advise and recommend to the Attorney General investigations and prosecutions of the financial industry, and oversee and coordinate such initiatives with other federal and state officials.⁶ Notwithstanding this mandate, to date, none of the federal or state criminal prosecutions under the auspices of the Task Force contains criminal charges against any high level official of a major Wall Street bank or any bank itself for fraud or misconduct in connection with RMBS. Although the Justice Department distributed a document at the January 27, 2012, press conference describing the main accomplishments of the Task Force, a perusal of the cases listed shows that, while important, none of the highlighted cases focused on the RMBS market or industry-wide practices within that market. Moreover, several high-profile cases closely related to subprime mortgages and securitization have ended either with no charges filed or acquittals.⁷ The creation of the Working Group demonstrates the seriousness with which the government intends to enhance its efforts and its determination to target the industry as a whole.

State Investigations

Despite the difficulties that federal agencies have faced in bringing large-scale prosecutions against wrongdoers involved in the RMBS industry, several state attorneys general have actively pursued, both criminally and civilly, banks and other financial entities in connection with their issuance and promotion of mortgage-backed securities. A task force consisting of the 50 state attorneys general has proposed a settlement with Bank of America, Citigroup, Wells Fargo, and JPMorgan Chase, among others, that would require them to pay approximately \$25 million

to fund loan modification and counseling programs. However, despite the Obama Administration's pressure, New York Attorney General Schneiderman, along with the Attorneys General of Massachusetts, Delaware, and Nevada, refused to join in the proposed settlement, contending that it too broadly releases the banks from liability for other misconduct, including their securitization practices.

Indeed, New York Attorney General Schneiderman recently opened an investigation of the securitization of mortgage loans by several major banks, including Bank of America. Schneiderman has committed to investigating fraud at financial institutions and has reportedly shared information with the Delaware Attorney General. The inclusion of Schneiderman as a co-chair of the Working Group exponentially increases the likelihood of a coordinated and effective federal-state effort which could yield significant prosecutions and settlements.

Future Investigations

The importance of the Working Group cannot be overstated. During his State of the Union address on January 24, 2012, President Obama specifically referenced the formation of the Working Group and noted that it "will hold accountable those who broke the law, speed assistance to homeowners, and help turn the page on an era of recklessness that hurt so many Americans." As a result, banks and other financial institutions, as well as other businesses involved in the securitization process should be particularly mindful of the administration's effort to work jointly with state law enforcement authorities and be prepared to address questions related to the entire securitization process, from the acquisition of mortgages, the bundling of those mortgages into securities, and their valuation, promotion and sale, to the timing of industry executives' knowledge of the decline in value of the RMBS and their conduct thereafter.

Cadwalader's Business Fraud Group

The Business Fraud Group of Cadwalader's Litigation Department focuses on the representation of companies, boards of directors, audit committees, and executives in complex civil and criminal cases, including internal investigations and inquiries by state or federal law enforcement and regulatory authori-

ties. Several partners in the group, as well as in the Firm, have extensive experience in all aspects of inquiries arising from the financial crisis, including in the defense of conduct relating to mortgage securitization, allegations of bank and mortgage fraud, and more broadly in investigating the financial crisis and its causes.

Endnotes

- 1 Ryan Bonistalli, an associate in the Business Fraud Group, assisted in the writing of this alert.
- 2 Press Release, U.S. Department of Justice, Attorney General Holder Speaks at the Announcement of the Financial Fraud Enforcement Task Force's New Residential Mortgage-Backed Securities Working Group, January 12, 2012, www.justice.gov/iso/opa/ag/speeches/2012/ag-speech-120127.html.
- 3 *Id.*
- 4 *Id.*
- 5 www.justice.gov/ag/residential-mortgage-backed-securities.pdf.
- 6 Exec. Order No. 13,519, 74 Fed. Reg. 60,121 (Nov. 19, 2009).
- 7 For example, in June 2008, the United States Attorney's Office for the Eastern District of New York brought the first criminal case against bankers for their conduct relating to failing investments in mortgage-backed securities, charging two former Bear Stearns portfolio managers on conspiracy and fraud charges. However, a jury found the defendants not guilty on all charges. A parallel civil suit brought by the SEC against the bankers for misleading investors regarding the exposure of the portfolios under their management to subprime mortgage-backed securities is still pending.

In early 2011, federal prosecutors closed an investigation of Angelo Mozilo, the co-founder of Countrywide Financial, one of the most prolific lenders of subprime mortgages, without filing criminal charges. However, Mozilo settled a civil case against him in which the SEC charged Mozilo for securities fraud and insider trading related to the bank's mortgage lending practices. Mozilo neither admitted nor denied wrongdoing, but agreed to pay a \$22.5 million fine. The SEC also charged two other Countrywide Financial executives who agreed to fines totaling more than \$5 million.

UPCOMING EVENTS

The 26th Annual National Institute on White Collar Crime

February 29–March 2, 2012

Eden Roc Renaissance Miami Beach

The 26th Institute will focus on significant white collar criminal trials that took place in the past year, and the ethical obligations of white collar lawyers. The program attracts attendees from the corporate sector, including members of the compliance and legal groups of British Airways, CME Group, Exxon Mobil, Qualcomm, Microsoft and Morgan Stanley.

Partners **Ray Banoun**, *Chair of the Institute*, **Peter B. Clark**, **Jodi Avergun** and **Gregory Mocek** will be speaking at this event. Erin Lewis assisted Ray in organizing the conference and editing the conference book. For more information on this program, please visit:

www.americanbar.org/calendar/2012/02/white_collar_crime.html

Foreign Corrupt Practices Act

April 17–18, 2012

New York Marriott Downtown, New York, NY

This program will provide insights on the latest FCPA cases, global anti-corruption compliance strategies and exceptional networking opportunities. Topics that will be discussed include: Legislative reform of the Foreign Corrupt Practices Act; FCPA compliance and risk management for private equity firms and hedge funds; and Disclosing post Dodd-Frank: Balancing whistle-blower, defense and corporate governance obligations.

Partners **Ray Banoun** and **Peter B. Clark** will be speaking at this event. For more information or to register for the program, please visit: www.americanconference.com/2012/860/foreign-corrupt-practices-act/overview

Business Fraud Alert is published periodically by the Business Fraud & Complex Litigation Group of Cadwalader, Wickersham & Taft LLP. ©2012 Cadwalader, Wickersham & Taft LLP. All rights reserved. Quotation with attribution is permitted. The newsletter provides general information and should not be used or taken as legal advice for specific situations, which depend on the evaluation of precise factual circumstances. The views expressed in these articles are those of the individual authors and do not necessarily represent the views of Cadwalader, Wickersham & Taft LLP or its clients. For further information on the articles contained in *Business Fraud Alert*, or matters related to Cadwalader, Wickersham & Taft LLP's practice, please contact a member of the Firm.

Editor-In-Chief: Raymond Banoun **Managing Editor:** Jodi L. Avergun

Business Fraud & Complex Litigation Group Partners



Jodi L. Avergun
+1 202 862 2456
jodi.avergun@cwt.com



Bret A. Campbell
+1 202 862 2253
bret.campbell@cwt.com



Anthony M. Mansfield
+1 202 862 2321
anthony.mansfield@cwt.com



Raymond Banoun
+1 202 862 2426
ray.banoun@cwt.com



Peter B. Clark
+1 202 862 2448
peter.clark@cwt.com



Gregory Mocek
+1 202 862 2322
gregory.mocek@cwt.com



Bradley J. Bondi
+1 202 862 2314
bradley.bondi@cwt.com



Michael Horowitz
+1 202 862 2407
michael.horowitz@cwt.com



Dale C. Turza
+1 202 862 2261
dale.turza@cwt.com

Business Fraud & Complex Litigation Group Senior Counsel



Bruce A. Hiler
+1 202 862 2256
bruce.hiler@cwt.com

Business Fraud & Complex Litigation Group Special Counsel



Jeannine D'Amico
+1 202 862 2452
jeannine.damico@cwt.com



Joseph V. Moreno
+1 202 862 2262
joseph.moreno@cwt.com



Christopher E. Tierney
+1 202 862 2444
christopher.tierney@cwt.com



Thomas A. Kuczajda
+1 202 862 2246
tom.kuczajda@cwt.com



Thomas Stimson
+1 202 862 2275
thomas.stimson@cwt.com

CADWALADER

Cadwalader, Wickersham & Taft LLP
www.cadwalader.com

New York London Charlotte Washington
Houston Beijing Hong Kong Brussels



Cadwalader, Wickersham & Taft LLP respects the privacy of our clients and friends. Your contact information is maintained in our marketing database and may be used to advise you of firm news, events and services, as well as for internal statistical analysis. We may forward contact details to appointed agencies that assist us in processing mailings but will not provide them to any other party for any other purpose, other than as required by law. If you wish to correct your information or would like to be removed from our marketing database, please contact Claudia Freeman, Director of Marketing, at claudia.freeman@cwt.com or at our New York address listed above.