

Eric Holder Finally Gets Tough On Banks: Bloomberg View



By Jonathan Weil: 10/25/2013

BLOOMBERG VIEW

See if you can make sense of this. Somehow, in the space of seven months, U.S. Attorney General Eric Holder has gone from being:

- 1) the defeatist law-enforcement chief who told the Senate Judiciary Committee that some banks are too big to prosecute because of the economic damage that might ensue, to
- 2) the crackdown artist who presided over a meeting in which his team told JPMorgan Chase & Co. (JPM) Chief Executive Officer Jamie Dimon that the bank would need to enter a guilty plea in order to end a criminal investigation by prosecutors in California.

What gives? Maybe Holder will let JPMorgan skate once the probe is completed. Yet clearly a new approach is afoot. After that meeting, the Justice Department proposed that JPMorgan plead guilty to making false statements related to sales of defective mortgage bonds. The bank proposed a non-prosecution agreement, which Holder rejected, according to an Oct. 22 article by Bloomberg News.

Not long ago, large banks could be fairly confident they wouldn't face criminal charges in the U.S. no matter what they got caught doing. Now the Justice Department is keeping the threat of such charges hanging over JPMorgan while the bank wraps up \$13 billion in civil settlements with various government agencies.

New Aggressiveness

Holder said in an interview that the department's new aggressiveness on bank investigations was a top priority for both President Barack Obama and himself. (Holder didn't talk about JPMorgan specifically.) Obama promised in his 2012 State of the Union address to hold banks accountable for their role in helping cause the worst recession since the Great Depression. A task force was set up, and it played a significant role in the pending JPMorgan deal.

Other important questions remain unanswered. For instance, what about before 2012? Why did the Justice Department do so little to go after banks during Obama's first term?

Here is one way to look at it: For about five years, there were entire categories of wrongdoing by large financial-services companies that were all but deemed exempt from criminal prosecution. We've never gotten a satisfactory explanation from anyone in the government as to why.

But it wouldn't be a surprise if someday we learned that a conscious policy decision was made during the Obama administration's early days that aggressive investigations of too-big-to-fail banks and their senior executives would be contrary to the national interest because of the threat that prosecutions posed to financial stability and the economic recovery.

Even if this isn't what happened, the White House and Justice Department must know this is the outward impression they created by their unexplained inaction. What's more, the facade of trying to look tough while doing almost nothing was coming undone. In August, for example, the Justice Department admitted to grossly inflating how many mortgage-fraud prosecutions it had brought in years past.

A crucial difference between now and when Obama took office is that the stock market has rebounded and the financial-services industry has stabilized after much help from the government, especially the Federal Reserve. Even so, public anger over the lack of accountability has failed to subside, and cynicism about Wall Street's pull in Washington has skyrocketed. The government didn't want to be seen as giving the banking industry a pass.

So the administration had to come up with new, creative ways of holding the country's banks to account. The largest ones seem healthy enough again to withstand government attacks. Yet the five-year statute of limitations for many fraud cases has elapsed. This, of course, presented a problem for the Justice Department, which had to be a bit more inventive than normal.

Strange Creature

One of the department's favorite new tools has been a once-obscure statute called the Financial Institutions Reform, Recovery and Enforcement Act of 1989, which was passed in response to the 1980s savings-and-loan crisis. Federal prosecutors in New York used the act, known as Firrea, to win their jury verdict this week in a civil trial against Bank of America Corp. (BAC)

The law, which has a 10-year statute of limitations, lets prosecutors file civil claims for violations of criminal mail-fraud and wire-fraud statutes that affect "a federally insured financial institution." It is a strange creature that has led to some odd outcomes.

In the case against Bank of America, prosecutors accused the company of defrauding Fannie Mae and Freddie Mac. Those two entities don't take federally insured deposits. Nonetheless, in an August ruling, U.S. District Judge Jed Rakoff said the case could proceed on the grounds that Bank of America is a federally insured financial institution and that any fraud it may have committed would have affected itself.

That reasoning may follow the letter of the statute, but it isn't an intuitive basis for a lawsuit. Plus, if the government believes criminal laws were broken, why pursue only civil claims? Maybe it's because even on their best days, prosecutors seem interested mainly in easy wins for which the burden of proof is low.

We have yet to see what violations the Justice Department will cite in its civil settlement with JPMorgan. Another Firrea case may be possible. The Justice Department filed a second Firrea lawsuit against Bank of America in August and, as Bloomberg News reported this week, Bank of America faces three other Firrea probes across the country. Several other large banks, including Citigroup Inc. (C) and Credit Suisse, are contending with Firrea investigations, too.

Prosecutors also used Firrea in their February lawsuit against Standard & Poor's. In that case, the government alleged that Citigroup was duped by S&P credit ratings on subprime mortgage bonds that Citigroup itself created and sold. Bank of America, too, allegedly was "affected" by S&P's ratings in the same way. The theory is bizarre at first glance. But for now, the law seems to be on the Justice Department's side.

There is no telling what great things U.S. prosecutors might have accomplished had Holder and his team been this determined and creative all along, before the biggest fraud cases of the financial crisis turned cold.
