



Suggested Questions for Attorney General Loretta Lynch's Oversight Hearing before the Senate Judiciary Committee

I. Questions about DOJ's failure to prosecute individuals responsible for the financial crisis

Nine years ago yesterday, New Century Financial Corporation announced that it would no longer originate subprime loans. New Century was one of the largest subprime mortgage lenders and the first of many to go under in the years before the Great Recession. New Century, like most of the subprime lenders, committed massive mail and wire fraud by originating and then selling toxic mortgages while making representations and warranties to the buyers that the mortgages were investment-quality. But the mortgages were designed to fail – and New Century knew this, as its settlements with the SEC and investors made clear. Under FIRREA, because this fraud affected financial institutions, the statute of limitations to criminally prosecute the responsible executives is ten years, which means that the Department of Justice has, as of today, less than one year in which to initiate action before New Century executives receive an irrevocable Get-Out-Of-Jail-Free card. The same is true for any chance that DOJ might seek civil penalties against any New Century executives under FIRREA—making the responsible individuals pay rather than the company's shareholders.

And it's not just New Century: Over the next eighteen months, dozens of other nine-year anniversaries will come, followed in each case one year later by immunity from any accountability for the fraud at the heart of the financial crisis. As of today, the United States has not yet criminally prosecuted a single high-ranking individual whose frauds contributed to the financial crisis, and it has won only one meaningful civil penalty against a relatively high-ranking executive—and that was in a case brought originally by a relator rather than the United States. These facts raise serious questions about DOJ's commitment to enforcing the law when economic crimes are committed, including the following:

1. First, were you already aware that you have less than a year to prosecute the executives at New Century? If you don't care to comment on a particular company, can you say whether DOJ is aware of the dates that each of the subprime originators closed up shop, and the corresponding date ten years later by which you must bring a criminal prosecution or civil-penalty action if the responsible executives are ever to be held accountable? What type of tracking system does the Department use? Is there a whiteboard or database that you have seen?
2. Second, is DOJ adequately staffed to bring criminal or civil enforcement actions against all those financial executives whose frauds contributed to the Great Recession? Do you need more investigators, more prosecutors? If so, have you asked for them?
3. Third, are DOJ's civil and criminal arms cooperating on financial fraud, such that, if you determine that there is not proof beyond a reasonable doubt to criminally prosecute an executive for

fraud, the case can be seamlessly handed off to the civil side to bring an action for a civil penalty in time?

4. Fourth, if the current trend continues, and DOJ does little to hold responsible those individuals whose frauds contributed to the financial crisis, what is your explanation for the difference between that result and the DOJ's response to the S&L crisis, which included hundreds of successful criminal prosecutions of responsible executives?

II. Questions about the Yates Memo and corporate settlements

Just under a month ago, the Department of Justice announced a \$2.6 billion settlement with Morgan Stanley that settled allegations about that company's fraudulent peddling of toxic mortgage-backed securities in the years before the Great Recession. It was reported that this settlement was reached in principle a year earlier. Regardless, last September's memo from Deputy Attorney General Sally Yates should have resulted in a major change from the prior practice, in which the shareholders pay big penalties but no responsible individuals are named, let alone held accountable. So it was surprising that DOJ's settlement with Morgan Stanley did not identify a single individual who was responsible for the illegal conduct that the company paid billions of dollars to settle. Phil Angelides, the chair of the Financial Crisis Inquiry Commission, aptly describes such a situation, in which fraud was committed but no individual apparently committed it, as "immaculate corruption."

This raises a number of questions, including:

1. First, was the Yates Memo applicable to the Morgan Stanley settlement? Why or why not?
2. Second, the underlying facts of the Morgan Stanley settlement show that certain employees of Morgan Stanley knew that loans it was securitizing had loan-to-value ratios of up to 120%, even though it promised investors in the securities that no mortgages had loan-to-value ratios of more than 100%. One executive even wrote, of this increased risk: "Please do not mention 'the slightly higher risk tolerance' in these communications. We are running under the radar and do not want to document these things." That strongly suggests that those individuals were engaged in fraudulent activity using the interstate wires. Why were those individuals not named? Will they ever be criminally prosecuted, or at least held accountable with a civil penalty?
3. Third, moving away from just Morgan Stanley, as I understand it, none of DOJ's settlements with financial institutions resolve any individuals' criminal or civil liability, and in most cases, the institutions are obligated to assist DOJ in investigating that liability or they violate the terms of the settlement. So my question is: Has DOJ asked *every* financial institution with which it has settled to provide additional information about the individuals who are responsible for the illegal conduct that gave rise to the settlement? If not, why not?

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