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Justice Department takes on 'malicious' mortgage lenders

In times of national economic upheaval, the criminal justice system often seems to be the janitorial squad of emergency management.

Elected officials arrive first on the scene, moving through legislation, economic policymaking and the like to "solve" the problem — or at least to shield the public from some of the trauma (think the dot-com bust, or the collapse of Enron).

The regulators and prosecutors then move in for mop-up duty, dragging a few carefully chosen high-profile individuals (Jeffrey Skilling and Ken Lay, for example) off to trial or into enforcement proceedings. These prominent targets serve as an example to those who might in the future seek to profit by taking advantage of weak points in our economic infrastructure. So goes the criminal and regulatory clean-up.

That clean-up serves important social ends: retribution and deterrence. In the current mortgage crisis, however, our criminal justice and regulatory systems are going beyond their usual mop-and-bucket roles. They're pointing the way for our policymakers to establish an important avenue for change — a reform of the mortgage system that will address an underappreciated but very real cause of the current meltdown.

An enduring element in the national discussion of the mortgage crisis has been the age-old national parlor game: Who is to blame?

The popular press has rightly upbraided the mortgage-lending behemoths (and the purchasers of their securities) for carelessness in making billions of dollars worth of bad loans. And it has lavished attention on the various lender bailouts and failures of the past few months. Policymakers have followed suit: Every congressman capable of speech has excoriated the big lenders and mortgage speculators for bringing this crisis upon us.

Beyond the hot spotlight of journalistic and political attention, though, another movement has been under way. Law enforcement agencies at both the federal and state levels have given mounting attention to the mortgage crisis. And in the midst of a crisis that often seems overwhelm-



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ingly huge and complex, it is these agencies that are standing on the front lines, doing some of the most effective and important work to fix the systemic weaknesses that underlie the current crisis.

There is no question that bad judgment, endemic carelessness and widespread corporate greed played major roles in the mortgage meltdown. It is also true, however, that an array of small and even individual actors exploited these cracks in the mortgage system's infrastructure to commit fraud.

While this criminal activity has generated only a small portion of the losses in the current crisis, it has contributed to the problem in significant ways — and to the collective tune of billions of dollars. In taking on thousands of these "small-time" bad actors, law enforcement officers and prosecutors are both pointing to a part of the problem that deserves more attention and making great strides in doing something about it.

These smaller actors are now being held accountable for exploiting the flawed mortgage lending infrastructure. In June, the federal Department of Justice, in coordination with United States Attorney offices across the country, announced the prosecutorial fruits of "Operation Malicious Mortgage."

The operation is a nationwide mortgage fraud initiative partnering federal prosecutors and several law enforcement agencies. The Justice Department announced that from March 1 to June 18, 2008, 206 defendants were charged across 144 mortgage fraud cases, covering crimes estimated to have created losses of approximately \$1 billion.

Notably, the Justice Department press release announced arrests of only two individuals who might qualify as "big fish" — two senior managers of Bear Stearns hedge funds that invested heavily in mortgage-backed securities.

The remaining arrests appear to have grown out of localized investigations of relatively small-time actors. In other words, although utilized for deterrent effect in the aggregate, these arrests were more traditional — discrete prosecutions intended to curtail conduct which contributed to

the mortgage crisis or was making it worse.

In a June 19 press release, the United States Attorney for the District of Oregon announced that as part of Operation Malicious Mortgage, charges had been filed against three Portland-area individuals and a fourth Portland resident had been sentenced in April of this year to 30 months in prison, all for mortgage fraud. Combined, the four individuals were, according to the United States Attorney, involved in more than \$50 million in fraudulent loans.

Of course, \$50 million represents only a small fraction of the Oregon mortgage market. In 2007 alone, Freddie Mac invested more than \$9 billion in Oregon mortgages. Nevertheless, \$50 million in fraud-related losses is substantial in any community, and it is likely that many more such charges will be brought in the near future.

Plainly the problems that currently plague the American mortgage industry are deep and multifaceted. Many of the solutions posed by the government will likely come in the form of tighter regulation and legislation designed to prevent the excesses and recklessness that have been revealed in recent months. But criminal investigators, prosecutors and regulators have pointed the way to an important part of the problem that has until now not gained much popular currency: holding accountable the bad actors of all shapes and sizes who brought greed and criminality to the already-flawed mortgage system.

In taking them on, law enforcement will play a critical role in turning around the economy. Other leaders in public and private life could learn a valuable lesson from these enforcers. A long-term, broad-based strategy will surely be required to repair the mortgage industry. But the development of such a strategy should address its constituent malignant parts. Prosecutors at all levels are leading the way.

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