

With time running out, US government ramps up mortgage litigation

By Zach Fox

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The U.S. government is facing a time crunch to prosecute claims of mortgage transgressions that contributed to the 2008 credit crisis, potentially spurring a flurry of settlements in the near term.

Last week, the Justice Department secured settlements with two banks and filed suit against a third as the 10-year statute of limitations approaches for mortgages sold just before the crisis. Deutsche Bank AG agreed to pay a civil penalty of \$3.1 billion, and Credit Suisse Group AG settled with a \$2.5 billion penalty. Prosecutors were unable to reach a settlement with Barclays Plc and filed suit against the lender Dec. 22.

In the government's complaint against Barclays, prosecutors argue the bank securitized loans it knew to be defective, a "pump-priming activity [that] contributed to the housing bubble and to the ensuing crash." The government identified \$31 billion worth of residential mortgage-backed securities, or RMBS, from the bank between 2005 and 2007. Several other banks, including Wells Fargo & Co., could be next to face Justice Department litigation, based on regulatory disclosures and other RMBS settlements.

The Financial Crisis Inquiry Commission, a government committee to investigate the causes of the crisis, tabbed fraudu-

lent RMBS as a significant contributor, and the Justice Department redoubled its efforts to charge securitizers with additional resources announced in 2012.

The government has relied on the Financial Institutions Reform, Recovery and Enforcement Act of 1989, or FIRREA, which allows the government to secure large civil penalties for violations of existing criminal statutes. The broad powers and lengthy statute of limitations have made FIRREA a popular tool for the Justice Department.

"As the recent activity suggests, for at least the immediate future, statutory fraud claims asserted under FIRREA's 10-year statute of limitations remain an arrow in the government's quiver," said Joseph Cioffi, a partner for Davis & Gilbert LLP with RMBS litigation experience.

Other laws have shorter statutes of limitations, so the next 12 months could represent the government's last chance to prosecute RMBS issued before the crisis. The Federal Housing Finance Agency, or FHFA, filed litigation against 18 lenders for securities law violations back in 2011. Most lenders have settled with the agency, which oversees the government-sponsored enterprises Fannie Mae and Freddie Mac that suffered significant RMBS losses. In total, 12 lenders settled with the agency for more than \$250 million, and

Department of Justice secures billions in mortgage-backed securities settlements

Company name (parent ticker)	Date of settlement	Justice Department civil penalty (\$M)	Consumer relief (\$M)	Federal Housing Finance Agency settlement (\$M) [^]
JPMorgan Chase & Co. (JPM)	11/19/13	2,000	4,000	4,000
Citigroup (C)	07/14/14	4,000	2,500	250
Bank of America Corp. (BAC)*	08/21/14	5,000	7,000	5,830
Goldman Sachs & Co. (GS)	01/14/16	2,390	1,800	1,200
Morgan Stanley (MS)	02/11/16	2,600	400	1,250
Ally Financial Inc. (ALLY)	11/21/16	52	None	475
Deutsche Bank AG (DBK)	12/22/16	3,100	4,100	1,925
Credit Suisse Holdings (USA) Inc. (CSGN)	12/23/16	2,480	2,800	885

Data compiled Dec. 28, 2016.

* Includes securities sold by Merrill Lynch & Co. and Countrywide Financial Corp., businesses acquired by Bank of America.

[^] Date of Federal Housing Finance Agency settlement may differ from date of Justice Department settlement.

Analysis limited to banks that have settled with the Federal Housing Finance Agency for at least \$250 million and paid a civil money penalty to the Department of Justice for the sale of mortgage-backed securities.

Source: SNL Financial, an offering of S&P Global Market Intelligence

Some banks continue to face Department of Justice investigations

Company name (parent ticker)	Federal Housing Finance Agency settlement (\$M)	Regulatory filing disclosure regarding Department of Justice (DOJ) investigations into residential mortgage-backed securities (RMBS)
Barclays Bank Plc (BARC)	280	"Regulatory and governmental authorities, including amongst others, the DOJ, SEC, Special Inspector General for the US Troubled Asset Relief Program, the US Attorney's Office for the District of Connecticut and the US Attorney's Office for the Eastern District of New York have initiated wide-ranging investigations into market practices involving mortgage-backed securities, and [Barclays] is cooperating with several of those investigations."
HSBC North America Holdings (HSBA)	550	"Since 2010, various HSBC entities have received subpoenas and requests for information from the DOJ and the Massachusetts state Attorney General seeking the production of documents and information regarding HSBC's involvement in specific private-label RMBS transactions as an issuer, sponsor, underwriter, depositor, trustee, custodian or servicer. ... HSBC is cooperating with the US authorities and is continuing to produce documents and information responsive to their requests. HSBC expects the focus on mortgage securitisations to continue. As a result, HSBC companies may be subject to additional claims, litigation and governmental or regulatory scrutiny relating to its participation in the US mortgage securitisation market."
UBS Americas Inc. (UBSG)	885	"In 2014, UBS received a subpoena from the US Attorney's Office for the Eastern District of New York issued pursuant to the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), which seeks documents and information related to UBS's RMBS business from 2005 through 2007. ... UBS continues to respond to the FIRREA subpoena and to subpoenas from the New York State Attorney General and other state attorneys general relating to its RMBS business."
Wells Fargo Bank NA (WFC)	335.23	"Federal and state government agencies, including the United States Department of Justice, continue investigations or examinations of certain mortgage related practices of Wells Fargo and predecessor institutions. ... This includes discussions with various government agencies that are part of the RMBS Working Group of the Financial Fraud Enforcement Task Force in which potential theories of liability have been raised."

Data compiled Dec. 28, 2016.

Analysis limited to banks that have settled with the Federal Housing Finance Agency for at least \$250 million and have not settled with the Department of Justice over the sale of mortgage-backed securities.

Source: SNL Financial, an offering of S&P Global Market Intelligence

eight of those have now settled with the Justice Department to resolve FIRREA claims following the Deutsche and Credit Suisse settlements.

Barclays is one of the remaining four yet to settle. The other three lenders with large FHFA settlements — Wells Fargo, HSBC Holdings Plc and UBS Group AG — all disclose an ongoing Justice Department investigation into RMBS operations in their latest regulatory filings.

While some praised Barclays' decision to fight the settlement, it is not clear the government will back down in the face of its shrinking statute-of-limitations window. JPMorgan Chase & Co. was the first lender to resolve its FIRREA claims as the Justice Department touted a whopping \$13 billion headline figure for the settlement, which might make Deutsche Bank's \$7.2 billion settlement look like a bargain. But JPMorgan's payout included settlements with the FHFA and other regulatory agencies. JPMorgan actually paid a smaller civil penalty to the Justice Department than Deutsche Bank did.

Stephen Ellis, an analyst for Morningstar, said Barclays' decision to fight the litigation in court appears to be a reasonable approach, especially since the company has limited exposure to other Justice Department investigations where the government might seek retribution. And Ellis said the court battle will last until President-elect Donald Trump takes office, potentially presenting an opportunity as many expect a business-friendly administration.

"There could be a default change in the lawyers and change in the regulatory oversight that might be friendlier towards Barclays and ultimately could mean a better outcome," Ellis said.

Cioffi, the lawyer with Davis & Gilbert, did not necessarily agree with the logic, suggesting many of the Justice Department's lawyers will stay on and will have incentives to continue pursuing the lawsuit.

"Is there any bigger aircraft carrier to turn around than the federal government?" Cioffi said. "I don't know if anyone should be holding out for a change in direction from the incoming administration."