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A Financial Crisis With Little Guilt

After Widespread Reckless Banking, a Dearth of Prosecutions

By GRETCHEN MORGENSON and LOUISE STORY

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?

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 tra-



ANDREW HARRER/BLOOMBERG NEWS

William Black, an official in the S.& L. cleanup, said this crisis's investigation was less robust.

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

ditionally 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 mindset could have spurred far

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 Cor-



ALEX WONG/GETTY IMAGES

In October 2008, Timothy Geithner, then the president of the Federal Reserve Bank of New York, told New York's attorney general he was concerned about the financial markets.



BRENDAN McDERMID/REUTERS

In late 2010, then-Attorney General Andrew Cuomo sued the accounting firm Ernst & Young, accusing it of helping Lehman Brothers “engage in massive accounting fraud.”

poration 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 over-

Two Financial Crises and Responses Compared: the Savings and Loan Debacle and the Mortgage Mess

DAMAGES

The savings and loan crisis, 1983 to 1992

- The government rescues the seventh largest bank in the country, Continental Illinois (the bank is considered “too big to fail,” and that phrase is coined.)
- 747 S.&L.’s (and other institutions) failed over all, costing \$90 billion to resolve. Among the institutions that disappeared were the Bank of New England, MCorp and Lincoln Savings and Loan.

INVESTIGATIVE RESPONSE FROM THE GOVERNMENT

FIRST YEAR

TexCon, a task force of regulators and prosecutors, is set up in Dallas to prosecute fraud at financial institutions.

1 YEAR IN

Federal Home Loan Bank Board creates another task force to build cases against top executives. Financial regulators jointly develop criminal referral procedures to be used by all financial institutions operating in the United States.

President Reagan signs Comprehensive Crime Control Act, which includes a fraud statute aimed at banks and grants prosecutors additional powers to stop fraud schemes while investigations continue.

4 YEARS IN

ThriftCon, an expanded fraud task force, is formed to deal with more cases.

5 YEARS IN

President Bush directs the U.S. attorney general to give the highest priority to S.&L. fraud cases.

8 YEARS IN

150 people from the Justice and Treasury Departments are employed full time on S.&L. investigations.

The financial crisis, 2007 to the present

- Government provides assistance to failing financial institutions, including Bear Stearns, Washington Mutual, Merrill Lynch, Fannie Mae and Freddie Mac.
- Government provides rescue money to 707 banks as well as major auto companies and insurers, including A.I.G.
- 353 commercial banks have failed since the crisis began.
- National housing prices fell 33 percent to their lowest point in April 2009 from their peak in July 2006 and recession pushes unemployment above 10 percent.
- Total cost of government intervention remains to be seen, but hundreds of billions of dollars were used.

FIRST YEAR

The F.B.I. partners with the Mortgage Bankers Association to combat mortgage fraud and kicks off “Operation Malicious Mortgage.”

Andrew Cuomo, the attorney general of New York, opens an investigation of banks and ratings agencies for their mortgage bond securities.

1 YEAR IN

The F.B.I. tries to reallocate more resources to mortgage fraud but is pushed back by the Justice Department. Justice considers and rejects idea of a national task force focused on crimes related to the financial crisis.

2 YEARS IN

The nation’s largest banks have been bailed out, and the S.E.C. institutes a previously undisclosed policy to avoid high penalties for companies while they have government money.

Congress passes the Fraud Enforcement and Recovery Act (FERA), giving \$165 million to the F.B.I and Justice Department for new financial investigations, but later allocates only \$30 million to the effort.

3 YEARS IN

More than a year after rejecting the idea, Justice creates a financial crimes task force, but provides no additional resources, and gives it a much broader mandate than the financial crisis.

4 YEARS IN

The Financial Crisis Inquiry Commission, created by Congress, issues a report on the causes of the crisis but does not publicly identify crimes.

It has been four years since the financial crisis began, it is possible there will be more prosecutions in the coming years.

sight 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 star-

ting 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 Seefter, 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."



JACQUELYN MARTIN/ASSOCIATED PRESS

Phil Angelides, chairman of the Financial Crisis Inquiry Commission, said a hearing for the chief of Countrywide Financial was canceled at the request of Republican members.



JAY MALLIN/BLOOMBERG NEWS

A United States attorney dropped an investigation of Angelo Mozilo, former chief executive of Countrywide Financial, after the S.E.C. settled a civil fraud case against him.

- By 1992, there had been 1,100 criminal prosecutions of individuals involved in “major” S.&L. fraud.
- There were 839 convictions of these individuals.
- In total, the F.B.I. opened 5,490 criminal investigations in this area because of referrals from bank regulators.

- The S.E.C. has filed or settled a few high-profile civil suits, including one against Goldman Sachs, another against Angelo Mozilo, the former Countrywide chief executive, and one against the mortgage company Taylor, Bean & Whitaker.
- The F.D.I.C. has filed a civil suit against Kerry Killinger, the former chief of Washington Mutual.
- Justice filed a case against two Bear Stearns executives, but lost in court.
- Justice decided not to pursue cases against Mr. Mozilo of Countrywide or against Joseph Cassano, an executive at A.I.G.
- The F.B.I. boasts it has over 3,000 pending investigations of mortgage fraud.
- Regulators and state attorneys general continue to work to try to achieve settlements with major banks over questionable foreclosure practices that ballooned as the housing market fell.

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 execu-

tives 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

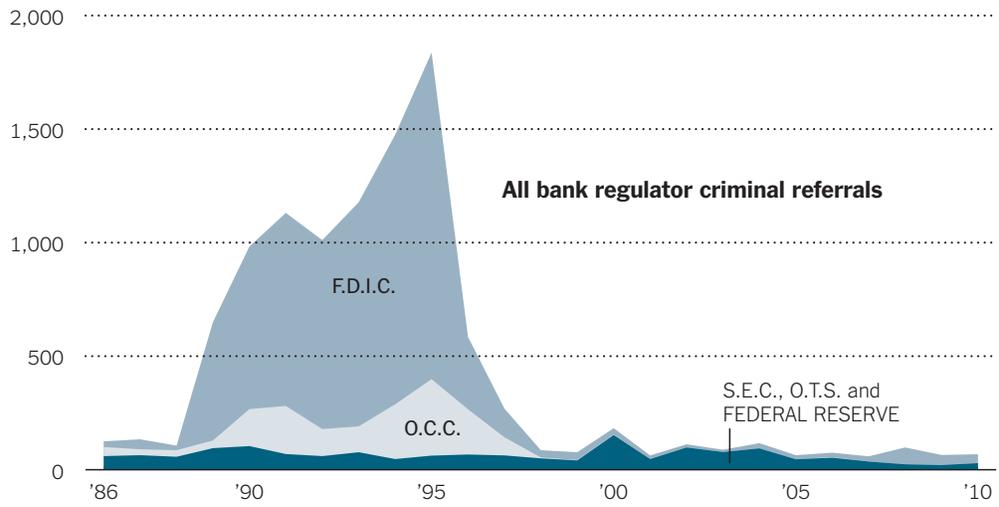
did not recall internal requests.

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.

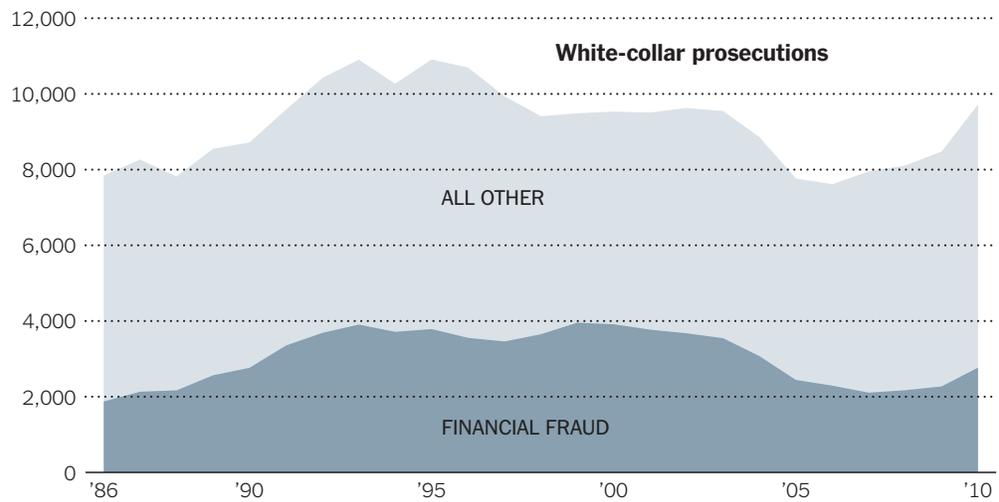
A year later — with precious time lost — several lawmakers decided that the government needed more people tracking financial crimes. Congress passed a bill, providing a \$165 million budget increase to the F.B.I. and Justice Department for investigations in this area. But when lawmakers got around to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

The surge in regulatory referrals from the S.&L. crisis has not been repeated in the latest financial crisis.



And although white-collar prosecutions have increased recently, they have tended to involve smaller operators and institutions.



THE NEW YORK TIMES

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 regu-

lators 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.

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S.E.C. Case Stands Out Because It Stands Alone

By LOUISE STORY and GRETCHEN MORGENSON

AT the height of the housing boom, the 26th floor of Goldman Sachs's former headquarters on Broad Street in Lower Manhattan was the nerve center of Goldman's fast-growing mortgage trading business.

Hundreds of employees worked closely in teams, devising mortgage-based securities — billions of dollars' worth — that were examined by lawyers, approved by management, then sold to investors like hedge funds, commercial banks and insurance companies.

At one trading desk sat Fabrice Tourre, a midlevel 28-year-old Frenchman who was little known not just outside Goldman but even inside the firm. That changed three years later, in 2010, when he achieved the dubious distinc-

tion of becoming the only individual at Goldman and across Wall Street sued by the Securities and Exchange Commission for helping to sell a mortgage-securities investment, in one of the hundreds of mortgage deals created during the bubble years.

How Mr. Tourre alone came to be the face of mortgage-securities fraud has raised questions among former prosecutors and Congressional officials about how aggressive and thorough the government's investigations have been into Wall Street's role in the mortgage crisis.

Across the industry, "it's impossible that only one person was involved with fraudulent activities in connection to the sales of these mortgage securities," said G. Oliver Koppell, a New York attorney general in the 1990s and now a New York City councilman.

In the fall of 2009, when Mr. Tourre learned that he had become a target of investigators for helping to sell a mortgage security called Abacus, he protested that he had not acted alone.

That fall, his lawyers drafted private responses to the S.E.C., maintaining that Mr. Tourre was part of a "collaborative effort" at Goldman, according to documents obtained by The New York Times. The lawyer added that the commission's view of his role "would have Mr. Tourre engaged in a grand deception of practically everyone" involved in the mortgage deal.

Indeed, numerous other colleagues also worked on that mortgage security. And that deal was just one of nearly two dozen similar deals totaling \$10.9 billion that Goldman devised from 2004 to 2007 — which in turn were



ANDREW HARRER/BLOOMBERG NEWS

In April 2010, Fabrice Tourre waited to testify before a Senate Homeland Security and Governmental Affairs subcommittee.



JOSHUA ROBERTS/BLOOMBERG NEWS

Fabrice Tourre, formerly on the mortgage desk at Goldman Sachs, was sued by the S.E.C. for helping to sell a mortgage-securities investment.

similar to more than \$100 billion of such securities deals created by other Wall Street firms during that period.

While Goldman paid \$550 million last year to settle accusations that it had misled investors who bought the Abacus mortgage security, no other individuals at the bank have been named. Now, however, as criticism has grown about the lack of cases brought by regulators, the scope of the inquiries appears to be widening. The United States attorney general, Eric H. Holder Jr., has said publicly that his lawyers were reviewing possible charges against other Goldman officials in the wake of a Senate investigation that produced reams of documents detailing other questionable decisions that were made in the firm's mortgage unit.

The Senate inquiry was one of several in the past three years. These investigations by Congressional leaders and bankruptcy trustees — into the likes of Washington Mutual, Lehman Brothers and the ratings agencies — were undertaken largely to understand what had gone wrong in the crisis, rather than for law enforce-

ment. Yet they uncovered evidence that could be a road map for federal officials as they decide whether to bring civil and criminal cases.

One person who already has come under investigation is Jonathan M. Egol. A senior trader at Goldman who worked closely with Mr. Tourre, he had a negative view on the housing market early on, and took a lead role in creating mortgage securities like Abacus that enabled Goldman and certain clients to place bets that proved profitable when the housing market collapsed.

Last year the S.E.C. examined Mr. Egol's role in the Abacus deal in its lawsuit, according to a report by the commission's inspector general. But Mr. Egol, now a managing director at the bank, was not named in the case, in part because he was more discreet in his e-mails than Mr. Tourre was, so there was less evidence against him, according to a person with knowledge of the S.E.C.'s case.

Though Mr. Tourre was a more junior member of the Goldman team, the S.E.C. case against him was bolstered by colorful e-mails he wrote,

calling mortgage securities like those he created monstrosities and joking that he sold them to “widows and orphans.”

The S.E.C. declined to comment about its focus on Goldman and Mr. Tourre, beyond pointing to a section in its complaint that said that Mr. Tourre had been “principally responsible” for the Abacus deal in the case.

A spokesman for Goldman, Lucas van Praag, did not dispute that Mr. Tourre had worked on the Abacus deal as part of a collaborative team. But he said that the bank had disagreed with many of the conclusions about its mortgage unit contained in the recent Senate report. Mr. Egol and his lawyer did not respond to inquiries for comment.

As the government continues to investigate the activities of Goldman and other banks, it is uncertain whether other individuals will be named. Neil M. Barofsky, who as the first inspector general of the Troubled Asset Relief Program, the federal bank bailout program, investigated whether banks had properly obtained and handled the money they received, said prosecutors should look as high up as possible.

“Obviously in any investigation that results in charges against a company,” he said, “you’d like to see the highest-ranking person responsible for the conduct at the company to be held accountable.”

A Booming Market

A math whiz who got his undergraduate degree at the École Centrale in Paris, Fabrice Tourre joined Goldman in 2001 after getting a master’s degree at Stanford. As the housing market and the demand for mortgages boomed over the next few years, Goldman went from creating just \$3 billion of mortgage securities called collateralized debt obligations in 2002 to at least \$22 billion in 2006, according to Dealogic, a financial data firm.

The C.D.O.’s were linked to the performance of underlying mortgages that were bundled into securities; as long as homeowners stayed current on payments, investors who bet that the housing market would stay healthy made money. Only if many borrowers defaulted would the investors lose money.

Goldman’s mortgage desk worked as a tight team. Dan Sparks was the head of all mortgage operations, including the Abacus team, which Mr. Egol led.

The team worked so closely that its members shared a group e-mail address, “Ficcmgtcorr-desk.” Nearly all of the e-mails about the Abacus deal in the S.E.C.’s case, as well as those about other, similar deals, were sent by Mr. Tourre or his colleagues using the shared e-mail address.

The 2007 memo that proposed the Abacus deal to higher managers at Goldman was signed by all seven members of the group. The marketing materials for Abacus, and other complex mortgage securities, often listed around 15 people in addition to Mr. Tourre, with their contact numbers.

Abacus and related mortgage securities deals were a huge success for Goldman, allowing the firm to earn tens of millions of dollars in fees by selling securities to investors and to place bets on the securities that helped Goldman perform better than most other banks during the crisis.

But Mr. Tourre’s world would soon be turned upside down. In fall 2009, the S.E.C. issued him a Wells notice, a formal warning that he was likely to be named in a civil fraud suit for his role in the mortgage deals. Mr. Egol also received such a notice in 2010.

In their Oct. 10 response to the S.E.C., Mr. Tourre’s lawyers, including Pamela Chepiga of Allen & Overy, made an argument that they have not emphasized publicly. They contended that “singling Mr. Tourre out for criticism regarding the content of this clearly collaborative effort is unreasonable.”



TIM SLOAN/AGENCE FRANCE-PRESSE — GETTY IMAGES

John Paulson, the hedge fund manager, helped devise the Abacus deal.

These legal replies, which are not public, were provided to The New York Times by Nancy Cohen, an artist and filmmaker in New York also known as Nancy Koan, who says she found the materials in a laptop she had been given by a friend in 2006.

The friend told her he had happened upon the laptop discarded in a garbage area in a downtown apartment building. E-mail messages for Mr. Tourre continued streaming into the device, but Ms. Cohen said she had ignored them until she heard Mr. Tourre's name in news reports about the S.E.C. case. She then provided the material to The Times. Mr. Tourre's lawyer did not respond to an inquiry for comment.

In the drafted replies, lawyers for Mr. Tourre named the other Goldman employees who they say worked closely on the Abacus deal with him: In addition to Mr. Egol, they included David Gerst, a securities lawyer in the Abacus group and Darren Littlejohn, another lawyer at Goldman who worked on the deal; Cactus Raazi and Gail Kreitman, sales representatives; Shin Yukawa, a credit ratings specialist; and others.

The S.E.C. focused in the complaint on disclosures in the marketing of Abacus, saying that the sales documents had failed to tell investors that the deal was devised with the help of John A. Paulson, the billionaire hedge fund manager, who was not named in the case. Mr. Paulson's firm suggested that the deal be linked to mortgages for which he expected a high rate of default, the S.E.C. said; when that came to pass, the bets he placed against the securities proved very profitable for him. But investors on the other side lost more than \$1 billion, according to the S.E.C.

Mr. Tourre's lawyers wrote that their client was "simply one member of a large team that worked on the 2007-AC1 transaction" — referring to the Abacus deal — "and was entitled to rely on Goldman Sachs's institutional processes to ensure that disclosures were properly drafted." He was not a lawyer, they argued. Legal counsel on a deal, in this case Mr. Littlejohn and Mr. Gerst, typically review documents and decide what must be disclosed to investors.

The S.E.C. has not said why it focused on just one Abacus deal, even though other mortgage securities created by Goldman and other banks had similar designs and disclosures. In many of the securities, for example, there was

an investor like Mr. Paulson or Goldman itself betting against the housing market, and often that party helped devise the deal, according to four former Goldman employees familiar with the securities.

Indeed, there was at least one other security that had involved Mr. Paulson, according to the 2007 memo written by Mr. Tourre's desk.

It was Mr. Egol's name that came up most prominently in Mr. Tourre's legal response to the S.E.C., as well as in interviews with traders knowledgeable about the Abacus deals.

A former colleague on Goldman's mortgage desk who now works for another financial firm said he did not understand why Mr. Tourre had been singled out. "That has baffled me from the very beginning. I just can't even begin to tell you how junior and insignificant his role was," said this person, who asked not to be named because it could damage his career.

Mr. Tourre's lawyers also pointed to an e-mail that February from Mr. Egol, which said "the cdo biz is dead we don't have a lot of time left." The S.E.C. pointed to that line as evidence that Mr. Tourre had known of the trouble in the market. Mr. Tourre's lawyers responded that those views were Mr. Egol's and "not necessarily" Mr. Tourre's.

The newly released Senate report also cites e-mails that it has made public, where Mr. Egol seems to have the stronger views. On Jan. 29, 2007, for instance, Mr. Egol wrote to Mr. Tourre that "the mkt is dead." Mr. Tourre replied, "ouahhh, what do you mean by that? Do you have any insight I don't?"

In April 2010, when the S.E.C. filed its case against the bank and Mr. Tourre, the young banker told friends that he believed Goldman had been chosen to be the commission's "case study," according to several who spoke on the condition that they not be identified. The friends also said they were concerned that Mr. Tourre's dependence on Goldman for advice and legal counsel was not in his best interest.

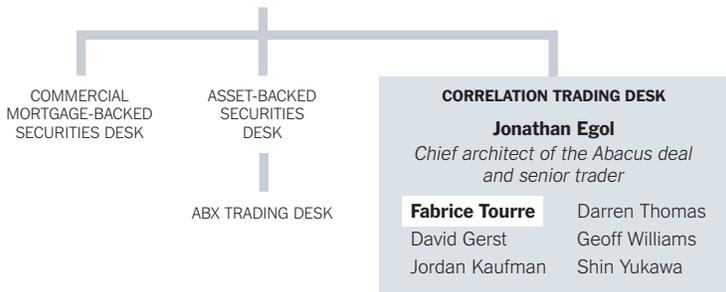
In September 2009, for instance, Mr. Tourre told friends he thought he had to use a lawyer from a list of lawyers at three firms that Goldman gave him.

Robert Follie, a lawyer in Paris, said Mr. Tourre told him he was not authorized to use lawyers other than those Goldman selected. Mr. Follie said he cautioned Mr. Tourre that his

DIVISION	STRUCTURED PRODUCT GROUP	STRUCTURED PRODUCT SYNDICATE	ASSET-BACKED SECURITIES FINANCE DESK	RESIDENTIAL FINANCE DESK	COMMERCIAL REAL ESTATE LOAN TRADING	At least 5 other divisions, with an additional
NUMBER EMPLOYED	23+	15+	25+	32+	10+	90+ employees

Michael J. Swenson
Group Head

Source: Internal Goldman Sachs document



Goldman employees from other departments involved with Abacus

SALES REPRESENTATIVES

Cactus Raazi
Gail Kreitman

SECURITIES LAWYER

Darren Littlejohn

interests might diverge from Goldman's, so he should consider hiring his own counsel.

"As a practitioner, I mentioned to him that I felt the risk in the long run was that the lawyer who was acting for him might end up in a near conflict-of-interest situation," Mr. Follie, whose daughter is friends with

Mr. Tourre, said in an interview last December.

After the S.E.C. case was filed in summer 2010, Mr. Follie wondered how Mr. Tourre had wound up as the only defendant. "I felt that somewhere down the line, he must have done or not done the proper things to get out of this. I was personally wondering if he had sufficient representation disassociated from Goldman," he said.

Mr. van Praag, the Goldman spokesman, said the bank did not impose lawyers on its workers and had not done so on Mr. Tourre. He said that "ultimately the decision is for the individual and counsel to determine whether they are right for each other."

For the last year, Mr. Tourre has been on paid leave from Goldman's London office, where he was transferred after the United States mortgage trading business dried up.

Mr. van Praag also pointed to testimony released this year to the Financial Crisis Inquiry Commission, created by Congress to identify the cause of the economic crisis, as evidence that might help Mr. Tourre's case because it included statements supporting his claim that the

One Among Many

Fabrice Tourre is the only Goldman Sachs employee to have been named in a Securities and Exchange Commission case related to the bank's mortgage unit. The S.E.C. says that Mr. Tourre failed to disclose pertinent information in early 2007 about a mortgage security called Abacus. But he was only one member of a team that developed and approved Abacus. A group at the bank, the structured product group, has received the most scrutiny since the crisis, but Goldman's mortgage department had hundreds of employees. Here is how the department looked at the end of 2007, after downsizing had begun.

deal had been created properly and independently of Mr. Paulson.

No Criminal Case

Even as Mr. Tourre awaits trial in the civil fraud case, it seems that he will not face criminal charges. When the S.E.C. referred the case to the Justice Department, the commission's top enforcement lawyer, Robert S. Khuzami, told his counterparts there that he did not believe it was a criminal case, according to two people briefed on the discussions.

Since Mr. Tourre was named in the case, other inquiries into the causes of the financial crisis have put the spotlight on activities of a number of Wall Street firms. This year, the Financial Crisis Inquiry Commission released a 633-page report, and the Senate's Permanent Subcommittee on Investigations issued its own 650-page report. While the S.E.C. focused solely on the single Abacus deal, the Senate's report raised questions about a handful of other Goldman mortgage securities.

The report also detailed Goldman's aggressive valuation of its customers' mortgage holdings. Goldman's "senior management knew its sales force was selling C.D.O. securities at inflated prices" and knew that those prices were dropping, the report said. It quoted from a Goldman sales representative's e-mail saying: "Real bad feeling across European sales about some of the trades we did with clients."

In addition, the Senate said that two Goldman employees, Deeb Salem and David Swenson, tried to manipulate prices of securities used to bet against mortgages. Both tried to help Goldman pile on larger bets against the mortgage market, and they wanted to be able to buy such negative bets more cheaply, the report said. Goldman, as a broker, was able to affect prices in the market through the bids and offers it gave out.

Mr. Swenson wrote in May 2007 that the bank should try to “start killing” prices on certain positions so that Goldman would be able to “pick some high quality stuff,” according to the Senate report. The strategy, Mr. Swenson wrote, would “have people totally demoralized.” The pair were unsuccessful in their attempt, and both denied making it to the Senate committee. Mr. van Praag said last week that the report had no evidence of manipulation.

Still, the Senate report said that “trading with the intent to manipulate market prices, even if unsuccessful, is a violation of the federal securities laws.”

Goldman is not the only firm to have been scrutinized in public reports. Washington Mutual and Deutsche Bank, for instance, were also cited in the recent Senate report. And last year, a trustee examining the Lehman Brothers bankruptcy uncovered questionable accounting maneuvers at that firm. Companies like Bank of America, the American International Group and Moody’s Investors Service have been featured in other hearings and reports.

Former United States prosecutors said there were limits to how these materials could be used in court. Still, they said, the reports should have given the government a head start on cases.

“They are good starting points,” said Juliet Sorensen, a professor at Northwestern University School of Law. “They are indicators of witnesses who would be subjects for additional interrogations; the reports may introduce documents which lead federal criminal investigators to do additional digging.”

Tom Torok contributed reporting.

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NEW YORK, FRIDAY, JULY 8, 2011

Behind the Gentler Approach to Banks by U.S.

As Wall St. Polices Itself, Charges Are Rare

By **GRETCHEN MORGENSON** and **LOUISE STORY**

AS the financial storm brewed in the summer of 2008 and institutions feared for their survival, a bit of good news bubbled through large banks and the law firms that defend them.

Federal prosecutors officially adopted new guidelines about charging corporations with crimes — a softer approach that, longtime white-collar lawyers and former federal prosecutors say, helps explain the dearth of criminal cases despite a raft of inquiries into the financial crisis.

Though little noticed outside legal circles, the guidelines were welcomed by firms representing banks. The Justice Department's directive, involving a process known as deferred prosecutions, signaled "an important step away from the more aggressive prosecutorial practices seen in some cases under their predecessors," Sullivan & Cromwell, a prominent Wall Street law firm, told clients in a memo that September.

The guidelines left open a possibility other than guilty or not guilty, giving leniency often if companies investigated and reported their own wrongdoing. In return, the government could enter into agreements to delay or cancel the prosecution if the companies promised to change their behavior.

But this approach, critics maintain, runs the risk of letting companies off too easily.

"If you do not punish crimes, there's really no reason they won't happen again," said Mary

Ramirez, a professor at Washburn University School of Law and a former assistant United States attorney. "I worry and so do a lot of economists that we have created no disincentives for committing fraud or white-collar crime, in particular in the financial space."

While "deferred prosecution agreements" were used before the financial crisis, the Justice Department made them an official alternative in 2008, according to the Sullivan & Cromwell note.

It is among a number of signs, white-collar crime experts say, that the government seems to be taking a gentler approach.

The Securities and Exchange Commission also added deferred prosecution as a tool last year and has embraced another alternative to litigation — reports that chronicle wrongdoing at institutions like Moody's Investors Service, often without punishing anyone. The financial crisis cases brought by the S.E.C. — like a recent settlement with JPMorgan Chase for selling a mortgage security that soured — have rarely named executives as defendants.

Defending the department's approach, Alisha Finelli, a spokeswoman, said deferred prosecution agreements require that corporations pay penalties and restitution, correct criminal conduct and "achieve these results without causing the loss of jobs, the loss of pensions and other significant negative consequences to innocent parties who played no role in the criminal conduct, were unaware of it or were unable



DANIEL ROSENBAUM FOR THE NEW YORK TIMES

“They threatened the HUD office of the inspector general that we would not be allowed to go forward with our investigation of executives if we didn’t agree to their settlement.”

KENNETH M. DONOHUE, former inspector general of HUD, speaking about the Justice Department.

to prevent it.”

The department began pulling back from a more aggressive pursuit of white-collar crime around 2005, say defense lawyers and former prosecutors, after the Supreme Court overturned a conviction it won against the accounting firm Arthur Andersen. That ended an era of brass-knuckle prosecutions related to fraud at companies like Enron.

Another example of this more cautious prosecutorial strategy: Government lawyers now go to companies earlier in an inquiry, and often tell companies to figure out whether improper activities occurred. Then those companies hire law firms to investigate and report back to the government. The practice was criticized last year when the Justice Department struck a settlement with Beazer Homes USA, a home builder accused of mortgage fraud.

This “outsourcing” of investigations — as some lawyers call it — has led to increased cozi-

ness between the government and companies, some critics say.

In banking, the collaboration is even stronger, dating to the mid-1990s when banks were asked to regularly report suspicious activities to the Treasury Department, an effort that aimed at relieving regulators of some of their enforcement loads. But it gave regulators a false assurance that banks would spot and report all wrongdoing, former investigators say. Moreover, companies are not as likely to come forward with evidence related to senior executives or to widespread patterns of misbehavior, some academics say.

Intended to make the most of the government’s limited investigative resources, the government’s cooperation with corporations and industry groups can work well and save money when business hums along as usual. But some veterans of government prosecutions question such collaboration in financial crisis cases, and



DANIEL ROSENBAUM FOR THE NEW YORK TIMES

“Traditionally, a bank would tell the Department of Justice when an employee engaged in crimes, but what do you do when the bank itself is run by a criminal enterprise?”

SOLOMON L. WISENBERG, former chief of a Justice Department financial institutions fraud unit.

contend they should have been pursued more aggressively.

“Traditionally, a bank would tell the Department of Justice when an employee engaged in crimes, but what do you do when the bank itself is run by a criminal enterprise?” said Solomon L. Wisenberg, former chief of the financial institutions fraud unit for the United States attorney in the Western District of Texas in the early 1990s. “You have to be able to investigate without just waiting for the bank to give you the referral. The people running the institutions are not going to come to the D.O.J. and tell them about themselves.”

A Clash of Agencies

Beazer Homes, based in Charlotte, N.C., became one of the nation’s 10 largest home builders in the 2000s — in large part because of mortgage lending options that attracted buyers. But its mortgage business eventually attracted prosecutors, too.

In March 2007, the inspector general and of-

ficials of the Department of Housing and Urban Development began investigating claims that Beazer had engaged in mortgage fraud, causing losses to the Federal Housing Administration’s insurance fund that covered mortgages when buyers couldn’t pay.

Investigators found that Beazer had been offering a lower mortgage rate if buyers paid an extra fee, but then not giving them the lower rate. And it was enticing homeowners by offering down payment assistance, but not disclosing that it then raised the price of the house by the same amount.

The Beazer board’s audit committee hired the law firm of Alston & Bird to conduct an internal investigation. Documents supplied to Congress by HUD show that Justice Department officials advised HUD investigators not to interview borrowers or former Beazer employees until Alston & Bird completed its review.

In April 2009, justice officials notified HUD that a deferred prosecution agreement with Beazer had been reached — the sort of deal that



MATT YORK/ASSOCIATED PRESS

Beazer Homes ran afoul of the Department of Housing and Urban Development over its mortgage practices. But the Justice Department came to an agreement with the company, ending HUD's inquiry.

Sullivan & Cromwell had celebrated in its client memo a year earlier — essentially shutting down the HUD investigation.

Beazer agreed to pay consumers and the government as much as \$55 million under the deal. It also paid approximately that amount to Alston & Bird, investigators found. While a member of the justice team told HUD that criminal proceedings would be forthcoming against individuals at Beazer, the documents show, there has been only one indictment: of Michael T. Rand, the company's former chief accounting officer, whose trial is to begin this fall.

A year after the settlement, Kenneth M. Donohue, the inspector general of HUD at the time, raised questions about its handling. He said he was disturbed by the interference by the Justice Department and its calls to stop pursuing Beazer executives so the deferred prosecution deal could be completed. "As a law enforcement official for over 40 years," Mr. Donohue wrote in a letter to Eric H. Holder Jr., the attorney general, "I have never witnessed a like action in any of my varied dealings."

In a recent interview, Mr. Donohue, now a senior adviser at the Reznick Group, an accounting firm in Bethesda, Md., said of the Justice Department: "The most important point of this whole thing is the fact that they threatened the HUD office of the inspector general that we

would not be allowed to go forward with our investigation of executives if we didn't agree to their settlement."

David A. Brown, acting United States attorney on the case, said: "What we do is work cooperatively as a team in conducting these investigations. We don't tell agencies to stand down when they are working as part of the team." He said that the investigation was continuing, and that the Justice Department was proud of the deferred prosecution agreement and the restitution Beazer paid, which more than covered the losses of the Federal Housing Administration fund.

Beazer did not respond to an e-mail, and Alston & Bird did not return a call seeking comment.

ment.

Ms. Finelli, the department's spokeswoman, said that deferred or nonprosecution agreements had led to charges against individuals in many cases; of the 20 companies she cited, three were financial companies. But none were cases related to the financial crisis.

Still, some lawyers applaud the closer relationship between the government and business. "Given the scanty resources that have been committed to corporate crime enforcement, I think the government's leveraging of its prosecution power from corporations and their lawyers has been critically important," said Daniel C. Richman, professor of law at Columbia and a former assistant United States attorney in New York.

But Professor Richman added that the government should have "a much more developed, funded and empowered S.E.C., Federal Reserve, E.P.A. and other agencies to do regulation, to do enforcement and feed cases where necessary to criminal prosecutors."

Changing Course

The names have become synonymous with corporate wrongdoing — and forceful prosecution: Not just Enron, but also WorldCom, Tyco, Adelphia, Rite Aid and ImClone. In the early

part of the last decade, senior executives at all these companies were convicted and imprisoned.

But by 2005, a debate was growing over aggressive prosecutions, as some business leaders had been criticizing the approach as perhaps too zealous.

That May, Justice Department officials met ahead of a session with a cross-agency group called the Corporate Fraud Task Force. It was weeks after Justice Department lawyers had presented to the Supreme Court their case against Arthur Andersen, which was seeking — successfully, it would turn out — to overturn its criminal fraud conviction in a prominent case.

In the meeting, the deputy attorney general at the time, James B. Comey, posed questions that surprised some attendees, according to two people there who asked to remain anonymous because they were not supposed to discuss private meetings.

Was American business being hurt by the Justice Department's investigations?, Mr. Comey asked, according to these two people, who said they thought the message had come from others. He cautioned colleagues to be responsible. "It was a total retrenchment," one of the people said. "It was like we were going backwards."

Mr. Comey said recently that he did not recall this conversation.

Around the same time, the Justice Department was developing instructions on dealing with companies under investigation — particularly companies that work with the government. It issued a memo in 2003 that gave companies more credit for cooperating than in the past. That message was reinforced in another memo in 2006.

As the first memo put it, "it is entirely proper in many investigations for a prosecutor to consider the corporation's pre-indictment conduct, e.g., voluntary disclosure, cooperation, remediation or restitution, in determining whether to seek an indictment."

During this period, the Justice Department increased the use of deferred prosecutions or even nonprosecution agreements.

Many well-known companies have benefited. In 2004, the American International Group, the giant insurer, paid \$126 million when it entered a deferred prosecution agreement to settle investigations into claims that it had helped

clients improperly burnish financial statements.

Deals over accounting improprieties also were struck that year by Computer Associates International, a technology company, and in 2005 by Bristol-Myers Squibb, a pharmaceutical concern. Prudential Financial entered into a deferred prosecution in 2006 over improper mutual fund trading.

No such prosecution deals for large banks have yet arisen out of the financial crisis. Some bank analysts say they may be coming. The government may eventually strike one with Goldman Sachs, which it continues to investigate for its mortgage securities dealings, Brad Hintz, a securities analyst at Sanford C. Bernstein & Company, wrote recently. "If an alleged violation is identified during a Goldman investigation, we expect a reasoned response from the Justice Department," he added.

Goldman Sachs declined to comment.

The S.E.C. can also file deferred prosecutions, and it sometimes issues reports about wrongdoing in lieu of litigation. It has been increasing the number of reports it files, and is considering issuing one about misleading accounting at Lehman Brothers, Bloomberg News has reported. The S.E.C. did something similar last year to resolve a credit ratings investigation of Moody's Investors Service. The reports from the commission are intended to give companies guidance on appropriate practices.

Such results provide bragging rights among corporate defense lawyers, according to longtime observers of the legal system.

"The corporate crime defense bar has this down to a science," said Russell Mokhiber, the editor of Corporate Crime Reporter, a publication that tracks prosecutions. "I interview them all the time, and they boast about how they've gamed the system."

Industry Advantage

Even as companies cooperate with the government, they also work closely with one another, creating industrywide strategies in response to investigations. Legal representatives for Goldman Sachs, Morgan Stanley, JPMorgan Chase and others talk regularly about what they hear from the government, according to lawyers in the industry. They have long held these conversations — known as joint-defense calls — but given the increased cooperation of

the government with companies, lawyers can exchange more information.

Goldman's recent battle against the S.E.C. — in which it agreed to pay \$550 million to settle claims that it had misled investors in a mortgage security it sold — was helpful to other banks, according to one lawyer who participates in these calls. On several occasions in 2009 and 2010, after Goldman and its law firm, Sullivan & Cromwell, visited the S.E.C., lawyers representing other banks received intelligence on the government's areas of interest. The result has often been that banks walk into prosecutors' offices well-prepared to rebut allegations.

One assistant United States attorney, who requested anonymity because he is not allowed to speak with the news media, said many inquiries had been tabled because banks had such good answers.

"They'll hire a counsel who is experienced," said the assistant attorney, who has direct knowledge of cases related to the financial crisis. "They often come in and make a presenta-

tion: 'We've looked at this and this is how we see it.' They're often persuasive."

Some defense lawyers say it is easier to make a persuasive case because prosecutors, having becoming more dependent on companies for investigative legwork, are less knowledgeable and thus less likely to counter with evidence they have uncovered.

The process, in the end, is cloaked, some critics say. The Justice Department does not disclose any details about its decision-making in specific cases, such as why it did not charge individuals at a company.

"We will not get an explanation of why there haven't been prosecutions; at best, we will get a reference back to the Department of Justice manual that leaves the discretion to the prosecutors," said Professor Ramirez of Washburn University. "The legal representatives will argue that since recoveries can be had by using civil measures, even private litigations, there's no need to bring criminal measures. I disagree with that very much." ■

The New York Times

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Financial Finger-Pointing Turns to Regulators

By LOUISE STORY and GRETCHEN MORGENSON

In the whodunit of the financial crisis, Wall Street executives have pointed the blame at all kinds of parties — consumers who lied on their mortgage applications, investors who demanded access to risky mortgage bonds, and policy makers who kept interest rates low and failed to predict a housing market collapse.

But a new defense has been mounted by a bank executive: my regulator told me to do it.

This unusual rationale is presented by the bank executive in one of the few fraud suits brought against a mortgage banking official in the aftermath of the financial crisis — the one filed by the Securities and Exchange Commission against Michael W. Perry, former chief executive of IndyMac Bancorp, which failed spectacularly in mid-2008.

After being accused of fraud and misleading investors about his company's financial health just before it collapsed, Mr. Perry set up a Web site this fall to defend himself.

In a document on the site, he said that a top official at the federal Office of Thrift Supervision, IndyMac's overseer, directed and approved an action related to the S.E.C.'s allegations.

"It was O.T.S. who had the final say regarding IndyMac Bank's capital levels," Mr. Perry wrote.

He went on to say that Darrel W. Dochow, former regional director for the Western region of the agency and a financial regulator for more than 30 years, had "specifically directed" Mr. Perry to backdate IndyMac's report to regulators to include an \$18 million cash infusion that would make it appear well capitalized.

The shift masked IndyMac's problems for any investors trying to assess its soundness and allowed it to continue attracting large deposits crucial to its operations.

The S.E.C., in its suit against Mr. Perry, con-

tends that more details about the cash infusion should have been disclosed, though the commission did not accuse him of accounting fraud.

Mr. Dochow was not accused of wrongdoing by the commission or any other prosecutor, though his role has been criticized by the inspector general of the Treasury Department, which oversees some bank regulators. It does not appear that Mr. Perry's argument persuaded the commission to back off. The S.E.C., as is its custom, did not elaborate.

A representative for Mr. Perry said he did not care to discuss the case further, but his lawyer described the lawsuit in an e-mail as "exceedingly weak, unfair and meritless." Mr. Dochow, who retired as a regulator in 2009 at age 59, said: "There's a lot more than what's been written, but I can't talk. I could go to jail."

The IndyMac collapse, with its multibillion-dollar cost to the Federal Deposit Insurance Corporation fund, highlights the role played by federal overseers of financial companies in the years leading up to the crisis. It also raises questions about whether government officials should be held accountable for dubious conduct related to the failure of an institution and whether the government has avoided pursuing some cases because of the roles regulators have played. For years, some bank overseers have maintained cozy ties with the institutions they monitor, treating bankers like clients because of the fees that banks pay to be regulated.

The Justice Department could not cite any regulator that it had named in a prosecution related to the crisis. However, Mr. Dochow's conduct was referred to Justice for possible criminal charges in 2009, according to Eric Thorson, the inspector general of the Treasury Department. Mr. Thorson said Mr. Dochow's action "was clearly improper and wrong." A spokeswoman

for the Justice Department in Washington declined to comment on the case and on whether the department investigated regulators for possible wrongdoing.

IndyMac is not the only institution whose questionable accounting was approved by regulators in recent years, though it is by far the largest of several highlighted by the Treasury inspector general.

Even if regulators are involved in wrongdoing, they have some immunity. Internal disciplinary measures are rarely taken against regulators who perform badly in their jobs, say government officials.

Some regulatory shortcomings may be chalked up to innocent mistakes and failures to spot problems. Still, some economists and lawyers would like the government to examine regulatory actions leading up to the financial crisis to determine whether officials actively participated in improper behavior. And, they say, in cases like Mr. Dochow's, penalties should be levied on overseers who acted improperly.

"The word conspired needs to be used here," said Edward J. Kane, a finance professor and regulatory expert at Boston College who is familiar with the case. "Dochow conspired with IndyMac management to misrepresent this. He was trying to fool certainly the F.D.I.C. and the public, and anyone who lost a dollar as a creditor to this institution was harmed by relying on something they had every right to rely on."

Longtime defense lawyers say one reason there have been so few prosecutions related to the credit crisis is because financial executives often solicited advice from outside parties — like accountants and lawyers — and experts shelter them from some potential charges because they can argue they relied on the advice. Regulatory advice may be a similar shelter against prosecution.

A Comeback From Demotion

Mr. Dochow had had a long run as a financial regulator when IndyMac ran into trouble. He started out in 1972 as an assistant national bank examiner with the Comptroller of the Currency. He rose through the ranks and in 1985, became a senior regulator with the Federal Home Loan Bank of Seattle and later with the Federal Home Loan Bank System's Office of Regulatory Activities in Washington.

It was during his time in that office that Mr. Dochow played a central role in trying to stop a regulatory attempt to rein in Lincoln Savings and Loan, an Arizona institution run by Charles Keating, with \$5.5 billion in assets. After regulators in San Francisco uncovered fraudulent sales and other improprieties at the institution, Mr. Dochow worked in Washington to avoid the issuance of a cease-and-desist order, the normal course of action in such a case, according to records handed over to Congress. The savings and loan institution failed in 1989 at significant cost to taxpayers, and Mr. Keating was convicted on multiple fraud charges, some later overturned. Mr. Dochow was demoted, according to a half dozen regulators who had worked with him, but remained a bank regulator.

Once again, he worked his way up in the organization, which became the Office of Thrift Supervision. By September 2007, he had been promoted to head the Western region, reporting directly to the agency's top officials in Washington.

In that position, Mr. Dochow oversaw a host of institutions that had dived headlong into risky mortgage lending. Among them were Countrywide Bank, IndyMac Bancorp and Washington Mutual, three of the most aggressive lenders — and largest flameouts — in the crisis.

Mr. Dochow was known within the O.T.S. to be bank-friendly. One former examiner said: "His approach was negotiating with the banks, as opposed to regulating the banks, and viewing them more as clients, as opposed to people or entities that needed to comply."

According to three former examiners who worked with Mr. Dochow but who requested anonymity because they feared retaliation from regulatory colleagues, he would sometimes negotiate between the banks and their lower-level O.T.S. overseers, arguing that an institution should be allowed to keep one component of its regulatory rating high if another was dropping. That way, the composite score representing a bank's financial standing, would change little, if at all.

At other times, Mr. Dochow exhibited a close relationship with a savings and loan association when it was under investigation. In 2007, when the attorney general of New York was investigating Washington Mutual for its possible role in appraisal fraud, Mr. Dochow called Ker-



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The direction of a former federal regulator, Darrel W. Dochow, top left, was cited by Michael Perry, left, once IndyMac's head, as justification for a cash infusion now at issue in a lawsuit. The bank, which has its headquarters in Pasadena, above, failed in 2008, costing taxpayers billions of dollars.

ry K. Killinger, the institution's chief executive, to discuss the matter, according to e-mail messages released by a Senate subcommittee in the spring of 2010. Washington Mutual had hired a law firm to do an internal investigation. Mr. Dochow told Mr. Killinger that he wanted to rely on Washington Mutual's investigation as much as possible as opposed to having O.T.S. officials do a completely separate one.

Mr. Dochow told his superiors that he planned to leverage the Washington Mutual report but noted that "we need to be able to defend that we have done our own independent examination."

Mr. Dochow retired in 2009, with his full government pension, according to the Treasury inspector general. Because of its woeful regulatory record during the recent mania, O.T.S. was abolished last summer. Of its remaining employees, 95 were transferred to the F.D.I.C., and 670 to the Comptroller's office.

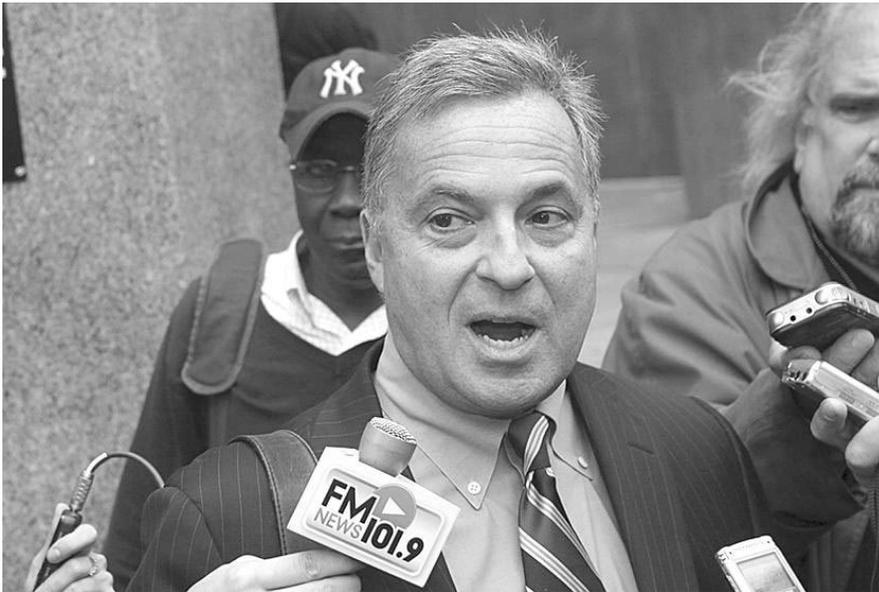
IndyMac's Survival Struggle

The S.E.C. case against Mr. Perry, IndyMac's longtime chief executive, and two former chief financial officer centers on disclosures made from February through mid-May of 2008. The disclosures related mostly to IndyMac's capital and liquidity. The bank collapsed in July of that year and was taken over by the F.D.I.C., which had to pay insured depositors \$10.7 billion.

By early May, it had become clear inside IndyMac that it could no longer be considered "well capitalized" unless money was shifted from its holding company.

This meant that IndyMac could not accept so-called brokered deposits, large amounts of money from investors looking for the highest possible rates of return. Brokered deposits represented just over a third of IndyMac's deposits; without them, it would have been out of business.

And so on May 9, Mr. Perry instructed his



JOHN MARSHALL MANTEL FOR THE NEW YORK TIMES

Dennis C. Vacco, who was New York State's attorney general in the 1990s, said regulators might want to avoid scrutiny of their own kind.

regulator, not Ernst & Young." And there has been no enforcement action against the accounting firm.

Mr. Thorson said that his referral for a case against Mr. Dochow was given to Ranee Katzenstein, an assistant United States attorney in Los Angeles, and that Ms. Katzenstein told his office she did not intend to pursue a prosecution. When reached by phone, Ms. Katzenstein declined to say why. A spokesman for her office said she could not discuss the case. The spokesman said the investigation into Mr. Dochow's actions was still open, although he cautioned that it might not yield a case.

deputies to shift money into the bank from the holding company and account for \$18 million of it as if it had been there on March 31.

Mr. Dochow as well as IndyMac's auditors, Ernst & Young, had signed off on the move, according to the Treasury inspector general. And Mr. Perry highlighted the regulatory approval in a document on his Web site.

"Mr. Dochow, with full knowledge of the circumstances, communicated O.T.S.'s approval," Mr. Perry wrote. "Mr. Dochow also directed Mr. Perry to amend the bank's thrift financial report to reflect the \$18 million receivable."

D. Jean Veta, a partner at Covington & Burling who represents Mr. Perry, said in an e-mail message that IndyMac's financial statements followed accounting rules and that Mr. Perry "was a completely transparent leader who always favored more disclosure rather than less." But the O.T.S., the Comptroller's office and the inspector general's office at the Treasury Department have all said the backdating of the cash infusion was improper.

Mr. Thorson, the Treasury inspector general, said last week that Mr. Perry and Ernst & Young could reasonably say that they acted with permission of the O.T.S. "I'm sure they said 'O.K., that's the guy who calls the shots; the umpire has called the shots,'" Mr. Thorson said.

Indeed, when asked about the IndyMac accounting, a spokesman for Ernst & Young said last week that it was "approved by the bank's

Another backdated capital shift with regulator approval took place in 2008 at a savings and loan association in Florida, according to Mr. Thorson's report. In August of that year, O.T.S. officials directed BankUnited to backdate capital that it had moved within its holding company. The report does not list their names, but it does include their titles, indicating that they were Timothy T. Ward, the deputy director for exams; Scott M. Polakoff, the agency's senior deputy director; and Jack Ryan, the Southeast regional director.

In another instance in July 2008, O.T.S. officials objected to a backdated capital shift at Century Bank, also of Florida, but did not require corrective action.

Mr. Polakoff was placed on leave in March 2009 pending a review of the capital backdating by the Treasury department. He now works as executive managing director at FinPro Inc., a financial services consulting firm in Liberty Corner, N.J. Mr. Polakoff defended his actions last week, saying that with BankUnited, it was a "rather innocuous accounting mistake."

Mr. Ward is a senior official at the Office of the Comptroller of the Currency; through a spokesman, he declined to comment.

Mr. Ryan, who retired in 2009, said on Tuesday that he had pointed out at the time that the capital shift violated accounting rules, though he says he now regrets that he did not fight

forcefully for his position.

“I think the regulators have to abide by the rules,” he said. “And, yeah, if they tell them, ‘forget the rule, go ahead and do it’ — they shouldn’t be doing that.”

Mr. Dochow, interviewed only briefly in front of his home outside Seattle, said he could not talk, but added that “I’m not sure there’s more to say.”

Regulators like Mr. Dochow, of course, would have the chance to publicly defend themselves if accusations against them ever resulted in court cases.

Regulators’ Protection

It would be difficult and unusual for the Justice Department or the S.E.C. to bring a case against a bank regulator, longtime securities lawyers say. Regulators enjoy some immunity from allegations of wrongdoing under the Securities Exchange Act, which says that you cannot file a case against an officer of a United States agency for violation of a securities law if the officer was acting within the scope of the job. For financial regulators like Mr. Dochow, a conflict comes into play when banks run into trouble — on one hand, regulators try to help banks maintain their stability. But, on the other hand, securities laws require companies to be transparent in their disclosures to public investors.

Jeffrey M. Kaplan, a lawyer at Kaplan & Walker in Princeton, N.J., said: “In a case of a regulator contributing to misrepresentations made to shareholders, you could have individual criminal liability. But those cases are pretty rare.” More common are cases involving a bribe or another element of corruption.

Congressional oversight could help identify regulatory misconduct, but such efforts have

been less than fruitful. Indeed, when Senate investigators tried to get information about the capital backdating that O.T.S. had allowed at IndyMac and other institutions, officials from the agency were not forthcoming, said a former Senate aide who was not allowed to speak publicly about the investigation.

Any financial crisis case that named a regulator probably would turn into a huge political battle, because it would question many of the nontransparent acts that bank regulators take while trying to save banks, said Denise Voigt Crawford, former commissioner of the Texas securities board and now a law professor at Texas Tech University.

In any prosecution of bank regulators, she said, “you’d have the Justice Department in a fight with the policy goals of the Department of Treasury. Particularly in this environment, you know the banking regulators would fight it tooth and nail.”

Some longtime lawyers go further and say the overall scarcity of cases related to the financial crisis might be in part because regulators want to avoid scrutiny of their own kind.

“It’s not just one 30-year-old wunderkind who was responsible for the financial crisis,” said Dennis C. Vacco, who was the New York State attorney general in the 1990s and now is a lawyer at Lippes Mathias Wexler & Friedman. “Once you start pulling the string through in these complex cases, you might be surprised what you find at the other end.”

Mr. Vacco continued: “What’s at the end of the string? The defense may be that ‘at the highest echelons of the financial institutions, we were in regular contact with the government.’ “

Isolde Raftery contributed reporting.