SEC announces settlement with JPMorgan over mortgage fraud

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21 November 2012

JPMorgan Chase and Credit Suisse will pay $416.9 million to settle charges by the Securities Exchange Commission (SEC) that they lied to investors about the quality of mortgage-backed bonds they sold both before and after the 2008 financial crash.

The SEC said November 16 that JPMorgan will settle for $296.9 million and Credit Suisse will pay $120 million. These settlements represent a small fraction of the yearly profits of these companies, little more than a slap on the wrist. JPMorgan alone made over $19 billion last year.

The SEC's suit against the companies alleged only negligence, and, as JPMorgan emphasized in a statement, "does not include charges of intentional misconduct." As part of the settlements, the companies admit no wrongdoing.

The settlements are less than the $550 million Goldman Sachs agreed to pay in a similar settlement with the SEC in 2010. The announcement sent JPMorgan's stock price up 14 cents.

Some of the allegations against JPMorgan stem from its acquisition of Bear Stearns in March of 2008. JPMorgan was given a multi-billion-dollar subsidy by the Federal Reserve to buy Bear Stearns, which was collapsing, at a fire sale price. When JPMorgan acquired the company, it also assumed legal responsibility for its activities, but the SEC alleged that Bear Stearns' fraudulent mortgage deals continued even after it was taken over by JPMorgan.

The same day the settlement was announced, the SEC said it was dropping all charges against Edward Steffelin, a former managing director at GSC Capital Corp. Steffelin is the only individual charged in connection with a $153.6 million civil settlement by JPMorgan last year.

The SEC alleged that Steffelin had worked with JPMorgan to create and sell a set of mortgage-backed securities without disclosing that a hedge fund that helped assemble and package the underlying home loans was betting against the resulting securities.

Steffelin was one of a handful of people facing individual charges in relation to the sub-prime mortgage meltdown. Not a single major bank or leading bank executive has been criminally prosecuted for the extra-legal wheeling and dealing that precipitated the Wall Street crash of September 2008 and the resulting global slump.

"Our duty in all cases is to achieve a just and appropriate outcome," said SEC Director John Nester (evidently maintaining a straight face) in connection with the dropping of charges against Steffelin.

In its press release on Friday's settlement with JPMorgan, the SEC said that the bank, the largest in the US, "misstated information about the delinquency status of mortgage loans that provided collateral for an RMBS (residential mortgage-backed security) offering in which it was the underwriter."

The SEC's lawsuit against JPMorgan was brought as part of the activities of the Residential Mortgage-Backed Securities Working Group set up by the White House in January of 2012. The group, according to the SEC, "brings together federal and state agencies to investigate those responsible for misconduct that contributed to the financial crisis through the pooling and sale of RMBS."

The SEC said that JPMorgan deliberately misled investors about the default rate for a $1.8 billion offering of mortgage-backed securities issued in 2006.

The SEC wrote that that JPMorgan "represented that only four loans… were delinquent by 30 to 59 days," while "at the time JPMorgan made these representations, the firm actually had information showing that more than 620 loans… were, and had been, 30 to 59 days delinquent, and the four loans represented as being 30 to 59 days delinquent were in fact 60 to 89 days delinquent."

The SEC further said that Bear Stearns "both before and after the merger with JPMorgan," frequently received settlements from loan originators for underperforming loans. But instead of passing the payments onto the holders of the securities it originated, Bear Stearns simply pocketed the settlement money and kept the bad performance of the assets a secret. Credit Suisse was culpable in the same practice, the SEC said.

The fraudulent activities of the big banks that led to the financial crash were documented in two government reports issued last year. The Financial Crisis Inquiry Commission report was followed by an even more detailed and incriminating report by the Senate Permanent Subcommittee on Investigations. The latter detailed mortgage fraud by the now-defunct Washington Mutual savings bank, Deutsche Bank and Goldman Sachs, as well as conflicts of interest and collusion by the credit rating firms and complicity by federal bank regulators.

In every case, civil cases brought against Wall Street firms by financial regulatory agencies in connection with the crisis have been settled out of court on terms favorable to the banks. The charged institutions agreed to pay fines—amounting to a fraction of the revenues they amassed from their fraudulent activities—while admitting no wrongdoing. In effect, the banks have been allowed to charge off fines for illegal activities as part of the cost of doing business.

No doubt one of the reasons regulators have avoided bringing cases to trial is concern that both the scope of the criminality of the banks and their own collusion in systematic fraud might be made public.