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$22 Trillion Lost, Zero Wall Street Executives Jailed: Prosecutors Should Utilize Whistleblowers to Establish Criminal Intent

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Cover Page Footnote

† J.D., University of Notre Dame Law School. The author formerly worked for Morgan Stanley from 2011 to 2013 and the Securities and Exchange Commission's Division of Enforcement in the summer of 2014. While at the Commission,the author had the opportunity to work closely with cooperators and whistleblowers while assisting in the investigation of possible violations of the federal securities laws. The views expressed herein are the author's own.

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If heads do not roll, nobody makes any changes.[1]

A Introduction

The Financial Crisis, which began in the United States on Wall Street in the fall of 2008, cost the global economy trillions of dollars, caused millions of people to lose their jobs, homes, life and retirement savings, and resulted in the collapse or taxpayer-funded government bailout of several century-old, storied financial institutions. Irresponsible risk-taking, fraudulent mortgage and lending practices, and misrepresentations around increasingly complex products are among the many theories that have been put forth as to what caused the Financial Crisis. Importantly, there are numerous state and federal statutes on the books prohibiting and criminalizing such activity. To put away those who engaged in such criminal behavior, Wall Street-focused prosecutors just had to

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[1] *Investigating and Prosecuting Financial Fraud After the Fraud Enforcement and Recovery Act: Hearing Before the Comm. on the Judiciary*, 111th Cong. (2010) (statement of Sen. Charles E. Grassley), *available at* `http://www.gpo.gov/fdsys/pkg/CHRG-111shrg71990/html/CHRG-111shrg71990.htm`; Senator Charles Grassley, Senate Hearing 111-1115, *Investigating and Prosecuting Financial Fraud after the Fraud Enforcement and Recovery Act*, (111th Congress, 2nd Session Sep. 22, 2010), *available at* `http://www.gpo.gov/fdsys/pkg/CHRG-111shrg71990/html/CHRG-111shrg71990.htm`.

establish that they did so with the requisite criminal intent, or mens rea.[2] Yet, not a single high-level Wall Street executive has been prosecuted criminally for their role in bringing about the worst crisis since the Great Depression.[3] In the rather blunt words of a former Senate investigator: "Everything's fucked up, and nobody goes to jail."[4]

This Note argues that the current enforcement framework, whereby cozy financial regulators and prosecutors are content with levying civil fines against financial institutions and allowing the bad actors therein to remain insulated, is insufficient. A key underlying premise throughout this Note is that the identification and prosecution of bad actors in the financial markets are "vital to the American economic engine."[5] This premise is especially true at this juncture in American history where, due to the interconnectedness and complexity of modern finance, a single harm or instance of wrongdoing can destabilize the entire global market.[6]

This Note, therefore, suggests that prosecutors overseeing the financial services industry should increasingly rely on whistleblowers from within a particular institution or the industry as a whole in order to establish the seemingly elusive element of criminal intent in these cases of alleged individual criminal financial wrongdoing.

A.1 A Brief History of the 2008 Financial Crisis

The 2008 Financial Crisis ("The Crisis") ultimately led to a four-year global "Great Recession" and resulted in sovereign debt crises for many nations, including Greece.[7] On the whole, the global economy has since recovered; gross domestic product (GDP) and unemployment rates have returned to pre-Crisis, or higher, levels. The Dow Jones Industrial Average, a major composite index and indicator of economic health in the United States, is currently trading north of $18,000. The index had peaked at just over $14,000 pre-Crisis. The current unemployment rate in the United States is under 6%, one percentage point higher than its pre-Crisis average of less than 5%.[8] Many Americans—and foreigners for that matter—however, are still undeniably feeling the effects of the Crisis and

2 Mens rea is defined as "[t]he state of mind that the prosecution, to secure a conviction, must prove that a defendant had when committing a crime." BLACK'S LAW DICTIONARY (9th ed. 2009).

3 Jon Hilsenrath, Serena Ng & Damian Paletta, *Worst Crisis Since '30s, With No End Yet in Sight*, WALL ST. J., Sept. 18, 2008, `http://www.wsj.com/articles/SB122169431617549947`.

4 Matt Taibbi, *Why Isn't Wall Street in Jail*, ROLLING STONE, Feb. 16, 2011, `http://www.rollingstone.com/politics/news/why-isnt-wall-street-in-jail-20110216`.

5 Samuel W. Buell, *What is Securities Fraud?* 61 DUKE L. J. 511, 573 (2011).

6 Sonny Eckhart, *Symposium: Citizen Employees: Whistleblowers and Other Employees Acting in the Public Interest: Postconference Reflector: A Nudged Solution to Securities Fraud*, 54 S. TEX. L. REV. 81, 87 (2012).

7 *See generally* ANDREW ROSS SORKIN, TOO BIG TO FAIL: THE INSIDE STORY OF HOW WALL STREET AND WASHINGTON FOUGHT TO SAVE THE FINANCIAL SYSTEM—AND THEMSELVES (Penguin Books 2010) (for an exhaustive history of the 2008 financial crisis).

8 *See* Bureau of Labor Statistics; Google Finance as of January 2015.

subsequent Recession, as their home values, their jobs, their retirement savings, and their beliefs in the integrity of the financial markets are yet to be restored.[9]

In its final report to Congress in 2011, the ten-member Financial Crisis Inquiry Commission (FCIC) put forth the following about the genesis of the 2008 Financial Crisis:

> The crisis …was caused by: widespread failures in financial regulation, including the Federal Reserve's failure to stem the tide of toxic mortgages; dramatic breakdowns in corporate governance including too many financial firms acting recklessly and taking on too much risk; an explosive mix of excessive borrowing and risk by households and Wall Street that put the financial system on a collision course with crisis; key policy makers ill prepared for the crisis, lacking a full understanding of the financial system they oversaw; and systemic breaches in accountability and ethics at all levels.[10]

This Note will focus primarily on those causes identified by the FCIC that contemplate the involvement of individual bad actors, namely: irresponsible risk-taking, fraudulent mortgage and lending practices, and misrepresentations around increasingly complex products.

Excessive risk-taking was all too prevalent on Wall Street in the decade or so leading up to the Financial Crisis. It was during this time that sophisticated Wall Street financiers claimed to have "banish[ed] risk," when, in fact, they had simply lost track of it."[11] Investment banks on Wall Street were leveraged upwards of 30-to-1 pre-Crisis, meaning they were executing their often risky trading strategies with borrowed money.[12] Indeed, these leverage ratios had ratcheted upwards from 2004 to 2008, skyrocketing from about 12-to-1 to 33-to-1, respectively.[13]

In regards to fraudulent mortgage and lending practices, these same financial institutions were approving loans to nearly anyone, with little regard to their

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9 *See* Attorney Gen. Eric. H. Holder, Jr., Remarks on Financial Fraud Prosecutions at NYU School of Law (Sept. 7, 2014), *available at* `http://www.justice.gov/opa/speech/attorney-general-holder-remarks-financial-fraud-prosecutions-nyu-school-law` ("[E]ven now[,] the scars of the Great Recession, its lingering impacts, and its echoes throughout our financial system are not hard to find."); *see also* William R. Emmons & Bryan J. Noeth, *Household Financial Stability: Who Suffered the Most from the Crisis?*, THE REG'L ECONOMIST, July 2012, at 11 (finding that between 2007 and 2009, household wealth declined by almost $17 trillion when adjusted for inflation).

10 FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES at xvii–xxii (2011), *available at* `http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf`.

11 *The Origins of the Financial Crisis*, THE ECONOMIST (Sep. 7, 2013), `http://www.economist.com/news/schoolsbrief/21584534-effects-financial-crisis-are-still-being-felt-five-years-article`.

12 *See* William D. Cohan, *How We Got the Crash Wrong*, THE ATLANTIC (June 2012), `http://www.theatlantic.com/magazine/archive/2012/06/how-we-got-the-crash-wrong/308984/` (defining leverage as the ratio of debt or assets to equity).

13 *Id.*

creditworthiness. As a result, many of the individual consumers obtaining these loans were "subprime" borrowers, who were, unsurprisingly, unable to repay their debt upon maturity.[14] Such subprime loans then were pooled consciously with loans of somewhat higher quality to disguise their risk. These pooled loans then were securitized into collateralized debt obligations (CDOs), asset backed securities (ABS), mortgage backed securities (MBS), and credit default swaps (CDS) by creative financial engineers at the investment banks.[15] These highly complex derivative products were blessed by self-interested rating agencies, too sophisticated for the majority of industry regulators to fully comprehend, and marketed and sold to less than sophisticated buyers with less than sufficient disclosures.[16]

As the Senate's Permanent Subcommittee on Investigations uncovered in a hearing on the role of investment banks in the Crisis, the banks selling these products often made misrepresentations about them to clients, or worse, played both sides of the deal.[17] Using mighty Goldman Sachs as a case study, Senator Carl Levin and Senator Tom Coburn determined that the investment bank had marketed several deals to its clients as good or long investments while simultaneously shorting such investments.[18] The Committee specifically exposed Goldman Sachs' now infamous Abacus collateralized debt obligation, where Goldman let a hedge fund that was shorting, or betting against, the CDO nonetheless cherry-pick the underlying assets that would be included in the CDO. The investment bank then marketed the CDO to several of its other clients as a good investment. In a rather terse exchange between Senator Carl Levin and Goldman Sachs' CEO, Lloyd Blankfein, Senator Levin asked: "Do you think they know that you think something is a piece of crap when you sell it to them and then bet against it? You think they know that?"[19] Such questionable behavior caused one investigative reporter to famously refer to the investment bank as a "great vampire squid" that was "wrapped around the face of humanity, relentlessly jamming its blood funnel into anything that smells like money."[20]

Fraud and financial misrepresentations—in addition to greed and moral lapses, which are not necessarily illegal[21]—were clearly rampant on Wall Street in the run up to the 2008 Financial Crisis. In its final lengthy presentation to Congress, the Financial Crisis Inquiry Commission used a variant of the word fraud over a hundred and fifty times in describing what led to the Financial Crisis, before concluding "that there was a 'systemic breakdown,' not just in accountability, but

14 *Origins*, *supra* note 11.

15 *Id.*

16 *Id.*

17 SEN. CARL LEVIN, Wall Street and the Financial Crisis: The Role of Investment Banks (April 27, 2010) *available at* `http://thehill.com/blogs/congress-blog/campaign/94549-wall-street-and-the-financial-crisis-the-role-of-investment-banks-sen-carl-levin`.

18 *Id.*

19 *Id.*

20 Matt Taibbi, *The Great American Bubble Machine*, ROLLING STONE (April 5, 2010), `http://www.rollingstone.com/politics/news/the-great-american-bubble-machine-20100405`.

21 Editorial, *No Crime, No Punishment*, N. Y. TIMES (Aug. 25 2012) `http://nyti.ms/PEQj5U`.

also in ethical behavior."[22] In light of the culture on Wall Street pre-Crisis, it is readily apparent that many executives committed criminal conduct that was expressly prohibited by the federal securities laws. Therefore, it should have been relatively easy for prosecutors to establish the actus reus element of financial crimes.[23] The heavy lifting for prosecutors would come in the way of proving these Wall Street executives acted with the accompanying element of mens rea by establishing the executives intentionally, or at least knowingly, committed the particular wrongful act.

The primary fraud enforcement provision of the federal securities laws is Rule 10b-5 under Section 10 of the Securities Exchange Act of 1934.[24] When the rule initially was presented to him in the early 1940s, SEC Commissioner Sumner Pike approved the enforcement mechanism by quipping, "Well, we are against fraud aren't we?"[25] Indeed, Rule 10b-5 explicitly prohibits: (1) devices, schemes, or artifices to defraud, (2) false statements or omissions of material facts, and (3) acts, practices, or courses of business that operate as frauds or deceits, in connection with the purchase or of sale of a security.[26] The rule has expansive powers and has been used broadly by industry regulators and prosecutors over the past seventy-five years to combat fraud.

In the course of investigating various Wall Street actors, the Securities and Exchange Commission can, in its discretion, make a criminal referral to the Department of Justice ("DOJ" or "Justice") when it suspects intentional, or willful, fraud under any of the three prongs of Rule 10b-5.[27] The Justice Department then conducts a parallel criminal investigation and can seek restitution, fines, or imprisonment of the individual at the focus of the investigation.[28] Although the DOJ does not have to prove reliance, damages, or loss causation, it does have to establish that the individual acted with scienter, or mens rea.[29] Regarding the requisite scienter in securities fraud cases, the Court in *United States v. Teyibo*[30] held that the government must prove that the defendant "participated in the scheme to defraud knowingly, willfully and with intent to defraud."[31]

When investigated and prosecuted effectively, a criminal fraud conviction is

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[22] *See* Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?*, N.Y. Rev. of Books (Jan. 9, 2014), `http://www.nybooks.com/articles/archives/2014/jan/09/financial-crisis-why-no-executive-prosecutions/`.

[23] *Actus reus* is defined as "[t]he wrongful deed that comprises the physical components of a crime and that generally must be coupled with *mens rea* to establish criminal liability." Black's Law Dictionary (9th ed. 2009).

[24] Securities Exchange Act of 1934, 15 U.S.C. §§78a–78pp (2006 & Supp. III 2009).

[25] Milton Freeman, *Conference on Codification of the Federal Securities Laws*, 22 Bus. Law 793, 922 (1967).

[26] 17 C.F.R. §240.10b-5.

[27] Jonathan M. Karpoff, et al., The Legal Penalties for Financial Misrepresentation (May 2, 2007) (unpublished manuscript), (`http://ssrn.com/abstract=933333`); *see also* Securities Exchange Act of 1934 §32, 15 U.S.C. §§78a–78pp.

[28] *Id.*

[29] United States v. Teyibo, 877 F. Supp 846, 862 (S.D.N.Y. 1995).

[30] *Id.* at 861.

[31] *Id.*; *see also* L. Sand, T. Siffert, W. Loughlin and S. Reiss, Modern Federal Jury Instructions: Criminal 57 (1994).

one of the most "serious, costly, stigmatizing, and punitive forms of liability imposed on actors in modern corporations and financial markets."[32] It is likely that fraud convictions related to the 2008 Financial Crisis would have the profound impact on improving norms, behavior, and attitudes in the financial industry.[33] During and following the Crisis, many justifiably felt the industry was desperately in need of such a reshaping. Yet, the powerful liability-attaching, deterrent mechanism that is a fraud conviction has not been used at all to go after Wall Street executives, despite the fact that their conduct was particularly blameworthy in light of the Crisis it precipitated. Indeed, when one asks how many of the executives who allegedly engaged in fraudulent behavior in the years leading up to and during the Financial Crisis were criminally prosecuted and put in jail, the answer is a troubling zero.

B Current Regulatory Framework Not Working

Following the 2008 Financial Crisis, "Main Street" was justifiably angered and wanted to see prosecutions. Industry regulators and federal prosecutors smelled blood and proclaimed they would hold those accountable responsible. On this point, the former head of the Department of Justice's Criminal Division, Lanny Breuer, stated the following at a Senate Oversight hearing in 2010:

> The Department [of Justice] has re-evaluated the manner in which it investigates financial fraud, and as a result, we have significantly heightened our enforcement efforts. We have forged even closer partnerships with the many law enforcement and regulatory agencies that are focused on fighting fraud, and we have redoubled our efforts to send a strong deterrent message to would-be fraudsters by vigorously prosecuting these criminals and sending them to jail.[34]

These groups also had the support of legislators in Washington. In 2009, Congress passed, and President Obama signed into law, the Fraud Enforcement Recovery Act, known as FERA. FERA appropriated an additional $165 million in federal funds to investigators and prosecutors with the directive to go after those on Wall Street who engaged in fraud connected to the Financial Crisis.[35] At the time, Senator Ted Kaufman insisted, "the men and women who duped would-be home owners, who defrauded the American investor, need to [be] identified, prosecuted, convicted and thrown in jail."[36] Such grand pos-

32 Buell, *supra* note 5, at 521.

33 *Id.* at 574.

34 *Investigating and Prosecuting Financial Fraud after the Fraud Enforcement and Recovery Act, Before the H. Comm. on the Judiciary*, 111th Cong. 5–6 (2010) (statement of Lanny Breuer, Head, Department of Justice Criminal Division).

35 Jeff Connaughton, "Financial Crisis and Financial Crimes" Address at the Federal Reserve Bank of New York (Nov. 2, 2010).

36 CONGRESSIONAL RECORD-SENATE, Vol. 155, Pt. 4, 4331, 4342 (111th Congress, 1st Session Feb. 23, 2009) (quoting Judiciary Committee Chairman Sen. Patrick Leahy "I want to see people who have committed such fraud and the havoc, it's caused this country—frankly, I want to see them go to jail").

turing by prosecutors and public encouragement by legislators produced minimal results, however. Not a single high-level Wall Street executive has been successfully criminally prosecuted for their role in precipitating the Financial Crisis.[37] This is true despite the fact that many traders and bankers on Wall Street—the alleged perpetrators—worried "they could be held criminally liable for fraud…and…expected investigations and at least some prosecutions."[38]

In June of 2008, just a few short months before the failure of the investment bank Lehman Brothers, the Department of Justice criminally charged two former executives of the now-defunct investment bank Bear Stearns with securities fraud for their alleged participation in creating the housing bubble.[39] These were to be the government's first of many successful criminal convictions relating to the 2008 Financial Crisis. A year later, however, a jury found the two former Bear Stearns executives not guilty and acquitted them of the criminal charges. The prosecutors working the case had struggled to convince a jury beyond a reasonable doubt—the burden of proof standard in criminal cases—of the executive's *mens rea*, or "guilty mind" in committing the prohibited criminal conduct.

This early setback had a tremendous effect on the prosecutorial effort at the Department of Justice. Former New York Governor and Attorney General Eliot Spitzer stated that as a result of the loss, "there was a definite sense that Justice backed off and…became timorous when it came to making the cases that would really have gone to the heart of what did happen in the crisis of '08."[40] Following the Bear Stearns loss, risk adverse United States Attorneys were no longer attracted to the idea of prosecuting white-collar crimes if evidence as to the defendant's intentions—their *mens rea*—was seemingly lacking up front.[41] Sadly, such a view would come to dominant Justice's response to the Financial Crisis.

Indeed, charges against alleged Financial Crisis precipitators have almost exclusively been brought as civil cases where prosecutors just have to establish guilt beyond a preponderance of the evidence, as opposed to the stricter criminal standard of guilt beyond a reasonable doubt.[42] Under the current prosecutorial framework, an individual or investment bank that is found to have committed a violation of the federal securities laws, can avoid admitting their guilt[43]

[37] *See* Rakoff, *supra* note 22; *see also* Taibbi, *supra* note 4.

[38] *The Untouchables*, PBS Frontline (Jan. 22, 2013), *available at* `http://www.pbs.org/wgbh/pages/frontline/untouchables/`.

[39] United States v. Cioffi, 08-CR-00415, (E.D.N.Y. 2009).

[40] *Untouchables*, *supra* note 38.

[41] Buell, *supra* note 5, at 572; *see also* Marian Wang, *Why No Financial Crisis Prosecutions? Ex-Justice Official Says It's Just Too Hard*, Pro Publica (Dec. 6, 2011), *available at* `http://www.propublica.org/article/why-no-financial-crisis-prosecutions-official-says-its-just-too-hard` (quoting a former FBI agent as saying following the loss, the federal government began to question its "ability to convince a jury that criminality has occurred" in complex financial cases).

[42] Jason M. Breslow, *Too Big to Jail: The Top Ten Civil Cases Against the Banks*, PBS Frontline (Jan. 22, 2013), *available at* `http://www.pbs.org/wgbh/pages/frontline/business-economy-financial-crisis/untouchables/too-big-to-jail-the-top-10-civil-cases-against-the-banks/`.

[43] *See* United States Securities and Exchange Commission v. Citigroup Global Markets Inc., 752

and pay a fine to the Justice Department, the Securities and Exchange Commission, or one of the other relevant authorities tasked with overseeing Wall Street, such as the New York Department of Financial Services or New York Attorney General. Some Wall Street commentators are appropriately skeptical of this arrangement, referring to such civil settlements as "cash for secrecy" deals, whereby investment banks agree to pay the large fines after a series of secret negotiations, without the presence of trials or judges.[44] Further, following such a civil settlement, the only thing disclosed to the public is a quasi-official statement of facts, which, some reporters have quipped, "is conveniently devoid of anything like actual facts."[45]

For the large investment banks that dominate Wall Street, such a civil fine is merely seen as a "mild and modest" cost of doing business[46] that the bank can pass on to its employees and shareholders.[47] Indeed, in such cases, a corporation that has entered a guilty plea may still see its share price rise the very next day on the New York Stock Exchange.[48] Until very recently, such civil enforcement measures against financial institutions were the exception, not the rule, and "prosecutions of companies without simultaneous prosecutions of their managerial agents were even rarer."[49] The Department of Justice has nonetheless made these civil enforcement actions the focus of their response to the 2008 Financial Crisis. In doing so, the DOJ has relied heavily on the Financial Institutions Reform, Recovery and Enforcement Act, known as "FIRREA." FIRREA, which was passed shortly after the Savings and Loan Crises of the 1980s, essentially

F.3d 285 (2d. Cir. 2014)(overturning Judge Rakoff's Southern District of New York opinion that the "no admit, no deny" policy employed by the SEC for civil settlements was inappropriate); *see also* Chair Mary Jo White's Speech to the Council of Institutional Investors (Chicago, Sep. 26, 2013), *available at* `http://www.sec.gov/News/Speech/Detail/Speech/1370539841202` (stating "To reiterate, no-admit-no-deny settlements are a very important tool in our enforcement arsenal that we will continue to use when we believe it is in public interest to do so. In other cases, we will be requiring admissions. These decisions are for us to make within our discretion, not decisions for a court to make.").

44 *See* Matt Taibbi, The $9 Billion Witness: Meet JP Morgan's Worst Nightmare, ROLLING STONE (Nov. 6, 2014).

45 *Id.*

46 *See* Securities Exchange Commission v. Citigroup Global Markets Inc., 827 F.Supp.2d 328, 333–35 (S.D.N.Y. 2011)(Judge Rakoff referring to one such civil fine of $285 million levied against Citigroup as "a mild and modest cost of doing business" and "pocket change" to any large investment bank); *see also* William D. Cohan, *On Wall Street Whistleblowers*, THE FINANCIAL TIMES (May 30, 2014) (quoting director Beatrise Edwads of the public-interest law firm Government Accountability Project, "Calculate how much money you can make doing 'x' or selling 'y' before getting caught at it, and what you think essentially you could settle for, and if what you can make is substantially more than what you can settle for, then you go forward…It's a cost-benefit analysis. It works because nobody's going to jail. Jail would put a stop to it.").

47 *See* Rakoff, *supra* note 22 (stating that "from a moral standpoint, punishing a company and its many innocent employees and shareholders for the crimes committed by some unprosecuted individuals seems contrary to elementary notions of moral responsibility"); *see also* Attorney General Holder Remarks, *supra* note 9 (stating that it's not right for punishment to be borne exclusively by the company, its employees, and it's innocent shareholders.").

48 *See* Attorney General Holder Remarks, *supra* note 9; *see also* Taibbi, *supra* note 44 (illustrating that following a $13 billion civil settlement with the Department of Justice, JP Morgan's share price soared six percent.).

49 Rakoff, *supra* note 22.

allows regulators to civilly charge investment banks as having committed fraud against themselves.[50] In the aftermath of the Financial Crisis, the Justice Department has used FIRREA to obtain record civil settlements from J. P. Morgan, Citigroup, Bank of America, and many other investment banks.[51] This new trend in Wall Street enforcement is troubling; however, when prosecutors merely go after the financial institution, the "former executives, who actually committed the underlying misconduct…are left untouched."[52] Put another way, the proverbial buck stops nowhere.[53]

Many commentators, including former Wall Street-focused prosecutors, are justifiably unsatisfied with this current enforcement framework, whereby prosecutors claim that it is too hard to prove the requisite *mens rea* for a criminal conviction and therefore, keep the focus of their efforts in the civil and institutional arenas.[54] It does not have to be this way, however. In addition to the prosecutorial framework advocated by this Note—increased reliance on whistleblowing—it is worth noting that prosecutors could currently bring criminal cases under the doctrine of willful blindness or under the strict liability provisions of the Sarbanes-Oxley Act.

Indeed, one way to overcome the difficulty of proving that the alleged bad actor acted with the requisite criminal intent is by proving they at least acted with willful blindness, like an ostrich that buries its head in the sand to avoid trouble. Judge Jed Rakoff, of the Southern District of New York—the federal court that hears the majority of the cases pertaining to Wall Street—raises the example of a banker, who, despite growing evidence from the industry that mortgage fraud is rampant, refuses to ask just how it is that his investment bank's mortgage backed securities continue to receive AAA ratings from the rating agencies.[55] Judge Rakoff rhetorically posits, "Might it be because he did not want to know what such inquiries would reveal?"[56]

As the United States Supreme Court has stated, the "doctrine of willful blindness is well established in criminal law…[C]ourts applying the doctrine of willful blindness hold that defendants cannot escape the reach of these statutes by deliberately shielding themselves from clear evidence of critical facts that are strongly suggested by the circumstances."[57] It appears clear that federal prosecutors should have at least attempted to criminally charge Wall Street executives where applicable under this doctrine. There is simply no way that executives at the various investment banks were completely in the dark regarding the irresponsible risk-taking, fraudulent mortgage and lending practices, and misrepresentations around increasingly complex products individuals within their firms

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50 Attorney General Holder Remarks, *supra* note 9.
51 *Id.*
52 Rakoff, *supra* note 22.
53 Attorney General Holder Remarks, *supra* note 9.
54 *See id.* (stating that the failure to establish intent or the knowledge of a particular scheme by a high-ranking executive "has been a source of frustration for the public for a long time.")
55 Rakoff, *supra* note 22.
56 *Id.*
57 Global-Tech Appliances, Inc. v. SEB S.A., No.10-6 (U.S. May 31, 2011).

engaged in. That is, unless they wanted to be in the dark. In the aftermath of prior crises, more resolute federal prosecutors have asked juries to infer intent on this basis, especially in complex cases "at least as esoteric as those involved in the events leading up to the financial crisis."[58]

The Sarbanes-Oxley Act is another method by which prosecutors could have held Wall Street executives criminally responsible for their actions in bringing about the Financial Crisis. The Sarbanes-Oxley Act, or "SOX" as it is known colloquially, was passed after the Enron and WorldCom debacles in the early twenty-first century with the well-intentioned goal of cleaning up corporate accounting practices. Section 302 of the Sarbanes-Oxley Act is a stringent, catch-all provision that requires chief executive officers and chief financial officers to certify financial statements prior to their filing with the Securities and Exchange Commission to ensure that the statements are free of any untrue statements or omissions of material facts and further, that adequate internal controls around such information exist.[59] Section 1350 of the Act adds teeth to §302, making it a strict liability, criminal offense for corporate executives to knowingly sign a false financial statement. Knowingly doing so is punishable by up to ten years in prison and a fine of up to one million dollars, with punishments increasing to twenty years and five million dollars if their misconduct is willful.[60] The basic premise behind these provisions of SOX was to "have a criminal statute in place that would make CEOs and CFOs think twice, think three times before they signed their names attesting to the accuracy of financial statements or the viability of internal controls."[61]

There is much evidence suggesting that Wall Street executives were well aware of the "toxicity" of the sub-prime mortgage-backed and asset-backed securities sold by their firms. In the words of one former investment banker turned Wall Street commentator, "One damning email after another makes clear [Wall Street executives] knew some of the mortgages would probably default and that the securities should never have been sold in the first place."[62] Despite their apparent clear applicability, these provisions of Sarbanes-Oxley have not been used at all by the Justice Department, the New York Department of Financial Services, or any other body with criminal authority to prosecute and jail such corporate executives. This was arguably a missed opportunity.

It is also important to note that the Justice Department's response to the individual misconduct that brought about the 2008 Financial Crisis differs substantially from that of the Department's response to instances of individual misconduct in prior financial crises. As Judge Rakoff of the federal district court for the Southern District of New York has noted, comparing current efforts to those during the Junk Bond Bubble in the 1970s, the Savings and Loan Crisis of the 1980s and 1990s, and the Accounting Frauds of the 1990s thus reveals a

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58 Rakoff, *supra* note 22.

59 15 U.S.C. §7241 (2002).

60 15 U.S.C. §1350(c)(1)(2) (2002).

61 *Prosecuting Wall Street*, CBS 60 MINUTES (Dec. 05, 2011).

62 *See* Cohan, *supra* note 46.

troubling picture.[63] The progenitors of the fraud in the Junk Bond Bubble in the 1970s, such as Michael Miliken, were criminally prosecuted.[64] The same is true for the Savings and Loan Crisis of the 1980s, where special government task forces and prosecutors put more than eight hundred bank officials in jail, many of them top executives.[65] The prosecutorial result was similar with the accounting fraud scandals that characterized the early 2000s. Those individuals allegedly responsible were prosecuted and found guilty; indeed, formerly well-respected CEOs, such as Enron's Jeffrey Skilling and Worldcom's Bernard Ebbers, were hauled off to jail.[66]

The investigation and prosecution of the 2008 Financial Crisis produced quite a different story, however. As the press has noted, "There were no criminal referrals from the regulators. No fraud working groups. No national task force. There has been no effective punishment of the elites here."[67]

Rather than taking a note from their predecessors and working to convict bad actors of criminal fraud or financial misrepresentation, federal prosecutors have chosen to bring the easier cases. Indeed, they have focused their efforts on civil cases that have a lower burden of proof and on going after institutions as opposed to individuals.[68] Perhaps the most obvious example of this is the case of Countrywide Financial's CEO Angelo Mozilo, who arguably "headed the single most corrupt subprime mortgage lender in America during the period preceding the crisis."[69] Indeed, in a 2008 interview with Bloomberg News, Senator Charles Schumer of New York stated that Countrywide Financial "will come to symbolize what went wrong with housing" in the run up to the Financial Crisis.[70]

Despite instilling a culture that consciously abandoned loan-underwriting standards—Mozilo operated under a "fund 'em" philosophy—he was not criminally prosecuted and therefore, received zero jail time.[71] Instead, Mozilo was able to settle a civil suit with the Securities and Exchange Commission by paying a $67.5 million fine, almost a third of which was covered by his institution, Countrywide Financial.[72] If the amount of the civil fine sounds like a substantial sum of money, it is worth noting that as the chief executive officer of one of the

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63 Rakoff, *supra* note 22.

64 *Id.*

65 *Id.*

66 *Id.*

67 Gretchen Morgenson & Louis Story, *In Financial Crisis, No Prosecution of Top Figures*, The New York Times (Apr. 14, 2011).

68 In recent remarks at NYU School of Law, Attorney General Holder defended this approach, noting the difficulty in proving intent and knowledge of a fraudulent scheme, and concluding Justice "cannot bring cases unless, based upon the facts and the law, we believe that we are likely to succeed in court." *See* Attorney General Holder Remarks, *supra* note 9.

69 Matt Taibbi, *Angelo Mozilo, Former Countrywide CEO, Claims He Doesn't Know What 'Verified Income' Is*, Rolling Stone (Dec. 28, 2012).

70 Keri Geiger, Tom Schoenberg & Greg Farrell, *Countrywide's Mozilo Said to Face U.S. Suit Over Loans*, Bloomberg News (Aug. 21, 2014).

71 Untouchables, *supra* note 39 (quoting a Countrywide employee saying 'fund 'em' was "Angelo Mozilo's growth strategy for 2006.")

72 Taibbi, *supra* note 69.

nation's largest mortgage underwriters, Angelo Mozilo made over half a billion dollars from 2000 to 2008.

In the words of University of San Diego law professor and former Wall Street derivatives trader Frank Partnoy, the Mozilo case is characteristic of the "dual nature" of how financial crimes are prosecuted:

> We have the Department of Justice, which can put people in jail and the Securities and Exchange Commission, which can't. And its sort of like we have this two-headed monster—one head has some teeth. The other head has no teeth. And it was the head with no teeth that went after Angelo Mozilo. So the greatest danger he was in from the beginning was maybe he'd be gummed to death, but not even that happened.[73]

Indeed, shortly after the civil settlement with the Securities and Exchange Commission, federal prosecutors with the Department of Justice dropped their criminal investigation and Mozilo was spared a conviction and jail time.[74]

The response of federal prosecutors to the 2008 Financial Crisis—focusing on civil prosecutions against institutions as opposed to criminal prosecutions against individuals—can be fairly characterized as one of missed opportunity. While outgoing Attorney General Eric Holder defended the Justice Department's response to the Crisis in recent remarks at New York University Law School, he conceded that criminally prosecuting individual bad actors on Wall Street would have had the threefold effect of increasing accountability, promoting fairness, and serving as a deterrent.[75] Regarding the deterrence effect criminal prosecutions would have had, Attorney General Holder continued:

> Few things discourage criminal activity at a firm—or incentivize changes in corporate behavior—like the prospect of individual decision-makers being held accountable. A corporation may enter a guilty plea and still see its stock price rise the next day. But an individual who is found guilty of a serious fraud crime is most likely going to prison.[76]

Indeed, levying a civil fine against the financial institution—a separate entity under law—does not have the same deterrent effect as criminally prosecuting those

[73] Prosecuting Wall Street, *supra* note 61.

[74] *Id.*

[75] *See* Attorney General Holder Remarks, *supra* note 9 ("First, it enhances accountability…corporate misconduct must necessarily be committed by flesh-and-blood human beings. So wherever misconduct occurs within a company, it is essential that we seek to identify the decision-makers at the company who ought to be held responsible. Second, it promotes fairness—because, when misconduct is the work of a known bad actor, or a handful of known bad actors, it's not right for punishment to be borne exclusively by the company, its employees, and its innocent shareholders. And finally, it has a powerful deterrent effect…few things discourage criminal activity a firm—or incentivize changes in corporate behavior—like the prospect of individual decision-makers being held accountable.")

[76] *Id.*

individuals actually responsible for the wrongdoing. In the words of Georgetown Law Professor Donald Langevoor, to effectively deter criminal behavior, "You have to scare the executives, not just the firm."[77]

Without this deterrence effect, there has been a perpetuation of Wall Street's pre-Crisis culture of greed, zero accountability, and risk-taking. A recent review of the New York Times and Wall Street Journal details several new instances of financial misconduct by Wall Street Executives, including the rigging of the London Interbank Offered Rates (LIBOR), colluding on foreign exchange (FX) rates over messaging systems, issuing credit ratings without conducting the proper diligence, hiding stock options and other forms of compensation from public disclosure, and undervaluing portfolios.[78]

As the statute of limitations on many of the would-be crimes from the Financial Crisis toll or continue to tick down,[79] it has become quite evident that "the failure of the government to bring to justice those responsible for such colossal fraud bespeaks weaknesses in our prosecutorial system that need to be addressed."[80] Moreover, the total absence of criminal prosecutions related to the Crisis is "consistent with what many people were worried about during the crisis, that different rules would be applied to different players. It goes to the whole perception that Wall Street was taken care of, and Main Street was not."[81]

This Note seeks to therefore advocate for the prosecutorial framework that should have been used by regulators and prosecutors in the aftermath of the most recent financial crisis and can be used going forward. This new framework allows prosecutors to overcome the difficulty of proving criminal intent in violations of the federal securities laws and focus once again on the individual by encouraging prosecutors to work hand in hand with—and indeed rely on—whistleblowers to establish the element of *mens rea*. Such a framework will hold accountable those responsible for subsequent crises and succeed in having a profound deterrent effect on prospective bad actors. Such effects should have arisen from criminal prosecutions following the 2008 Financial Crisis.

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77 Jonathan Berr, *Why So Few Sketchy Bankers are Behind Bars*, CBS MONEY WATCH (Oct. 1, 2014) (Georgetown Law Professor Donald Langevoor speaking about the "common impression").

78 *See generally* Various, DEAL BOOK NEW YORK TIMES (2014); Various, WALL STREET JOURNAL (2014).

79 *See No Crime, No Punishment*, *supra* note 21 (stating that the statute of limitations is generally five years for securities fraud and most other federal offenses); *see also* Berr, *supra* note 77 (quoting Cornell Law School professor Robert C. Hockett that there would "be arguments in court over when DOJ 'should' have known about the wrongs having occurred (since that's when the clock starts running)"); *see also* Taibbi, *supra* note 44 (quoting former prosecutor and New York Attorney General Eliot Spitzer, "A conspiratorial way of looking at it would be to say the state waited far too long to look at these cases and is now taking its sweet time investigating, while the last statutes of limitations run out.").

80 Rakoff, *supra* note 22.

81 Morgenson, *supra* note 67 (quoting University of Pennsylvania Law Professor David A. Skeel); *see also* Matt Taibbi, *The People v. Goldman Sachs*, ROLLING STONE, May 26, 2011, at 41 ("[T]he mountain of evidence collected against Goldman by…investigators—details of gross, baldfaced fraud delivered up in such quantities as to almost serve as a kind of sarcastic challenge to the curiously impassive Justice Department—stands as the most important symbol of Wall Street's aristocratic impunity and prosecutorial immunity produced since the crash of 2008.").

C Whistleblowing as Solution to Insufficient Prosecutorial Framework

As outgoing Attorney General Eric Holder has noted:

> Since no financial fraud case is prosecutable unless we have sufficient evidence of intent, [prosecutors] should seek to better equip investigators to obtain this often-elusive evidence. This means, among other things, thinking creatively about ways to…encourage whistleblowers at financial firms to come forward.[82]

This sentiment lays the foundation for the prosecutorial framework advocated by this Note: prosecutors need to start working extensively—indeed, relying on—whistleblowers to establish the so-called "elusive" element of intent in criminally prosecuting potential violators of the federal securities laws. In doing so, Wall Street prosecutors will be able to conduct the *mens rea* inquiry they have been avoiding. Such an inquiry is the only method to "separate the malign from the benign,"[83] and ensure investigations into alleged financial wrongdoing stay in the criminal arena where appropriate.

According to Blacks Law Dictionary, a *whistleblower* is an employee who reports "illegal or wrongful activities of his employer or fellow employees."[84] As far as Wall Street's cop, the Securities and Exchange Commission, is concerned, a whistleblower is "any individual who provides, or 2 or more individuals acting jointly who provide, information relating to a violation of the securities laws to the Commission."[85]

United States President Barack Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") into law in 2010 with the lofty goal of preventing future financial crises. Among other things, the Dodd-Frank amends the Securities Exchange Act of 1934 by adding Section 21F, entitled "Securities Whistleblower Incentives and Protection." This Section seeks to do exactly that: financially incentivize whistleblowers to report wrongdoing and also protect them from retaliation from their employer once they do make such a report. In doing so, Dodd-Frank has dramatically improved the whistleblower regime in the United States. The financial incentive, or bounty, component of Dodd-Frank fills a void that was missing from previous whistleblower statutes, such as those provided in the Sarbanes-Oxley Act.[86] To quote Paul Kanjorski, the former Congressman from Pennsylvania, the goal of the statute was to "put

[82] Attorney General Holder Remarks, *supra* note 10; *see also* Cohan, *supra* note 47 (quoting Eliot Spitzer: "Very few prosecutors would claim that they could make great cases without individuals on the inside…We cannot make the complicated cases or begin to see the difficulties there without people who come forward to discuss what is going on that s improper. So we desperately need them and we're going to continue to apply pressure to ensure that Wall Street and the other major institutions live by the rules.").

[83] Buell, *supra* note 5.

[84] BLACK'S LAW DICTIONARY 1734 (9th ed. 2009).

[85] 15 U.S.C.S. §78u–6(a)(6)

[86] M. Thomas Arnold, "*It's Déjà vu All Over Again": Using Bounty Hunters to Leverage Gatekeeper Duties*, 45 TULSA L. REV. 419, 460 (2010).

more cops on the beat," by allowing the Securities and Exchange Commission "to pay bounties to whistleblowers whose tips result in catching fraudsters."[87] In respect to number of tips received, the Act's bounty scheme seems to be working thus far. Prior to Dodd-Frank, the Securities and Exchange Commission was receiving only around two-dozen "high-value" tips per year from whistleblowers regarding financial wrongdoing; in the first six months after Dodd-Frank was signed into law, the SEC was averaging the receipt of one to two high-high value tips per day.[88]

Section 922 of Dodd-Frank specifically states that "the Commission…shall pay an award or awards to 1 or more whistleblowers who voluntarily provided original information[89] to the Commission that led to the successful enforcement of the covered judicial or administrative action, or related action," resulting in "monetary sanctions exceeding $1 million."[90] The award the SEC "shall pay" (meaning such a payment is mandatory) to whistleblowers is set at ten to thirty percent of the collected monetary sanctions;[91] a considerable sum of money considering the average amount recovered by the SEC in an enforcement proceeding is tens of millions of dollars.[92] "Related actions," as defined by the Act, importantly include Department of Justice and State Attorney General criminal actions.[93] The takeaway here is that although a whistleblower may initially come forward to assist the SEC in its civil enforcement investigation, they are also incentivized to work with the criminal enforcement authorities, such as the DOJ.

In other industries, such financial incentives have been proven effective in motivating whistleblowers to detect and report fraud to the relevant authorities. In a recent study, researchers at the University of Toronto found that the presence of a "strong monetary incentive to blow the whistle does motivate people to come forward."[94] Yet there are some in government that believe the reward amounts currently available to prospective whistleblowers may not be enough to induce current Wall Streeters to actually take the risk of blowing the whistle. This is especially true in light of the fact that in 2013, the financial industry's collective bonus pool was north of $26 billion and median executive pay was $15 million.[95] In recent remarks, Attorney General Holder advocated increasing financial incentives for individual cooperation to "significantly improve the Justice Department's ability to gather evidence of wrongdoing while complex financial crimes are still in progress—making it easier to complete investigations

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[87] *Industry Perspectives on the Obama Administration's Financial Regulatory Reform Proposals: Hearing Before the H. Comm. On Fin. Serv.*, 111th Cong. 62 (2009).

[88] Dave Clarke, *SEC Gets More Whistleblower Tips*, REUTERS (Feb. 4, 2011).

[89] "Original information" is defined by the statute as information derived from the "independent knowledge or analysis of a whistleblower…not known to the [SEC] from any other source." *See* Dodd-Frank Act §922, 15 U.S.C.S. §78u–6(a)(3).

[90] *Id.* at §78u–6.

[91] *Id.* at §78u–6(b)(1).

[92] `www.sec.gov`.

[93] Dodd-Frank Act §922, 15 U.S.C.S. §78u–6(a)(5) & (b)(1).

[94] Alexander Dyck et al., *Who Blows the Whistle on Corporate Fraud?*, 65 J. FIN. 2213, 2215 (2010).

[95] Attorney General Holder Remarks, *supra* note 9.

and to stop misconduct before it becomes so widespread that it foments the next crisis."[96]

The decision by a Wall Street employee to become a whistleblower has two profound effects: "first, increased whistleblowing raises the likelihood of detection, thus reducing the opportunity to commit fraud. Second, the threat of whistleblowing—and the public condemnation it triggers—makes rationalization more difficult."[97] Whistleblowing is seen as one of the most effective ways of detecting fraud.[98] Indeed, more than forty percent of fraud detection occurs as a result of tips from whistleblowers.[99] Thus, the role of whistleblowing in fraud detection should not be underestimated: in their recent study at the University of Toronto, researchers revealed that the SEC itself uncovered just seven percent of 216 major financial fraud scandals between 1996 and 2004.[100]

One of the main reasons that whistleblowing has been so successful in rooting out instances of fraud is that whistleblowers are often insiders with access to information sources not otherwise easily available to prosecutors.[101] The newly created Office of the Whistleblower at the Securities and Exchange Commission states, "Through their knowledge of the circumstances and individuals involved, whistleblowers can help the Commission identify possible fraud and other violations much earlier than might otherwise have been possible…allow[ing] the Commission to…hold accountable those responsible for unlawful conduct."[102]

In the financial fraud context, these insiders also often have the financial and accounting training and acumen that allow them to "comprehend, synthesize, and evaluate" information that directly or indirectly points to fraud.[103] This financial know-how allows whistleblowers within financial institutions to decipher between transactions that appear criminally fraudulent and those that are just overly complex, yet lawful.

D "UNHEARD WHISTLEBLOWING" AS MISSED OPPORTUNITIES

An often provided motivation as to why whistleblowers come forward is "the desire to correct the wrongdoing which is harming the interests of the organization itself, the consumers, the co-workers and the society at large."[104] If the foregoing rationale is indeed true, then it follows that many Wall Street employees should

96 *Id.*

97 Geoffrey Christopher Rapp, *Mutiny by the Bounties? The Attempt to Reform Wall Street by the New Whistleblower Provisions of the Dodd-Frank Act*, 2012 B.Y.U. L. REV. 73, 108 (2012).

98 *Id.* at 108.

99 Ass'n of Certified Fraud Examiners, 2010 Report to the Nations, *available at* `http://www.acfe.com/rttn-highlights.aspx`.

100 Dyck, *supra* note 94, at 2213–14 (2010); *see also* Rapp, *supra* note 97, at 107 (stating that "while the legal and regulatory environment is predicated on the notion that regulators will detect fraud, there is very little support for this position.").

101 Rapp, *supra* note 97, at 108.

102 SEC OFFICE OF THE WHISTLEBLOWER, `www.sec.gov/whistleblower`.

103 Rapp, *supra* note 97, at 109.

104 Siddhartha Dasgupta & Ankit Kesharwani, *Whistleblowing: A Survey of Literature*, 9 IUP J. CORP. GOVERNANCE 57, 62 (2010).

have blown their respective whistles during the Financial Crisis and blown them loudly. Indeed, many did.[105] Unfortunately, industry regulators and prosecutors did not always listen to them nor work with them to the extent advocated by this Note. The shortcoming was therefore not that whistleblowers were "reticent to complain," but rather that they were "not getting the response" which they should have from regulators and prosecutors.[106]

When given appropriate attention, whistleblowers can essentially hold "Wall Street's collective feet to the fire by exposing wrongdoing when it occurs."[107] If prosecutors had listened to and relied on these would-be Wall Street whistleblowers, the story of the aftermath of the 2008 financial crisis would have undoubtedly included a final chapter detailing the criminal prosecutions and subsequent jailings of several Wall Street executives. This Note will now explore a few instances in which Wall Street whistleblowers attempted to do the right thing, but were either not listened to, or not utilized to their full potential by regulators and prosecutors. This Note will refer to such instances as "unheard whistleblowing."

The first illustrative case of "unheard whistleblowing" is that of Oliver Budde, a former legal adviser with the now-defunct investment bank, Lehman Brothers.[108] During his time with the bank, Budde noticed Lehman was failing to disclose the sizable unvested stock options it had granted to its Chairman and CEO, Dick Fuld, as part of his compensation package. Despite Budde's internal protests, the brass at Lehman Brothers refused to disclose the grants in their annual filings and chose instead to rely on a small loophole that arguably allowed them to skirt the disclosure requirements of the Securities Exchange Act of 1934.[109]

Not wanting to become complicit in Lehman's scheme, Budde resigned from the investment bank in 2005. A few years later, however, the SEC closed the disclosure loophole Lehman Brothers had been exploiting. Budde recalls thinking at the time, "Now they're going to have to disclose these awards…[the] s*** that had been bothering me for years was now at least out in the open."[110] When Budde opened the March 2008 proxy Lehman Brothers filed with the SEC, he was appalled to see the investment bank was still hiding Dick Fuld's stock options, to the tune of $264 million.[111] Budde decided that he had seen enough;

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105 *See Capital Markets Regulatory Reform: Strengthening Investor Protection, Enhancing Oversight of Private Pools of Capital, and Creating a National Insurance Office: Hearing before the H. Comm. On Fin. Serv.*, 111th Cong. 84 (2009) (Texas Securities Commissioner and President of the North American Securities Association noting that the SEC receives close to 750,000 tips a year and stating that "the problem isn't that people were coming to the Securities Exchange Commission…but that they were ignoring them or at least not making good determinations with regard to those complaints that really needed to be followed up on.").

106 *Id.*

107 Cohan, *supra* note 46.

108 *Id.*

109 *See id.* (the loophole, Budde states, has to do with the vesting process of the "restricted stock units." If the process is tied to a benchmark—return on equity, share price, etc.—then the value of the stock options does not have to be disclosed until that benchmark is reached.).

110 *Id.*

111 *Id.*

it was time to the blow the whistle on his former employer. He contacted the Securities and Exchange Commission five times between April and September of 2008 (the month Lehman collapsed), outlining Lehman's scheme of nondisclosure, naming names, and providing the calculated amounts of Fuld's hidden compensation. Lehman's house of cards came crashing down in September of 2008. As of May 2014, Oliver Budde still had not heard from anyone at the SEC about his allegations.[112]

The conscious decision not to disclose such clearly material information to investors via filings with the SEC appears to be a clear violation of several federal securities laws, including §302 of SOX (discussed supra). If the SEC listened to Budde, they would have had a much easier time assessing the *mens rea*, or willful intent, of these bad actors, so as to exercise their discretion in deciding whether to make a criminal referral to DOJ. Indeed, had Oliver Budde's whistleblowing been heard and acted upon, prosecutors may have been able to criminally prosecute the Lehman Brothers's executives responsible for failing to make such disclosures.

The second case of "unheard whistleblowing" concerns Alayne Fleischmann, a former securities lawyer with the investment bank J. P. Morgan. Fleischmann claims to have uncovered a "massive criminal securities fraud" within the bank's mortgage group in the years leading up to the Financial Crisis.[113] As a transaction manager, it was Fleischmann's job to quality check the thousands of mortgages J. P. Morgan was buying, pooling, and securitizing.

During her tenure, Fleischmann was asked to review a $900 million package of home loans. In doing so, she discovered that around forty percent of the loans were based on overstated annual incomes; one of the more incredible examples involved a manicurist making $117,000 per year from that job alone.[114] Several senior sales and diligence executives ultimately forced more junior diligence employees to mark such preposterous incomes as reasonable, paving the way for the deal's error rate to fall from an unacceptable forty percent to a much more palatable ten percent. As the investment bank's traders prepared to market and sell these high-risk loans as low-risk securities, Fleishmann knew she had to act. She confronted the senior executives, arguing: "You can't securitize these loans without special disclosure about what's wrong with them."[115]

From Fleishmann's story, it appears clear that executives at J. P. Morgan were selling products they *knew* were full of subprime, inaccurate loans, without making the necessary disclosures.[116] Such behavior is in direct violation of several federal securities laws and is potentially criminal, if these executives, like those at Lehman Brothers, acted willfully. At least one press account reported that despite Fleishmann's attempts to volunteer information to the Securities and Exchange Commission and the Department of Justice, the DOJ's "political wing" led by Attorney General Holder was more interested in using her not

112 *Id.*
113 Taibbi, *supra* note 44.
114 *Id.*
115 *Id.*
116 *Id.*

yet obtained evidence as a "bargaining chip" to extract a larger civil settlement from J. P. Morgan.[117] The Justice Department ultimately settled the case with J. P. Morgan, civilly and out of court, for what was hailed by the U.S. Justice Department as a "record $13 billion settlement."[118] Following the civil settlement, the same press account reports that prosecutors told Fleishmann they would be in touch shortly to seek her help in building their supplementary criminal case against the bank. Despite these assurances, the Department of Justice never contacted Fleischmann again. The individuals at J. P. Morgan who potentially engaged in mortgage fraud were never held criminally accountable. In the words of Fleischmann, "I guess I was just a trusting person…I kept hoping."[119] Unable to make any headway with federal prosecutors, Fleishmann ultimately turned to media outlets to tell her story.[120]

A third case of unheard whistleblowing concerns Eileen Foster, formerly of Countrywide Financial (the case against Angelo Mozilo, Countrywide's CEO is discussed supra). Foster was an executive vice president in charge of fraud investigations. Countrywide was the largest mortgage lender in the country during the Financial Crisis and the loans it made were among the most subprime, with "a third ending up in foreclosure or default, many because of mortgage fraud."[121] Thus, her job arguably kept her very busy. In a televised interview with CBS's 60 Minutes, Foster stated that the fraud she witnessed while employed by Countrywide appeared "systemic."[122] In conducting an internal investigation of the lender's Boston office, Foster found evidence—in the form of shredded paper in recycling bins—that loan officers were "forging and manipulating borrowers' income and asset statements to help them get loans they weren't qualified for and couldn't afford."[123]

Foster attempted to blow the whistle on these types of 'fund 'em' lending practices, but has never been contacted for information by the Justice Department.[124] When asked by 60 Minutes's Steve Kroft if she believed there were people at Countrywide who had committed crimes and belonged behind bars, Foster solemnly, yet unwaveringly, answered "Yes."[125] Foster continued that she would name names to a grand jury, *if asked*. As discussed infra, the Justice Department has not pursued a single criminal case against mortgage executives at Countrywide, settling instead to bring a civil case against Countrywide's CEO Angelo Mozilo. If Foster's whistleblowing had in fact been heard by the DOJ, the outcome might well have been different; such information could have served

117 *Id.*; *See also* Laurie Asseo & Tom Schoenberg, *JP Morgan Employee Said to Be Cooperating in RMBS Probe*, Bloomberg News, Oct. 1, 2013; Devlin Barrett, *J. P. Morgan Insider Helps U.S. in Probe*, Wall St. J., Sep. 30, 2013.

118 Tom Schoenberg, et al., *JP Morgan Reaches Record $13 Billion Mortgage Settlement*, Bloomberg News, Nov. 19, 2013.

119 Taibbi, *supra* note 44.

120 *Id.*

121 *Prosecuting Wall Street*, *supra* note 61.

122 *Id.*

123 *Id.*

124 *Id.*

125 *Id.*

as a very strong basis for starting a criminal investigation.[126]

Finally, it is worth pointing out that even in the rare case of a successful criminal prosecution—albeit one unrelated to the causes of the 2008 Financial Crisis—"unheard whistleblowing" by regulators and prosecutors was still present. The extensive Ponzi scheme orchestrated by Bernie Madoff ultimately came crashing down in 2008 only after Madoff's sons, to whom he had confided, informed prosecutors of the fraud.[127] Madoff confessed to his fraud, was successfully prosecuted, and is currently serving a one-hundred-and-fifty year sentence in federal prison.

Yet, a whistleblower by the name of Harry Markopolos had tried to bring the fraud to the attention of Wall Street regulators for nearly ten years prior to the fraud's unraveling in 2008.[128] Markopolos testified that if the Securities and Exchange Commission acted when he initially—and repeatedly—contacted them with credible warnings, losses to investors could have been capped at between $3 and $7 billion, as opposed to $50 billion.[129] Markopolos identifies the failure of the Commission to listen to his whistleblowing as a "tragedy of epic proportions."[130]

The above examples of "unheard whistleblowing" provide just a glimpse into what was going on at several of the biggest investment houses on Wall Street in the years leading up to and during the 2008 Financial Crisis. To date, none of the individuals responsible for bringing about the Financial Crisis have been criminally charged. If prosecutors had worked with whistleblowers and seriously relied upon their information concerning alleged criminal activity, the prosecutorial response to the 2008 Financial Crisis might well have been very different.

E CONCLUSION

The current enforcement approach in which prosecutors are content with levying civil fines against financial institutions while allowing those individuals who actually engaged in potentially criminal activity to essentially go free, is nothing more than a convenient way for prosecutors to avoid the harder-to-prove criminal cases while increasing their winning percentage by focusing on the easier cases.[131] The entirety of the Department of Justice's prosecutorial response to the

[126] *Id.* (quoting University of San Diego Law Professor and former Wall Street derivatives trader Frank Partnoy, "It certainly sounds like it. And it certainly sounds like a good place to start a criminal investigation. Usually when the federal government hears about facts like this, they would start an investigation and they would try to move up the organization to try to figure out whether this information got up to senior officers, and why it wasn't disclosed to the public.").

[127] Felicia Smith, *Madoff Ponzi Scheme Exposes "The Myth of the Sophisticated Investor"*, 40 U. BALT. L. REV. 215, 241 (2010).

[128] *Id.*

[129] Mary Kreiner Ramirez, *Prioritizing Justice: Combating Corporate Crime from Task Force to Top Priority*, 93 MARQ. L. REV. 971, 995 n.126 (2010); *see generally* HARRY MARKOPOLOS, NO ONE WOULD LISTEN: A TRUE FINANCIAL THRILLER (2010).

[130] MARKOPOLOS, *supra* note 129.

[131] Paula Dywer, *Why No Bankers Go to Jail*, BLOOMBERG VIEW Nov 17, 2013, (paraphrasing a portion of Judge Rakoff's speech to New York securities lawyers, "law enforcement agencies have

Financial Crisis boils down to the collection of billions in civil fines, but yielded criminal guilty pleas from zero individuals and only two investment banks. Given the cost to the global economy from the Financial Crisis of $22 trillion, this is an unacceptable result. Wider and more effective use of whistleblowers—many of whom are lawyers or market participants with significant financial acumen—might have significantly changed this result.

The often-cited rationale for the enforcement response by regulators and prosecutors to the Financial Crisis is the fact that it is just too difficult to prove Wall Street executives acted with the requisite criminal *mens rea* while violating the federal securities laws. This Note advocates a new framework in which prosecutors rely on whistleblowers from within the financial institutions where such individual wrongdoing is occurring or occurred to establish this seemingly elusive element of intent. This new framework is vital, considering that inadequate enforcement of Wall Street in the early part of the twenty-first century may have actually "created perverse incentives leading to [the] economic crisis."[132] Relying on whistleblowers will indeed ensure that "heads roll," where appropriate.[133]

had to compete for a shrinking pot of money from Congress, and the best way to do that is by beefing up their statistics with smaller, easier cases and avoiding the years-long financial fraud probes that may turn up nothing.").

132 Ramirez, *supra* note 129, at 972.

133 Grassley, *supra* note 1.