FBI Opens Investigation

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A Labyrinthine Path to Justice

FBI, SEC Join Complex Probe of Housing Crisis
By Carrie Johnson
Washington Post Staff Writer
Thursday, February 14, 2008; D01

Congress approved an economic stimulus package. The Treasury Department pressed lenders to reset mortgage rates for millions of troubled homeowners. And New York's insurance regulator is attempting to bail out a critical sector of the industry.

But progressing more slowly is the work of investigators probing dozens of companiesfor fraud and insider trading in connection with the subprime mortgage crisis that set off the country's current economic woes.

FBI officials said yesterday that they are conducting criminal investigations of 16 companies, while their partners at the Securities and Exchange Commission are probing nearly two dozen more. Those federal investigations follow subpoenas from attorneys general in at least four states and class-action lawsuits that target home builders, lenders, credit-rating agencies and the banks that packaged groups of mortgages into securities.

"These are going to be complex investigations," FBI section chief Sharon E. Ormsby said in an interview. Policing mortgage and **credit-related fraud is the "number one priority" of the FBI's financial crimes unit, she added.**

FBI agents are working hand-in-hand with the SEC, which has enlisted 100 lawyers as part of its nationwide subprime mortgage working group and which has made criminal referrals to other government agencies. Legal experts say most probes are in early stages and that if the economic downturn continues, they could widen.

"This subprime-credit crisis is going to be vastly more expensive and vastly longer running from a legal perspective than [recent] accounting frauds," said James D. Wareham, head of litigation for the Paul Hastings law firm, which represents banks and home builders involved in the mortgage probes. "These are not easy cases to understand, but the money is so huge that people are going to want to get to the bottom of it."

Law enforcement officials have yet to roll out their first major case related to the downturn in the housing market. That could take some time, although civil and criminal investigators are sharing documents and interviewing witnesses at major Wall Street banks and mortgage lenders, according to lawyers involved in the probes.

The cases are challenging for the government because they concern complex accounting and business decisions and often are accompanied by loads of paperwork and trading records.

"We are devoting significant resources to this area and looking at a broad range of possible misconduct," said Cheryl J. Scarboro, an associate SEC enforcement director who leads the subprime working group.

On the criminal side, where prosecutors must meet a higher burden of proof to secure convictions, the government is looking for clear documentary evidence that bankers and lenders intended to run afoul of the rules, such as companies keeping two sets of books that conflict with each other, experts said.

Justice Department lawyers first must find insiders who understand mortgage loans and the ways in which they are bundled and sold.

"With every layer of complexity," said Leslie R. Caldwell, the former director of the Justice Department's Enron Task Force, "the case becomes less likely to be a criminal one" because the deals have been vetted by accountants and lawyers, giving banks a good-faith defense that they relied on paid advisers.

Instead, criminal investigators at the FBI are looking for the most blatant misconduct, such as executives at lenders, builders and investment banks unloading shares of stock in advance of bad news.

"Prosecutors are looking for discrete cases on which they can focus their ammunition," said Richard W. Grime, a defense lawyer at O'Melveny & Myers who used to work at the SEC. "You need a relatively simple story with an obvious bad guy."

Investigators are starting with their usual tack: trying to determine whether sky-high valuations and delayed announcements of big losses on mortgage investments were mistakes made by many bankers and lenders or part of a pattern of deceit intended to improve financial results.

"Are people trying to delay the bad news?" asked Susan G. Markel, chief accountant in the SEC's enforcement unit. "That's something that we are looking for . . . **not just in subprime but in other contexts, too."**

Pat Huddleston, a former SEC lawyer who now runs Investors' Watchdog, an Atlanta company that provides vetting services for investors, predicted that civil authorities would bring several accounting fraud cases alleging that brokerage firms inflated values on subprime loan packages or disguised their own losses on the bum investments.

"A significant area of concern is whether firms were using different models to price securities on their own books versus those of clients," said Doria Bachenheimer, assistant regional director in the SEC's New York office. "Is the bank giving itself better prices than it's giving its own clients?"

Huddleston added: "It is a story as old as the SEC -- corporations hiding the truth from investors in order to prop up their stock price."

In recent interviews, SEC officials have pointed to a few recent cases as a guide to how they might approach the spate of subprime probes, particularly the issue of how to value complicated securities and whether companies engaged in accounting tricks to move under-performing assets off their books.

Doral Financial, a Puerto Rican bank holding company, paid a $25 million penalty to the SEC two years ago after investigators alleged that the bank had improperly accounted for risky mortgage loans, unloaded the troubled investments through secret agreements with other companies and overvalued the portions of the investments that remained on its books.

Last year agency officials charged First BanCorp, another Puerto Rican holding company, with helping Doral unload the problem mortgages in exchange for $100 million. First BanCorp agreed to pay $8.5 million to resolve the charges but did not admit wrongdoing.

A third company, R&G Financial, yesterday settled SEC charges that it had inflated its profit by $180 million by improperly accounting for mortgage deals.

FBI investigates sub-prime crisis

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Graem Wearden

Fourteen companies, including some of the world's largest banks, are being investigated over possible accounting fraud, improperly securing loans and insider trading during the sub-prime mortgage scandal.

The FBI said yesterday that it had opened criminal investigations into improper lending in the American housing market.

Neil Power, head of the FBI's economic crimes unit, told journalists that the investigation includes the companies that securitised the loans and investment banks that bought those products, as well as the developers and sub-prime lenders.

"We're looking at the accounting fraud that goes through the securitisation of these loans," said Power.

The FBI did not name the companies it is investigating.

Several of the world's largest banks separately revealed yesterday that they are cooperating with official investigations. Bear Stearns, Goldman Sachs and Morgan Stanley all announced, via official filings to the US Securities and Exchange Commission, that government investigators have asked for information about their sub-prime lending practices.

According to Reuters, Swiss bank UBS – which today unveiled new sub-prime losses – is also being investigated by the FBI.

The sub-prime crisis broke last year, after billions of dollars of home loans were made to people with poor credit history or little income. The mortgages were initially available at attractively low rates, but when these "teaser rates" ended many borrowers found they were unable to keep up with the payments.

These sub-prime mortgages were then bundled together with other loans and sold on to other financial institutions – **often with a high credit rating**.

Once the US housing market began to slide, banks began admitting that they had incurred large losses – prompting the credit crunch, as bankers became increasingly unwilling to lend to each other.

It is estimated that more than $100bn (£50bn) was been wiped off the balance sheets across the financial sector, in losses and asset writedowns. Share prices have also fallen heavily.

The SEC is already conducting a clutch of civil investigations into the scandal.

Some US states have launched their own legal action. Yesterday, Connecticut state attorney general Richard Blumenthal said his office has issued subpoenas to all major rating agencies and bond insurers in a widening probe of industry practices related to the sub-prime mortgage crisis.

He said this includes MBIA and Ambac, the two monoline insurers who guarantee municipal loans whose shares plunged last week over concern they do not hold enough capital to guarantee their ratings, after getting caught in the sub-prime chaos.

Blumenthal also told Reuters that Connecticut was cooperating with the state of New York over its investigation.

FBI in subprime crackdown

By Jeremy Grant in Washington
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The Federal Bureau of Investigation is investigating 14 companies for possible accounting fraud and insider trading offences related to **subprime** mortgages.

The development, another sign of fallout from the subprime mortgage crisis, comes as light regulation of the industry – in particular mortgage brokers – has been blamed for mis-selling and abuse of mortgage products.

The Securities and Exchange Commission already has about three dozen different investigations into a range of subprime-related issues.

Bill Carter, an FBI spokesman, said the agency had been working "very closely" with the SEC, with some of the latest investigations moving "in parallel". He declined to name the companies involved.

The number of mortgage fraud cases opened by the FBI jumped to 1,210 in fiscal 2007 from 436 in fiscal 2003, the agency said.

"We've been raising this issue since 2004," Mr Carter said. "We view mortgage fraud as a significant and growing crime problem and an area of concern. Combating this is a priority given the housing market's impact on the wider economy."

In a report out last year, the FBI classified mortgage fraud into two broad areas. The first is fraud for property, involving "minor misrepresentations" by a mortgage applicant for the purpose of buying a property as a primary residence.

The second category – **of most concern to the FBI** and the mortgage industry – is **"fraud for profit".** ***(Note from GSW staff: e.g., a demonstrably false rating)***

This often involves multiple loans and "elaborate schemes perpetrated to gain illicit proceeds from property sales", the FBI report said.

It said such schemes usually involved "gross misrepresentations concerning appraisals and loan documents". The most common form of mortgage fraud is "illegal property flipping", which involves false appraisals and other fraudulent loan documents. Some of the SEC's investigations are related to potential insider-trading, focusing on wider-than-expected writedowns unveiled recently by some large Wall Street banks. **The way credit rating agencies rated the securities into which mortgages were repackaged is part of the effort**. John Nester, SEC spokesman, said: "We've drawn no conclusions in terms of whether securities laws were violated." Attorneys general in New York and Connecticut are also conducting similar investigations. On Tuesday, Democratic congressman Barney Frank said much of the money that made mortgage securitisation possible came from places other than depository institutions, which are regulated.

BREAKING: Subprime Debacle Goes Criminal. FBI Investigates 14 Companies

By admin on February 4th, 2008

It was bound to happen. The subprime mortgage fiasco is now the target of investigations by several law enforcement organizations.
The FBI today announcing it is looking at 14 companies—companies that may have committed fraud in the handing out of loans to mortgage borrowers who should not have gotten loans in the first place because of their obvious inability to be able to make payments on time.
Also in the picture—the Securities and Exchange Commission, working along with the FBI, to see whether there were insider trading violations.
Seperate from these investigations, there are ongoing ones at the state level in both New York and Connecticut; they are taking a close look at Wall Street banks–banks that may have hidden information from investors who purchased certain securities that had high risk subprime loans bundled in.
And now, it gets really interesting!

EU Leaders Call For Transparency

Lower Growth Forecast
LONDON, Jan. 30--The leaders of Europe's biggest economies have called on financial institutions to improve transparency in all their activities. UK Prime Minister Gordon Brown met his French, German and Italian counterparts at Downing Street to discuss the recent global market turmoil, BBC reported.
The leaders also called on the IMF and other bodies to monitor risks better. If the finance industry did not address their concerns, they said they would consider imposing regulatory measures.
“We need a better early warning system for the global economy,“ Brown told reporters. “We want the prompt and full disclosure of the write-offs that are now to take place as soon as possible; I think these are the immediate things people want to be done,“ Brown said.
Brown said credit rating agencies, that assess the risks of financial instruments, needed to increase investors' understanding of complex products.
Brown met German Chancellor Angela Merkel, French President Nicolas Sarkozy and Italian Prime Minister Romano Prodi.

“We want the kind of capitalism that promotes entrepreneurship not speculation,“ said Sarkozy afterwards. “We can’t let this **lack of transparency** jeopardize growth.“

The leaders said in a statement that if financial institutions did not rapidly address their concerns, they were ready to introduce rules and regulations as an alternative to “market-led solutions“.

Merkel said that the lack of openness about the activities of some financial institutions had eroded trust and could lead to a rise in protectionism.

Consumer confidence is deteriorating across Europe as stock markets plummet and the Societe Generale rogue trader scandal makes headlines. And the US economy, a major destination for European exports, could be headed for a recession, some economists say.

Earlier, European Commission President Jose Manuel Barroso said on Tuesday that the European Commission would next month lower its Eurozone growth projections, but Europe is not facing a recession, AFP wrote.

The EU’s economy is “not completely immune“ to any downturn in the United States, but “nobody is speaking about a recession in Europe,“ he told a conference in Brussels. He conceded that “yes there is turbulence in the financial markets“ and that investor confidence had been hit but insisted that in Europe “there is no need to rush for the life boats“.

Investors Urged to Look Beyond Ratings; Investors Urged to Be Wary of Risks As Credit Rating Agencies Come Under Scrutiny

By admin on February 12th, 2008

NEW YORK (AP) — For the big three credit rating agencies, growing criticism this past week that their ratings systems are flawed must have sounded like a familiar refrain.Standard & Poor’s, Moody’s Investors Service, and Fitch Ratings are being criticized by government officials and some investor groups for not identifying weakness in subprime mortgage-backed securities before they went sour and contributed to massive loss in financial firms and, in turn, the stock market. **They’re also criticized for having too cozy a relationship with the debt issuers that pay them for their ratings.**

This isn’t the first time the rating agencies have found themselves under pressure. The beleaguered industry got similar complaints after the collapse of Enron Corp. in 2001, and before that the bankruptcy of Orange County, Calif., in 1994.

In all three situations, ratings assigned to these issuers went from near-stellar to junk almost overnight. As the agencies begin to think about changing the way they do business, **analysts say investors must become more vigilant about what debt securities they sink money into — and not rely solely on what the rating agencies say.**

“This happens every other year or so when something shakes up the ratings industry and ends up on the Op-Ed pages,” said Martin
Fridson, the former head of Merrill Lynch high-yield research and now proprietor of the specialist firm FridsonVision. “You have to do extra homework, you have to be wary about the way securities are being marketed, and use the ratings that are out there as just a tool.”

Investors are plowing more money than ever into fixed-income products, from municipal bonds to exchange traded funds. According to The Securities Industry and Financial Markets Association, a New York-based trade group, outstanding public and private debt underwritten by bonds was valued at about $25 trillion.
Some 10 percent of corporate bonds are held directly by individual investors, while institutions like pension funds hold the rest, according to the group. These securities — which are more conservative than stocks — are an integral part of retirement planning and diversifying portfolios during rocky times in the equities market.
Fridson and others say most investors don't hold the kind of opaque asset-backed securities that caused global banks to lose about $130 billion since last year.
However, there are certain tip-offs investors should watch for when investing in the fixed-income markets — no matter what ratings the securities hold.
For instance, he said "one sure guide is to be skeptical if you see something yielding much more than comparably rated bonds." Investors might also obtain fixed-income holdings through investment managers — like Vanguard or PIMCO — where analysts scrutinize debt issues beyond just the ratings.
"Over the last six months, a lot of people have learned the hard way that this risk exists — and that the rating agencies aren't fool proof," said John Flahive, director of fixed income at BNY Mellon Wealth Management. **"We've been reminding clients for a long while of the risk, which is why you hire a professional manager that you can use as a safeguard."**
Rating agencies, which are regulated by the Securities and Exchange Commission, have been pressured to sell subscriptions to investors for their ratings instead of taking payment right from debt issuers; that, many observers believe, will avoid potential conflicts of interest. Debt issuers seek out higher ratings because that makes it easier to raise money in the capital markets.
And, aside from that, the agencies have already taken some preliminary steps to deflect such criticism and ease mounting regulatory and government concerns.
This past week, S&P said it is aiming to improve governance through measures ranging from establishing an ombudsman's office to address complaints to hiring an external firm for better oversight. Moody's also said it was considering changes in how it rates mortgage-related securities.
But, it has left many on Wall Street asking if this will be enough — and wonder if the industry itself will begin to shift to other rating models.
"There are people out there right now trying to figure out how to build a better mousetrap," Flahive said. **"If I was John Q. Public, I wouldn't feel overly better — it is going to take more than a few alterations to how the rating agencies are doing things."**

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FBI to Focus On Area Mortgage Loan Fraud

Agency to Host Investigators, Law Enforcement Officials
By Carrie Johnson and Tomoeh Murakami Tse
Washington Post Staff Writers
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The FBI today will launch a mortgage fraud task force in its Washington field office, joining a widening net of state and local investigators digging into the market crisis. Investigators are seeking to uncover evidence of overvalued home appraisals, shoddy lending practices and alleged irregularities in the packaging and sale of groups of loans that were marketed to ordinary investors, state investment funds and big Wall Street banks.

Today the FBI will host the top federal prosecutors in the District and Northern Virginia as well as investigators from the Department of Housing and Urban Development, the Internal Revenue Service and the Small Business Administration. Law enforcement officials from Loudoun, Fairfax and Prince William counties also will attend to devise strategies for attacking the issue across the region, an FBI official said.

FBI officials have opened 1,210 mortgage-related probes this year, said Sharon E. Ormsby, a section chief in the financial crimes section at the agency's headquarters. Ormsby called the figure "an exponential increase" that reflects a rise in suspicious loans reported by financial institutions.

Activity by federal and state investigators can carry profound consequences for the companies involved. After New York Attorney General Andrew M. Cuomo issued subpoenas to Fannie Mae and Freddie Mac last month, the stock prices of both mortgage finance companies dropped, even though they were not clear targets of his probe of overvalued house appraisals.

Cuomo instead wanted the companies to employ an auditor to review loans connected to Washington Mutual, the nation's biggest savings and loan, which Cuomo accused of pressuring appraisers to boost their judgments about house values. The bank has denied the allegations but said it would cooperate with investigators. Cuomo last summer sent a batch of subpoenas to at least half a dozen investment banks, including Merrill Lynch and Deutsche Bank.

Those subpoenas, reported by the Wall Street Journal, seek information on how billions of dollars in complex securities backed by mortgages were packaged and sold to yield-hungry investors all over the world, according to people familiar with the matter. These securities are at the heart of the credit crisis that has been roiling financial markets since summer. Spokesmen at the banks declined to comment or did not return calls.

Attorneys general in Ohio and California, among other states, are investigating whether credit-rating agencies minimized the risks of mortgage debt because of alleged conflicts of interest in the way raters are paid. They have also expressed interest in losses at mortgage finance firms, including New Century Financial and Countrywide Financial.

Investigating wrongdoing in the real estate market "is at the very top of my priority list," said Ohio Attorney General Marc Dann. He said he was moving beyond small-time fraud schemes to investigate lenders, **credit raters** and others who may have looked the other way rather than acknowledging problem loans.

The state probes piggyback on new authority by the Securities and Exchange Commission, which recently gained more oversight of rating agencies. The SEC has opened more than two-dozen investigations across the subprime lending horizon, according to an agency spokesman. On the list: whether large banks knowingly concealed real estate losses from investors, whether mortgage company executives engaged in insider trading and whether risks stemming from the loans were adequately disclosed.

Whether heightened government scrutiny following billions of dollars in investor losses will result in a spate of criminal and civil cases remains unclear at this early stage. People involved in the probes say the critical question is whether companies or individuals knowingly violated the law in a desire to make money or avoid losing it as the housing and mortgage markets soured. Without questionable e-mails, it could be difficult for investigators to make a case that higher-level bankers, lenders and others knew about the troubled investments, former prosecutors said.

The cases so far generally involve a substantial paper trail. This week the U.S. Attorney in Manhattan announced criminal conspiracy indictments against half a dozen people for duping homeowners with financial troubles into turning over their houses in a bid to save them from foreclosure. Instead, the defendants refinanced the properties and took millions of dollars in loan proceeds for themselves, prosecutors said.

In another case, Jerold Levert, a Cleveland accountant, was sentenced to 10 years in prison for mail fraud as part of a wide-ranging scheme in which he manufactured documents to help customers get mortgage loans they otherwise would not have qualified for. According to a confidential price list obtained by the U.S. Postal Inspection Service, which helped break the case, Levert charged $200 for bank statements, $150 for tax returns and $25 for a pay stub.

Crooks and Liars.com

January 30th, 2008 at 4:56 PM – PST

The real scam was in the bundling of these loans into “mortgage backed securities” which were then assigned the highest investment grade “AAA” by the rating agencies, and then sold, enabling more loans. It was the bogus rating that allowed these securities to be sold for more than they were worth, providing the impetus for making more sub-prime loans. Now, certainly, many of these loans were unsuitable for the borrowers, but if these unsuitable loans (unsuitable makes them risky) were assigned the appropriate rating, they could not have been bundled and sold at a profit. The number one item that should be investigated was whether these mortgage backed securities were assigned the highest investment grade by the rating agencies with knowledge that they were not entitled to such a rating, in order to defraud the purchasers of these mortgage backed securities. Things such as collusion between the rating agencies and the bundler of these securities should be checked out.

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Business

Subprime mortgage crisis has bred lawsuits, FBI investigation

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BY MARK JEWELL
THE ASSOCIATED PRESS

BOSTON -- Regulators are trying to punish Wall Street for mortgage finance practices that expanded home ownership and spread risk among a host of new players -- but also may have duped borrowers and investors who supplied cash to fuel a housing boom that's turned bust.

A handful of state securities regulators and a couple of foreclosure-blighted cities have fired the opening shots with lawsuits trying to prove that investment banks and big lenders are guilty of more than just bad business decisions and failing to foresee looming mortgage troubles. Some regulators say greed and fraud underlie much of the subprime mortgage mess that has spread across the broader housing market, triggering a spike in foreclosures.

Aside from the civil cases, the **FBI** is looking at possible criminal action, focusing on what Wall Street firms knew about the risks of mortgage securities backed by subprime loans, **and whether they hid risks from investors.**

Observers don't expect the financial penalties that regulators extract in the civil cases to be massive. But the cases could turn up evidence that forces Wall Street to defend itself amid growing talk of government help to ease subprime-related financial strains on bond insurers. Revelations of bad behavior turned up by the government also could spur private investors to file even more lawsuits than the hundreds they've already brought to recover losses.

"This could get a lot nastier, for many reasons," said John Akula, a business law lecturer at the Massachusetts Institute of Technology's Sloan School of Management. **"Prolonged close scrutiny often turns up all kinds of dubious practices that in normal times are under the radar."**

Although the foreclosure-blighted cities of Cleveland and Baltimore have sued seeking to recover damages from mortgage lenders, most of the cases filed so far are from regulators alleging violations of state securities laws.

Attorneys general in New York and Ohio are targeting alleged systematic inflation of home appraisals by major lenders and appraisal firms. Litigation in Massachusetts and other states seeks to demonstrate that investment banks failed to disclose risks to investors who bought mortgage-related securities and weren't up front about conflicts of interest across their far-flung financial operations, including trading of subprime investments.

Gone are the days when most borrowers simply got loans from the neighborhood bank, which used to hold the bulk of mortgage risk. Now that risk is spread further -- mortgages are bundled together and sold to investors. Behind the scenes, **credit-rating agencies** offer advice on whether the investments are secure.

Until recently, cash from Wall Street banks and investors extended growing amounts of **credit** to low- and middle-income Americans enticed to enter a market when home prices appeared headed nowhere but up.

Lenders wrote $625 billion in subprime mortgages in 2005, nearly four times the total in 2001. **The boom brought in big fees to mortgage brokers, lenders, banks and ratings agencies.**

But now that prices are dropping, those players are hurting. Global banks have ousted executives and have written off nearly $150 billion since mortgage securities began collapsing last summer.

Criminal action also could be looming. The **FBI** said last month it was investigating 14 companies for possible accounting fraud, insider trading or other violations that could result in criminal charges. The **FBI** didn't identify companies but said the probe involves firms across the financial services industry. The **FBI** is working with the Securities and Exchange Commission, which has civil enforcement powers. The SEC said in January that it had about three dozen active investigations under way.