Notre Dame Journal of Law, Ethics & Public Policy

Volume 28
Issue 2 *Symposium: White Collar Crime: The Moral, Ethical, & Legal Implications of White Collar Crime in the 21st Century*

Article 5

6-1-2014

When Moral Reasoning and Ethics Training Fail: Reducing White Collar Crime through the Control of Opportunities for Deviance

Cynthia A. Koller

Laura A. Patterson

Elizabeth B. Scalf

Recommended Citation

Cynthia A. Koller, Laura A. Patterson & Elizabeth B. Scalf, *When Moral Reasoning and Ethics Training Fail: Reducing White Collar Crime through the Control of Opportunities for Deviance*, 28 Notre Dame J.L. Ethics & Pub. Pol'y 549 (2014).
Available at: http://scholarship.law.nd.edu/ndjlepp/vol28/iss2/5

WHEN MORAL REASONING AND ETHICS TRAINING FAIL: REDUCING WHITE COLLAR CRIME THROUGH THE CONTROL OF OPPORTUNITIES FOR DEVIANCE

Cynthia A. Koller,* Laura A. Patterson,** & Elizabeth B. Scalf***

Introduction

The contribution of unprincipled behavior and mortgage fraud in the United States to the global economic meltdown of 2008, and the subsequent, enduring recession, continues to kindle academic and political discourse. This is evident not only in the proliferation of research and publication on the topic,[1] but in the first presidential debate of 2012 between incumbent Barack Obama and challenger Mitt Romney. President Obama, responding to Governor Romney's statements on the potential repeal and replacement of the Dodd-Frank Act,[2] had this to say:

> The reason we have been in such a[n] enormous economic crisis was prompted by reckless behavior across the board. Now, it wasn't just on Wall Street. You had loan officers [were—] that were giving loans and mortgages that really shouldn't have been given, because the folks didn't qualify. You had people who were borrowing money to buy a house that they couldn't afford. You

* Assistant Professor of Criminal Justice, Shippensburg University, Pennsylvania. Ph.D., University of Cincinnati.

** Assistant Professor of Criminal Justice, Shippensburg University, Pennsylvania. Ph.D., University of Maryland, College Park.

*** Senior Legal and Compliance Counsel, Heartland Advisors, Inc. J.D., Marquette University Law School.

1. *See* 16 Sociology of Crime, Law and Deviance: Economic Crisis and Crime (Matthieu Deflem ed., 2011); *see also* Cynthia A. Koller, White Collar Crime in Housing: Mortgage Fraud in the United States (2012); *see also Accumulation, Dispossession, and Debt: The Racial Logic of Global Capitalism—An Introduction*, 64: 3 Am. Q. 361 (2012).

2. The Dodd-Frank Wall Street Reform and Consumer Protection Act Pub. L. No. 111–203, 124 Stat. 1376 (2010); *see* Morrison & Foerster, The Dodd-Frank Act: A Cheat Sheet 3 (2010), *available at* http://www.mofo.com/files/uploads/images/summarydoddfrankact.pdf. The Dodd-Frank Act, passed in 2010:

> implements changes that, among other things, affect the oversight and supervision of financial institutions, provide for a new resolution procedure for large financial companies, create a new agency responsible for implementing and enforcing compliance with consumer financial laws, introduce more stringent regulatory capital requirements, effect significant changes in the regulation of over the counter derivatives, reform the regulation of credit rating agencies, implement changes to corporate governance and executive compensation practices, incorporate the Volcker Rule, require registration of advisers to certain private funds, and effect significant changes in the securitization market.

Id.

> had credit agencies that were stamping these as A1 great investments when they weren't. But you also had banks making money hand over fist, churning out products that the bankers themselves didn't even understand, in order to make big profits, but knowing that it made the entire system vulnerable.[3]

President Obama summarized the "reckless" behavior succinctly, but he failed to underscore the criminal activities that accompanied the demise of the U.S. housing finance market, or how these combined with other factors to fuel an economic crisis around the world. Evidence of this illegal behavior continues to mount, with unprecedented numbers of civil lawsuits and criminal complaints now being routinely filed across the U.S. (with judgments and restitution in the billions of dollars and extended prison terms anticipated). These legal actions, coupled with accounts of what transpired to create the housing crisis, have painted a relatively clear picture of *what* fraudulent activities led to the meltdown.[4] What remains to be seen is *how* the mortgage finance industry reached this point of disrepute and collapse, and to identify which factors can best explain the criminogenic environment that materialized within the industry and the crime events that ensued.

Consistent with the notion of specialized access,[5] the opportunity perspective on white collar crime,[6] and the focus on industry and organizational factors which contributed to mortgage origination fraud,[7] the current review examines the context in which fraud occurred within the housing finance industry under the perspective of Routine Activities Theory. The purpose of the present Article is to use subprime mortgage fraud to further illuminate the viability of an environmental approach to explain, prevent, and control white collar crime.

Part I of this Article provides a brief overview of the nature and extent of the recent mortgage crisis. It illustrates how fraud in the 1990s and early 2000s was committed by unprecedented numbers of motivated offenders, while innovative and untested lending tools (such as subprime mortgages) simultaneously presented suitable targets in the absence of regulation and capable oversight. This review will provide the reader with a basic understanding of the growth, scope, and consequences of mortgage fraud in the U.S. through the early 2000s.

Part II describes how criminological theory has been used to explain occupational and organizational white collar crime, how economic boom/bust periods are cyclical and predicated on certain fac-

---

3. President Barack Obama, Presidential Debate at the University of Denver (Oct. 3, 2012) (transcript *available at* http://abcnews.go.com/Politics/OTUS/presidential-debate-transcript-denver-colo-oct/story?id=17390260).

4. *See* KOLLER, *supra* note 1.

5. *See* Marcus Felson, *The Routine Activity Approach: A Very Versatile Theory of Crime*, *in* EXPLAINING CRIMINALS AND CRIME: ESSAYS IN CONTEMPORARY CRIMINOLOGICAL THEORY 43 (Raymond Paternoster & Ronet Bachman eds., 2001).

6. *See* MICHAEL L. BENSON & SALLY S. SIMPSON, WHITE-COLLAR CRIME: AN OPPORTUNITY PERSPECTIVE (Chester Britt et al. eds., 2009).

7. *See* Tomson H. Nguyen & Henry N. Pontell, *Mortgage Origination Fraud and the Global Economic Crisis: A Criminological Analysis*, 9 CRIMINOLOGY & PUB. POL'Y 591 (2010).

tors, and how routine structures and activities within businesses and industries combine to produce opportunities for employees and companies to violate the law. Part III discusses the nature and intent of contemporary corporate compliance and ethics programming, changes made in the regulation of the housing finance industry since the mortgage crisis, and how deficits in any of these areas can produce/contribute to criminogenic business environments.

Part IV suggests that when moral reasoning, ethics training, compliance programs, and/or regulation fail to inhibit criminal activities within businesses or industries, improving an organization's or system's ability to control opportunities for deviance may be a more effective deterrent strategy to regulate behavior and prevent white collar crime. The Article concludes with a discussion of how an environmental and situational approach to explaining and understanding individual and group deviance poses implications for corporate, regulatory, and financial policy, criminal investigations, and future white collar crime research. Insights from housing industry practitioners to explain the opportunity structure of mortgage fraud and these other issues are used throughout the narrative to illustrate critical points and concepts.

I. Mortgage Crisis in the United States

The fallout from the economic bust of 2008 and the contribution of fraud in the housing finance industry to this crisis continues to reverberate through U.S. monetary markets as well as the enforcement agencies tasked with regulating them.[8]

A. *Subprime Mortgage Lending*

Three particular legislative actions have been credited with stimulating the birth of the subprime industry. These included the Depository Institutions Deregulation and Money Control Act of 1980 ("DIDMCA"), the Alternative Mortgage Transaction Parity Act of 1982, and the Tax Reform Act of 1986.[9] In combination, this legislation essentially created the subprime business as it allowed lenders to charge

8. *See* Complaint, People v. JP Morgan Sec. LLC, 2012 WL 4479076 (N.Y. Sup. 2012) (No. 0451556-20012), for the lawsuit against JP Morgan Chase (formerly Bear Stearns) for mortgage related frauds. The complaint reads: "Defendants' misconduct in connection with their due diligence and quality control processes constituted a systemic fraud on thousands of investors." *See id.* at 3. It goes on to say: "Defendants' representations about their due diligence process were materially false and fraudulent . . . ." *Id.* at 17. Furthermore, "due diligence reviewers were made to understand that because the loans could not be undone, a thorough reevaluation of loan quality was unnecessary, and even pointless." *Id.* at 18. Also note, "the review process itself—which gave underwriters and Team Leads discretion to approve but not to reject loans—was set up so as to make approval of a loan the path of least resistance." *Id.* at 20–21. The Defendants "disregarded Clayton's [JPMorgan's contracted due diligence firm] findings of defective loans up to 65% of the time in the third quarter of 2006 alone." *Id.*

9. *See* Richard Bitner, Confessions of a Subprime Lender: An Insider's Tale of Greed, Fraud, and Ignorance (2008); Souphala Chomsisengphet & Anthony Pennington-Cross, *The Evolution of the Subprime Mortgage Market*, 88 Fed. Res. Bank of St. Louis Rev. 31 (2006).

higher interest rates and fees (exceeding state limits), to offer adjustable interest rate mortgages ("ARMs") and balloon payment options, and allowed individuals to begin taking home mortgage interest tax deductions. Although other changes preceded these acts in the late 1960s through the 1970s, such as the Fair Housing Act of 1968, Equal Credit Opportunity Act of 1974, Home Mortgage Disclosure Act of 1975, and the Community Reinvestment Act of 1977, it was not until the enactment of the DIDMCA that the business of subprime lending became a standard "legal" financing alternative/enterprise.[10]

In addition to the legislative activity that positioned otherwise uncreditworthy borrowers to enter into exchange relationships with lenders, market changes also "contributed to the growth and maturation of subprime loans."[11] Brokerage and securitization were key elements in this growth (and in the industry's segmentation), as it gave traditional and non-traditional (non-depository) lenders the ability to supply and deliver creative financing and credit, while simultaneously passing on its accompanying risk. In sum, during a relatively short period of time, the general mortgage process as it exists today in the U.S. experienced considerable change since the days of localized lending.

Moreover, the federal government played a critical role in the modifications to this industry by enabling and encouraging securitization and off-balance sheet lending (pass through financing), particularly through the passage of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA").[12] For example, while FIRREA (adopted in the wake of the Savings & Loan crisis)[13] attended to bank lending and appraisal regulation, it also encouraged

---

10. Chomsisengphet & Pennington-Cross, *supra* note 9, at 38.

11. *Id. See also* Manuel B. Aalbers, *Wrong Assumptions in the Financial Crisis*, 5 CRITICAL PERSP. ON INT'L BUS. 94, 95 (2009) (arguing that "subprime lending should not be defined as lending to borrowers with poor credit, but as lending at higher fees and interest rates whether or not borrowers actually have bad credit"); Gerald H. Lander et al., *Subprime Mortgage Tremors: An International Issue*, 16 INT'L. ADVANCES IN. ECON. RES. 1, 2 (2009) (defines subprime lending as "predatory lending" or the offering of subprime loans to individuals who qualify for prime loans, as some borrowers are subjected to higher costs for reasons other than credit risk).

12. Aalbers, *supra* note 11, at 94; *see also* Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (1989). For a discussion of how a similar statute, the Fraud Enforcement and Recovery Act of 2009, assists the Department of Justice in prosecuting financial fraud, particularly money laundering, see Leslie A. Dickinson, Note, 28 NOTRE DAME J.L. ETHICS & PUB. POL'Y 579 (2014).

13. *See* Kevin M. LaCroix, *Regulatory Enforcement: Using FIRREA to Prosecute Financial Fraud*, D&O DIARY (Aug. 27, 2013, 3:49 AM), www.dandodiary.com/2013/08/articles/failed-banks/regulatory-enforcement-using-firrea-to-prosecute-financial-fraud/print.html. FIRREA is seeing increased applicability in response to financial fraud:

> There are a number of reasons that FIRREA has proved to be an attractive option for prosecutors and regulators. As the law firm memo notes, FIRREA has a lengthy statute of limitations, an arguably low burden of proof, and the [sic] also provides the government with the ability to issue administrative subpoenas to conduct a civil investigation in advance of filing a civil complaint.

Id.

the Government Sponsored Enterprises ("GSEs")[14] to *facilitate* lending opportunities to low and moderate-income individuals. With most new subprime lenders operating as non-banks, however, these regulations proved to be more ideal than real in the overall scheme of mortgage financing.

Growth continued to move in an upward trend from 1995 forward, with subprime lending making up 0.74% of the market share in the early 1990s to almost 9% by the year 2000; between 2002 and 2003, subprime originations increased another 56-62%.[15] Although it is clear that different data sources vary in their estimates,[16] one thing is certain: the subprime product enjoyed virtual overnight popularity and quickly became a major component of not only the U.S. financial structure, but by mortgage-backed securities ("MBSs")[17] and, by extension, the global economy as well.

Likewise, during the 1990s, the number of new independent mortgage brokers increased 14% annually; by the year 2000, "30,000 mortgage brokerage firms employed an estimated 240,000 workers and accounted for approximately 55% of all mortgage originations."[18] The

---

14. Kevin R. Kosar, Cong. Research Serv., RS21663, Government-Sponsored Enterprises (GSEs): An Institutional Overview 1, 3 (2007). Kosar explains:

> GSEs are instrumentalities, not agencies, of the United States. This distinction is both legally and administratively important. The federal government's control over an institution differs significantly depending upon whether that institution is an agency or instrumentality. An agency (as defined in Title 5, Part 1 of the *United States Code*) is managed directly through the federal management hierarchy. As a general rule, an agency is subject to all general management laws and regulations provided in the *United States Code* unless it is exempted from such coverage either in its enabling statute, or by virtue of being part of an exempted class of agency. Thus, an agency is subject to federal appointment of its senior officers (often requiring Senate confirmation), to civil service and federal procurement laws, and to the federal budget and other direct federal management controls, unless exempted.

Id.

15. *See* Chomsisengphet & Pennington-Cross, *supra* note 9, at 41.

16. Dan Immergluck & Geoff Smith, *Measuring the Effect of Subprime Lending on Neighborhood Foreclosures: Evidence from Chicago*, 40 Urb. Aff. Rev. 362 (2005); *see also* Chomsisengphet & Pennington-Cross, *supra* note 9, at 41.

17. *See* Edward L. Glaeser & Hedi D. Kallal, *Thin Markets, Asymmetric Information, and Mortgage-Backed Securities,* 6 J. Fin. Intermediation 64, 68, (1997) ("Mortgage-backed securities are 'pass through' securities where the initial lender still services the mortgages; the lender collects fees and then passes through interest and principal to owners of the bundled mortgages"). Glaeser and Kallal explain that the main issuers of conforming MBSs are the GSEs, who bundle these products for sale to dealers such as Salomon Brothers and Bear Sterns for resale to pension and mutual funds. *See also* Andrea Heuson et al., *Credit Scoring and Mortgage Securitization: Implications for Mortgage Rates and Credit Availability,* 23 J. Real Estate Fin. & Econ. 337, 337 (2001). In the secondary market of MBSs:

> a monopolist sells mortgage-backed securities, which yield a liquidity benefit, in exchange for mortgages offered by originators. The monopolist/securitizer sets both the price for these mortgages and the credit-quality standard that qualifies a mortgage for purchase. Although credit scoring ensures that originators do not enjoy an information advantage over the securitizer, they do enjoy a 'first mover advantage' in selecting which qualifying mortgages to sell.

Id.

18. Immergluck & Smith, *supra* note 16, at 365.

concern here is that mortgages originated by brokers are twice as likely to be subprime than those originated by lenders.

The growth of subprime lending in the 1990s was attributable to a variety of market and industry factors. These include, but are not limited to: consumer demand, rising interest rates, declining loan originations in the prime market, bundling and securitizing of subprime loans into MBSs, and the number of new non-depository finance companies (mortgage brokerage firms). Despite the benefits of this growth to homebuyers and the other participants in the mortgage finance continuum, change is typically accompanied by unintended consequences; the rapid expansion of the U.S. housing market and the manner in which the industry developed was "clearly excessive" and problematic.[19] It is clear that the rapid infusion of these new demands, products, and players into a traditionally risk-based/risk-averse industry may have undermined its ability to foresee or manage that risk.

As illuminated herein, from the initial borrower to final investors, financial risk was not evenly distributed throughout the subprime mortgage chain, and this contributed to a host of industry and participant behavior which many believe led to its eventual destruction. As others contend, the meltdown of the subprime market was predictable and inevitable: with the lack of information transparency in the process, and its asymmetrical structure (profits retained by some and losses borne by others), the system promoted short-sighted, risky behavior, and was never truly sustainable.[20]

B. *Subprime Mortgage Crisis*

By the early 2000s, continued expansion of the subprime market appeared limitless as demand for U.S. MBSs began to multiply around the world. For example, by the end of 2006, nearly 20% of MBSs (agency and non-agency issued; unregulated mortgage securities) were funded by foreign investors, up from 6% in 1994.[21] By mid-2006, China alone "held approximately $108 billion in MBSs, up substantially from $3 billion in 2003 and $100 million in 2002."[22] Although this international infusion of capital helped maintain low U.S. interest rates, it also provided a seemingly infinite source of mortgage funds; a boom situation that was clearly unsustainable.

A variety of factors led to the subsequent subprime crisis, which continues to be manifested in record mortgage defaults and foreclosures, reduced housing values, and record business exits and bankruptcies.[23] The crisis has been attributed to a combination of interest rate

---

19. Philipp M. Hildebrand, *The sub-prime crisis: A central banker's perspective*, 4 J. FIN. STABILITY 313, 314 (2008).

20. *Id. See also* James William Coleman, *Toward an Integrated Theory of White-Collar Crime*, 93 AM. J. SOC. 406 (1987); Joseph E. Stiglitz, *It Doesn't Take Nostradamus*, ECONOMIST'S VOICE, Nov., 2008, at 1.

21. *See* Lander et al., *supra* note 11, at 7.

22. *Id.* at 8.

23. Yuliya S. Demyanyk, *Quick Exits of Subprime Mortgages*, 91 FED. RESERVE BANK OF ST. LOUIS REV. 79, 79 (2009).

resets (maturity of ARMs), fraud, poor underwriting of subprime loans (inattention to risk), the temporary nature of subprime loans, discrimination, a housing market slowdown, and an overall deterioration of loan quality.[24] These factors eventually created a financial emergency that could no longer be ignored by even the most casual observer.

C. *Mortgage Fraud*

Fraud comes in many forms and has been credited with playing a substantial role in the downfall of the subprime mortgage market over the past two decades. Virtually all commentaries on the mortgage crisis have included some reference to the fraudulent activities of participants, ranging from home buyers to the rating agencies and beyond. Where each author places the blame is driven by their own interpretations of the empirical and anecdotal evidence, but all agree that many participants in the housing finance industry crossed the line from risky and unethical behavior to outright fraud in their pursuit of property or profit. Suffice it to indicate here that fraud in the mortgage industry has been perpetrated through material misrepresentations and manipulations across the board.[25] The Financial Crimes Enforcement Network (FinCEN) explains this in familiar terms:

> Mortgage loan fraud can be divided into two broad categories: fraud for property and fraud for profit. Fraud for property generally involves material misrepresentation or omission of information with the intent to deceive or mislead a lender into extending credit that would likely not be offered if the true facts were known . . . In contrast, the motivation behind fraud for profit is money. Fraud for profit is often committed with the complicity of industry insiders such as mortgage brokers, real estate agents, property appraisers, and settlement agents (attorneys and title examiners).[26]

FinCEN contends that these illegal trends and patterns are supported by its analysis of thousands of Suspicious Activity Reports (SARs)[27] filed over the years. One lender summarizes how the problems and deviance reflected in reports such as SARs became endemic:

It got to the point where mortgages were investments to be bought and sold, and local lenders just weren't big enough to take advantage of pooling of these mortgages. So the secondary market arose, looking again at the buy-ability of pooling these groups of mortgages, and then rating them and my understanding, a lot of the bond-rating companies were giving better ratings so that investors would buy these pools of

---

24. *Id.*

25. For a more complete analysis of the types of fraud throughout the U.S. housing finance industry, see KOLLER, *supra* note 1.

26. FINANCIAL CRIMES ENFORCEMENT NETWORK, MORTGAGE LOAN FRAUD: AN INDUSTRY ASSESSMENT BASED UPON SUSPICIOUS ACTIVITY REPORT ANALYSIS 3, (2006), *available at* http://www.fincen.gov/MortgageLoanFraud.pdf.

27. *Id.* Federal law requires SARs to be submitted to the Financial Crimes Enforcement Network (FinCEN) by financial businesses which encounter incidents of suspected money laundering or fraud.

mortgages. So again, it was the *fox watching the henhouse.* I mean there was not a lot of oversight there and I think you could go back to the Fed and say there should have been more oversight with how those mortgages were pooled.[28]

A capitalistic financial system is understandably built on motivation for property or profit, but predatory and fraudulent activity compromise the process; subprime lending becomes predatory when lenders target unqualified or undereducated potential borrowers (unethical) or fraudulent when misrepresentations occur (illegal).[29] Consumers are also motivated by the pursuit of property and profit, and thus predatory *borrowing* and fraud is also commonplace. In sum, individuals and organizations have been involved in fraudulent practices through opportunities provided by subprime mortgage products and their accompanying processes. For all parties beyond the initial borrower, these frauds can be subsumed under the phenomenon of *white collar crime.*

II. Theories Explaining White Collar Crime

Understanding the causes of financial crime on the scale of the subprime mortgage crisis requires a theoretical focus on opportunity structures and relaxed or ineffective oversight (e.g., guardianship). Economic crises emerging from financial institutions and industries over the past three decades reveal similar elements and patterns.[30] The subprime mortgage crisis, like other financial crises, conformed to a classic lending boom-bust cycle.[31] This precarious cycle is well-documented: deregulation promotes unchecked financial innovation; unprecedented investor demand for these financial securities increases; underwriting standards become attenuated; and, little consumer protection is available.[32] For example, there was a lack of transparency in

---

28. *See* Koller, *supra* note 1, at 394.

29. *See* Lander et al., *supra* note 11, at 3.

30. E. Philip Davis & Dilruba Karim, *Could Early Warning Systems Have Helped to Predict the Sub Prime Crisis?*, 206 Nat'l Inst. Econ. Rev. 35, 44 (2008) (contends there are generic patterns evident prior to most financial crises, including: (1) Regime shifts, first to laxity (such as deregulation) which provokes a credit cycle, later to rigour (e.g., monetary tightening) that triggers a crisis; (2) Easing of entry conditions to financial markets, leading to heightened competition and risk taking; (3) Debt accumulation and asset price booms, generating vulnerable balance sheets in the financial and nonfinancial sectors; (4) Innovation in financial markets, which increases uncertainty during the crisis; and (5) Risk concentration and lower capital adequacy for banks, which reduces robustness to shocks).

31. Yuliya S. Demyanyk & Otto Van Hemert, *Understanding the Subprime Mortgage Crisis* (2008), *available at* http://ssrn.com/abstract=1020396; *see also* Giovanni Dell'Ariccia & Robert Marquez, *Lending Booms and Lending Standards*, 61 J. Fin. 2511 (2006).

32. Éric Tymoigne, *Securitization, Deregulation, Economic Stability, and Financial Crisis, Part II: Deregulation, the Financial Crisis, and Policy Implications*, Levy Econ. Inst., Working Paper No. 573.2 14, 26 (2009). For a discussion on the intersection of white collar crime, federal securities law, and the Racketeer Influenced and Corrupt Organizations Act, see G. Robert Blakey & Michael Gerardi, *Eliminating Overlap or Creating a Gap? Judicial Interpretation of the Private Securities Litigation Reform Act of 1995 and RICO*, 28 Notre Dame J.L. Ethics & Pub. Pol'y 435 (2014).

complex MBSs and obscure derivatives in the developing mortgage boom,[33] and there was inadequate assessment and management of risk over life expectancy of these investments.[34] These factors contributed to short-term profits for those with the foresight to bundle and offload risky subprime mortgages to unwitting investors, while jeopardizing the long-term health of the entire system.

These patterned features contributed to a predictable financial crisis with global repercussions. The Savings & Loan scandals of the 1980s, the corporate crime of the 1990s, and the recent subprime mortgage-lending crisis of the past decade have altered our conventional conceptualizations and accounts of white collar crime. The focus on a professional offender who holds a high position of fiduciary trust is shifting to an interest in organizational cultures and opportunities within a firm or industry that are conducive to illegal activities.[35] Therefore, a truly substantial explanation must explore white collar crime as criminality, and as a criminal event (a crime).

This Part explores some theoretical approaches to identifying corporate cultures, organizational incentive structures, and economic pressures endemic to the financial crises emerging over the past three decades.[36] The literature supports that the subprime mortgage market capitalized on exclusive access to opportunities and means to offend. The mortgage industry insiders possessed specialized skills, relied on deceptive practices conducted within private domains, and leveraged this knowledge to violate public trust.[37]

We also introduce a conceptual framework for understanding how the subprime lending industry moved from boom to bust. Routine Activity Theory[38] offers a guide for what conditions are necessary and sufficient for a crime to occur. This theory posits that a crime requires the convergence in time and space of a motivated offender, a suitable target, and the absence of a capable guardianship (see Figure 1).

---

33. Stiglitz, *supra* note 20, at 2.

34. James Bullard et al., *Systemic Risk and the Financial Crisis: A Primer*, 91 FED. RESERVE BANK OF ST. LOUIS RESERVE 403 (2009).

35. In 1939, Edwin Sutherland advanced the definition of "white collar crime" as "crime committed by a person of respectability and high social status in the course of his occupation." *See* Edwin H. Sutherland, *White-Collar Criminality*, 5 AM. SOC. REV. 1 (1940).

36. The crises characterize financial opportunities that served to privatize profits and socialize risks. In the case of subprime mortgage lending, certain economic conditions served to convert accepted investment strategies into fraudulent practices.

37. The question remains whether the stakeholders understood the market dynamics well enough to capitalize or cash in on the innovation, the fraud, and its diffusion.

38. Lawrence E. Cohen & Marcus Felson, *Social Change and Crime Rate Trends: A Routine Activity Approach*, 44 AM. SOC. REV. 588 (1979).

FIGURE 1: BASIC MODEL OF ROUTINE ACTIVITIES THEORY[39]

Situational opportunities for crime are structured by routine activities (e.g., encounters or interactions), which increase the probability suitable (e.g., profitable and vulnerable) targets will intersect with motivated offenders in the absence of guardianship (e.g., formal or informal controls). As formulated, it offers a situational theory of crime[40] that is well-suited to help explain white collar criminality and crime.

Joseph Sheley synthesized four key elements most commonly cited in the literature to explain criminal behavior.[41] Building on the routine activity perspective, he considers motivation (desire to offend), freedom from social constraints (impunity from negative costs), skill (specialized knowledge), and opportunity. Opportunity is integral to integrating these explanatory concepts into a coherent explanation of corporate crime.[42] A prerequisite for white collar criminal opportunities is access to exclusive professions, businesses, and industries. In general, access is limited to those with specialized skills who hold positions of fiduciary trust within organizations with actual or projected legitimacy.[43] These necessary elements are evident in the innovative subprime mortgage products marketed to borrowers and the MBSs sold to investors (suitable targets) by financial institutions (opportunity) and commission-based brokerages (motivation), in the context of enabling legislation (absence of restraints or control) and conventional (and evolving unconventional) business practices.

Explaining white collar crime under one succinct criminological theory such as Routine Activities Theory has been a challenge, to say

39. For a more thorough theoretical model, see *A Theory of Crime Problems*, CENTER FOR PROBLEM-ORIENTED POLICING (Apr. 8, 2014, 10:44 PM EST), http://www.popcenter.org/learning/pam/help/theory.cfm.

40. Ronald V. G. Clarke, *"Situational" Crime Prevention: Theory and Practice*, 20 BRIT. J. CRIMINOLOGY 136, 137 (1980).

41. Joseph F. Sheley, *Critical Elements of Criminal Behavior Explanation*, 24 SOC. Q. 509, 510 (1983).

42. BENSON & SIMPSON, *supra* note 6, at 124.

43. Michael L. Benson et al., *White-Collar Crime from an Opportunity Perspective*, THE CRIMINOLOGY OF WHITE-COLLAR CRIME 175, 184–85 (Sally S. Simpson & David Weisburd eds., 2009).

the least.[44] Nevertheless, the routine activities and opportunity perspectives aid us in examining how individuals and aggregates might take advantage of occupational, organizational, and industrial routines to access rewarding crime opportunities. That being said, we turn our attention to motivation or what factors influence a respectable and legitimate professional to engage in white collar crime.

Felson argues, "[t]he motives of 'white-collar' criminals do not set them apart from other criminals."[45] As such, we need to understand how these motivated offenders (individuals and organizations) find opportunities to deviate within their conventional work routines and structures, and how these otherwise law-abiding employees and entities come to engage in illegal behavior.

Early research revealed that a relatively small number of corporations accounted for a disproportionate amount of white collar crime.[46] Furthermore, some types of industries were found to be more fertile ground for crime than others, and within certain industries, some firms were more involved in illegal actions than others. In other words, a small number of companies accounted for a disproportionate number of white collar crimes committed, suggesting divergent motivational or opportunity structures even within industries. To explain the pattern of offending both across and within types of organizations, it was argued that responsibility lay within the practice of business itself. That is, some industries (and some firms within industries) possess a set of norms that are "favorable to the violation of law."[47] Corporate crime reflects a culture within an industry that sponsors normative approval of illegal acts, with a perverse system of incentives to reward compliance and sanctions to address noncompliance with this expectation of deviance.[48]

Strain Theory advances a role for economic strain (or the inability to achieve economic goals) as relevant to explanations of illegal occupational and organizational activities.[49] Applied to white collar crime, motivations are rooted in a "culture of competition" and conveyed though organizational subcultures.[50] Performance in this context of competition and uncertainty creates pressure to meet goals using any

44. Felson, *supra* note 5. Similarly, see Gerald Cliff & Christian Desilets, *White Collar Crime: What It Is and Where It's Going*, 28 NOTRE DAME J.L. ETHICS & PUB. POL'Y 481 (2014) for a discussion on the changing definition of white collar crime.

45. MARCUS FELSON, CRIME AND EVERYDAY LIFE 96 (Steve Rutter et al. eds., 3d ed. 2002).

46. EDWIN H. SUTHERLAND, WHITE COLLAR CRIME 76 (1949).

47. *Id.* at 255.

48. Robert J. Apel & Raymond Paternoster, *Understanding "Criminogenic" Corporate Culture: What White-Collar Crime Researchers Can Learn from Studies of the Adolescent Employment-Crime Relationship*, *in* THE CRIMINOLOGY OF WHITE-COLLAR CRIME 15, 17 (Sally S. Simpson & David Weisburd eds., 2009).

49. *See e.g.*, Lynn Langton, *Can General Strain Theory Explain White-Collar Crime? A Preliminary Investigation of the Relationship Between Strain and Select White-Collar Offenses*, 35 J. CRIM. JUST. 1 (2007), *available at* http://dx.doi.org/10.1016/j.jcrimjus.2006.11.011.

50. *See* Coleman, *supra* note 20, at 1.

means necessary.[51] Edward Gross[52] argues that corporations are goal-directed entities evaluated in terms of their collective effectiveness in achieving the bottom-line. Goal blockage may reflect any financial difficulties confronted by a company's declining profits, threats by competitors, and/or ratio of liabilities to assets. When goal orientations focus exclusively on outcomes without regard for the "means-to-the-ends," then illegal or unethical avenues to those goals become viable.

In capitalist economies, corporations work to maximize profits and to minimize loss. General Strain Theory expects that corporations, and their top managers, are more likely to turn to white collar crime when legitimate means to attain these economic goals are blocked.[53] Sociologists argue that criminal propensities cross all classes; however, through corporate accessibility, the elite classes tend to have more attractive options or choices when confronted with strain or difficulties achieving goals. For instance, Robert Merton's Strain Theory proposed that adaptations to economic strain might include compliance, innovation, ritualism, retreatism or rebellion.[54] It has been argued that the privileged classes ascribe a more positive value to risk-taking (innovation), have greater access to illegal or unethical opportunities (entitlements), and are subject to weaker social controls (within private domains).[55]

The nature of the criminal act (intentional deceptive practices), in our view, stems more from an organizational culture, rather than a status or respectable role held by the offender; organizational factors drive corporate crime.[56] According to Friedrichs, "white collar crime—especially the most substantial and serious forms, including state-organized and corporate crime—is carried out on a group or organizational level."[57] Corporations sponsor cultures reflecting the values, orientations, and expectations that will guide managers and business practices.[58] That is, organizational factors significantly influence rational choice or individual decision-making within a corporate setting.[59] In essence, we are explaining the corporate crime or "collective behavior"

---

51. Robert Agnew, Nicole L. Piquero & Francis T. Cullen, *General Strain Theory and White Collar Crime*, *in* THE CRIMINOLOGY OF WHITE-COLLAR CRIME, *supra* note 48, at 35.

52. Edward Gross, *Organizational Crime: A Theoretical Perspective*, *in* 1 STUDIES IN SYMBOLIC INTERACTION 55 (1978).

53. Agnew et al., *supra* note 51, at 35.

54. ROBERT K. MERTON, SOCIAL THEORY AND SOCIAL STRUCTURE 41 (1957).

55. John Hagan & Fiona Kay, *Gender and Delinquency in White-Collar Families: A Power-Control Perspective*, 36 CRIME & DELINQ. 391, 404–405 (1990).

56. *See e.g.*, Amitai Etzioni & Derek Mitchell, *Corporate Crime*, *in* INTERNATIONAL HANDBOOK OF WHITE-COLLAR AN CORPORATE CRIME 187 (Henry Pontell & Gilbert Geis eds. 2007).

57. DAVID O. FRIEDRICHS, TRUSTED CRIMINALS: WHITE COLLAR CRIME IN CONTEMPORARY SOCIETY 226 (Carolyn Henderson Meier et al. eds., 4th ed. 2009).

58. Peter C. Yeager, *Understanding Corporate Lawbreaking: From Profit-Seeking to Law-Finding*, *in* INTERNATIONAL HANDBOOK OF WHITE-COLLAR AND CORPORATE CRIME, *supra* note 56, at 25; *see also* Maurice Punch, *Suite Violence: Why Managers Murder and Corporations Kill*, 33 CRIME, LAW & SOC. CHANGE 243 (2000).

59. Nguyen & Pontell, *supra* note 7; *see also* Raymond Paternoster & Sally S. Simpson, *Sanction Threats and Appeals to Morality: Testing a Rational Choice Model of Corporate Crime*, 30 LAW & SOC'Y REV. 549 (1996); *and* NEAL SHOVER & ANDREW HOCHSTETLER, CHOOSING WHITE-COLLAR CRIME (2006).

carried out on an organizational level on behalf of social entities or organizations.[60]

Others, however, criticize theoretical explanations that assign human attributes to corporate entities.[61] In essence, any model that attributes individual motivation or action to a corporate-level organization is simply misspecified. Presumably, corporate crime may not occur apart from the decisions, actions, or personal proclivities of its managers. Simply put, corporations are not people, capable of learning, or possessing motivation and intent. Vaughan echoes the objection noting that causal principles used to explain individual criminality are not appropriate or sufficient to explain the criminality of corporations.[62]

On the other hand, Gross argues that corporations "take on a life of their own."[63] There is evidence that corporations respond to external pressures, market, and/or regulatory changes, by modifying business practices. Some organizations will adhere to conventional, accepted business practices, irrespective of the market conditions. These adaptations adjust expectations (profit/risk ratios) to ride out a tight market (low-risk ritualistic or compliant responses). Other firms within an industry may sponsor different goal orientations (innovation) with a premium placed on short-term performance rather than long-sighted values (e.g., perpetuity and reputation based on fiduciary trust).

Hyman Minsky argued that over an extended period of "good times," economies tend to move from a financial structure grounded in sound, long-term investments to a structure engaged in speculative and Ponzi finance.[64] This was true of the subprime lending crisis. Subprime mortgage-lending set up a "bull market" offering opportunities, high-yield returns, and short-term risks for all key components in the industry. The "American Dream" promoted the homeownership ideal, commission-driven brokers solicited subprime borrowers (suitable or "technically" eligible targets), lending institutions invented teaser or hybrid products (adjustable rate, no documentation loans, etc.), risky subprime mortgages were bundled and securitized to attract investors, and guardians and regulators were either complicit or inept. As one can imagine, this type of increasingly uncertain market environment facilitates fraud. When industries experience economic strain, success by any means may be rewarded and executed with little scrutiny.[65]

---

60. MARSHALL B. CLINARD & PETER C. YEAGER, CORPORATE CRIME: ISSUES IN RESEARCH (2005); *see also* Marshall B. Clinard & Peter C. Yeager, *Corporate Crime: Issues in Research*, 16 CRIMINOLOGY 255 (1978).

61. *See* Donald R. Cressey, *The Poverty of Theory in Corporate Crime Research*, *in* 1 ADVANCES IN CRIMINOLOGICAL THEORY 31 (William S. Laufer & Freda Adler eds., 1989).

62. Diane Vaughan, *Rational Choice, Situated Action, and the Social Control of Organizations*, 32 L. & SOC'Y REV. 23 (1998).

63. Gross, *supra* note 52.

64. Hyman P. Minsky, *The Financial Instability Hypothesis*, Jerome Levy Econ. Inst. of Bard College, Working Paper No. 74, 7–8 (1992), *available at* http://ssrn.com/abstract=161024.

65. Marilyn Price & Donna M. Norris, *White-Collar Crime: Corporate and Securities and Commodities Fraud*, 37 J. AM. ACAD. PSYCHIATRY & L. 538, 541 (2009).

The opportunity to exploit the leading edge of a "boom-bust" cycle is available to all industry insiders. Why do some organizations exploit these market conditions? At some point, are innovative and deviant strategies developed to maximize profit and minimize risk diffused throughout the industry, thereby setting up the "new normal" and competitive bar for success? How do competitors resist the questionable practices and operate within expected margins of acceptable conduct? Corporate cultures, independent of executives and managers, dictate values and orientations compatible with the business model.[66] Furthermore, organizational factors determine whether corporations rely on legitimate or criminal means for achieving these goals.[67]

Accordingly, businesses develop a distinctive normative position—either a "culture of compliance" or a "culture of resistance" to criminal law and regulatory requirements—to inform goal achievement.[68] These symbolic goal orientations produce variations in ethical climates or cultures that support law violations in the pursuit of economic goals. These cultural orientations portraying illegal business practices in favorable terms can thus become pervasive in an industry; that is, deviance can become normalized.[69]

When corporations engage in criminal activities, they do so at the risk of criminal and civil liability.[70] As will be discussed more fully in the next section, corporate policies and procedures serve as proxies for corporate intentionality. Corporations represent complex structures, distinct subcultures, and goal orientations designed to carry out mandated responsibilities. They implement policy-coordinating complex tasks within a regulatory framework. Corporate decisions by representatives set into motion all activities of these business entities. To the degree an organization indoctrinates and pressures its members to engage in violations of law consistent with these expectations, one might find variable rates of white collar crimes being committed on behalf of organizations rather than individuals.[71]

Coleman applied the routine activities perspective to the intersection of opportunity and motivation in a professional or business context.[72] Motivation refers to "symbolic constructions" that sponsor organizationally-approved goals and activities. A process of socialization communicates goal orientations that direct executives to take actions, legal or otherwise, to protect and advance the interests of the

---

66. *See* Etzioni & Mitchell, *supra* note 56.

67. JAMES GOBERT & MAURICE PUNCH, RETHINKING CORPORATE CRIME (2003); *see also* R C. Kramer, *Corporate Crime: An Organizational Perspective*, *in* WHITE-COLLAR AND ECONOMIC CRIME: MULTIDISCIPLINARY AND CROSS-NATIONAL PERSPECTIVES (Peter Wickman & Timothy Dailey eds., 1982).

68. John Braithwaite, *Criminological Theory and Organizational Crime*, 6 JUST. Q. 333, 343 (1989).

69. SUTHERLAND, *supra* note 46; *see also* DIANE VAUGHAN, THE CHALLENGER LAUNCH DECISION: RISKY TECHNOLOGY, CULTURE, AND DEVIANCE AT NASA (1996).

70. John Braithwaite & Brent Fisse, *On the Plausibility of Corporate Crime Theory*, *in* 2 ADVANCES IN CRIMINOLOGICAL THEORY 15 (William S. Laufer & Freda Adler eds., 1990).

71. *Id.*

72. *See* Coleman, *supra* note 20.

corporation. Coleman described opportunity as a "potential course of action" that is made available by a particular set of social conditions recognized by the actor to be choice.[73] Thus, an individual's position within a social structure, as well as their personal cognitions and beliefs, play important roles in crime. Illegal opportunities increase in appeal as profits increase, risks of detection decrease, and as rationalizations for offending align with core beliefs or values. Yet opportunities "are only as good as those who would exploit them."[74]

As demonstrated above, theories of white collar crime have approached an explanation from various levels of analysis. Sutherland argued that individual involvement in white collar crime reflects a social process of differential association and learning whereby offenders acquire the "how to" and rationalizations needed to see offenses as necessary, standard, and acceptable business practices.[75] As part of any normal process of learning business practices—selection, induction, and promotion—white collar managers may order subordinates to engage in illegal or unethical practices as a normal course of business. In turn, the employee "learns specific techniques of violating the law, together with definitions of situations in which those techniques may be used."[76]

A major concern is whether the employee selection process attracts individuals with personality traits that either suggest a propensity to be deviant (e.g., low self-control, impulsive risk takers, questionable moral and ethical integrity, etc.) or traits likely to elevate them to positions of authority; or, whether those in positions of influence confront economic strain and blocked goals through individual or corporate deviance.[77] Some theorists attribute deviant cultures to the types of persons attracted to the organizations;[78] others argue the new hires are indoctrinated into the corporate world to accept deviant values and attitudes as normative and standard business practices.[79] Tackling this theoretical and empirical conundrum is beyond the scope of the current Article. In either case, inferential problems will persist until theoretical models simultaneously estimate independent indicators of personality traits and organizational cultures.

Problematic in either scenario though is that "techniques of neutralizations" serve individuals well to dismantle any moral resistance they might have to law violation, while at the same time justifying or

73. *Id.* at 409.

74. Peter Grabosky & Neal Shover, *Forestalling the Next Epidemic of White-Collar Crime: Linking Policy to Theory*, 9 CRIMINOLOGY & PUB. POL'Y 641, 649 (2010).

75. BENSON & SIMPSON, *supra* note 6.

76. EDWIN H. SUTHERLAND, WHITE-COLLAR CRIME: THE UNCUT VERSION 245 (1983).

77. Gross, *supra* note 52; *see also* Gerhard Blickle et al., *Some Personality Correlates of Business White-Collar Crime*, 55 APPLIED PSYCHO. 220, 221 (2006) (finding that "[b]usiness white-collar crime is predicated by gender (males higher rates than females), low behavioral self-control, high hedonism, high narcissism, and high conscientiousness").

78. Gross, *supra* note 52.

79. *See* Apel & Paternoster, *supra* note 48; *see also* CLINARD & YEAGER, *supra* note 60.

excusing their illegal behavior.[80] Coleman argued that in corporate cultures, these rationalizations and motivations are deeply rooted in the "culture of competition."[81] The resulting orientation will cast laws and regulations as cumbersome, ambiguous, unfair, or unnecessary. For example, people and organizations do not necessarily respond to new criminal prohibitions with compliance,[82] while resistance to law or regulation may nurture a "negative contagion" or more generalized disregard for law. Moreover, to the degree a criminogenic culture exists in a business, it ensures that successive generations of employees know the *rules of the game*: "It was a way of doing business before we ever got into the business. So it was like why do you brush your teeth in the morning or something? . . . It was a part of the everyday . . . It was a method of survival."[83] All told, if a culture of resistance or normalized deviance is in place, criminal activity is likely to occur in the presence of favorable opportunities in terms of suitable targets and minimal guardianship, irrespective of the criminal propensities of individuals within the workforce.

III. Compliance and Ethics

From the prior parts, it is evident that companies and industries cannot blindly rely on their employees to maintain high levels of moral reasoning and integrity, or to refrain from unethical or deviant behavior, when the environments they work in may undermine their ability to do so. Yet, whether workplace cultures attract or normalize deviance, or the structure and processes within them inadvertently contribute to illegal practices, it is the responsibility of corporate leaders to implement some levels of internal control; relying on external controls (e.g., criminal law legislation, civil regulation, and enforcement) alone will not suffice. Administrative and regulatory rules are constantly evolving and suggest the need for corporations to periodically review policies in light of external changes that may impact compliance. Effective policy governance programs build-in regular review cycles to establish new rules, to identify organizational impacts and to respond with compliance.[84] Compliance and ethics programming are cost-effective[85] approaches companies can and do take to improve internal controls.

---

80. Gresham M. Sykes & David Matza, *Techniques of Neutralization: A Theory of* Delinquency, 22 Am. Soc. Rev. 664 (1957).

81. Coleman, *supra* note 20.

82. Herbert L. Packer, The Limits of the Criminal Sanction 48 (1968).

83. Michael L. Benson, *Denying the Guilty Mind: Accounting for Involvement in a White-Collar Crime*, 23 Criminology 583, 591 (1985).

84. *See* OCEG, http://www.oceg.org (last visited Apr. 25, 2014) (example of consulting firm).

85. Michael Volkov, *Corporate Excuses to Avoid Compliance and Ethics Programs,* Corruption Crime Compliance (Aug. 27, 2013), http://corruptioncrimecompliance.com/2013/08/corporate-excuses-to-avoid-compliance-and-ethics-programs. Volkv argues that quality compliance programs can be cost-effective, despite executive resistance to change:

> The cost of a robust compliance and ethics program is far below the cost of insurance against an enforcement action or the cost of an enforcement action. The opportunity cost of an enforcement action can be devastating to a company

These proactive strategies help companies to implement policies that are aligned with corporate objectives and minimize unnecessary risk and liability.

A. *Compliance*

There are many sets of guidelines that lay out the necessary elements of an "effective" compliance program. In addition to industry-specific regulations, protocols, and standard operating procedures, which encourage legally-compliant practices, the U.S. Sentencing Guidelines ("Guidelines") surprisingly assist organizations as well—by helping companies frame their operations to reduce potential penalties for criminal conduct.[86] The general foundation of the applicable Guidelines is predicated on the concept that in order to have an effective compliance and ethics program, a company must promote an organizational culture that encourages ethical conduct and embraces a commitment to compliance with the law. This includes the obligation to exercise due diligence to prevent and detect criminal conduct. Based on this general framework, there are seven minimum core elements for establishing an effective compliance program:

1) Compliance standards and procedures must be established to prevent crime.
2) High-level personnel must be involved in oversight and knowledgeable about the operations of the compliance structure.
3) Substantial discretionary authority must be carefully delegated.
4) Compliance standards and procedures must be communicated to employees through education and training.
5) Reasonable steps must be taken to achieve compliance through the establishment of monitoring and auditing systems, periodic evaluations of the compliance program, and of reporting systems that provide anonymity.
6) Standards must be consistently enforced, utilizing appropriate incentives and disciplinary measures.
7) Any violations require appropriate responses, which may include modifications of compliance standards and procedures or implementing additional preventative measures.[87]

For the most part, these Guidelines do not go above and beyond what is required in most regulated industries. For example, U.S. Securities and Exchange Commission ("SEC")-registered investment advisors are subject to Rule 206(4)-7 of the Investment Advisors Act of 1940, as amended, which requires advisors to adopt and implement written policies and procedures designed to prevent violations from occurring, detect violations that have occurred, and correct promptly any viola-

---

> – everything in a company is put on hold during the time that the company devotes resources and attention to fending off a dangerous enforcement action.

Id.

86. *See* U.S. SENTENCING COMM'N, http://www.ussc.gov/index.cfm (last visited Apr. 25, 2014); *see also* 2012 Guidelines Manual § 8B2.1, U.S. SENTENCING COMM'N, http://www.ussc.gov/Guidelines/2012_Guidelines/Manual_HTML/8b2_1.htm.

87. *Id.*

tions that have occurred.[88] Guidelines (1), (5), and (7) are virtually identical to the obligations imposed by Rule 206(4)-7. In addition, Rule 206(4)-7 requires investment advisors to appoint a Chief Compliance Officer who is "competent and knowledgeable regarding the Advisers Act . . . empowered with the full responsibility and authority to develop and enforce appropriate policies and procedures for the firm."[89] Guideline (2), requiring the involvement of senior personnel, is consistent with this obligation.

The Financial Industry Regulatory Authority ("FINRA"), which is the self-regulatory organization that oversees broker-dealers, also has similar rules requiring the implementation of supervisory systems and controls to mitigate violations, including the National Association of Securities Dealers' ("NASD") Rule 3010 (Supervision), NASD Rule 3012 (Supervisory Controls), and FINRA Rule 3130 (Annual Certification of Compliance Supervisory Processes).[90] When compliance with the Guidelines and rules can be ascertained, corporations and executives can reasonably expect considerations with respect to criminal culpability. Yet much of what could be technically considered white collar "crime" does not come under the purview of criminal law, nor rise to the level of criminal prosecution. There are other civil and regulatory systems in place, however, to deal with similar deviant, unethical, and illegal behavior.

The SEC's Carlo di Florio outlined ten elements of an effective compliance and ethics program from a regulatory perspective. These elements, which are based on the U.S. Sentencing Guidelines, include recommendations for: governance; culture and values; incentives and rewards; risk management; policies and procedures; communication and training; monitoring and reporting; escalation, investigation, and discipline; issues management; and, an on-going improvement process.[91] In combination, the expectations outlined in the Guidelines

---

88. Staff of the Investment Adviser Regulation Office Division of Investment Management U.S. Securities and Exchange Commission, Regulation of Investment Advisers (2013), *available at* http://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf.

> Money managers, investment consultants, and financial planners are regulated in the United States as "investment advisers" under the U.S. Investment Advisers Act of 1940 ("Advisers Act" or "Act") or similar state statutes . . . . The Advisers Act is the last in a series of federal statutes intended to eliminate abuses in the securities industry that Congress believed contributed to the stock market crash of 1929 and the depression of the 1930s. The Act is based on a congressionally-mandated study of investment companies, including consideration of investment counsel and investment advisory services, carried out by the SEC during the 1930s.

Id. at 1.

89. Investment Advisors Act of 1940, 15 U.S.C. §§ 80b-1, 80b-21 (2012).

90. *See* Financial Industry Regulatory Authority, http://www.finra.org/ (last visited Apr. 25, 2014); *see also* U.S. Securities and Exchange Commission, *NASD Rulemaking* http://www.sec.gov/rules/sro/nasd.shtml (last visited Nov. 8, 2013) (stating, "As of July 30, 2007, NASD is now known as Financial Industry Regulatory Authority (FINRA) and new rule proposals will be listed under FINRA.").

91. Carlo V. di Florio, Director, S.E.C. Office of Compliance Inspections and Examinations, *The Role of Compliance and Ethics in Risk Management,* U.S. Securities and

(criminal) and by the SEC (civil; regulatory) tend to capture the standard by which corporations are required to operate, lest enhanced exposure to law enforcement (e.g., Department of Justice) or regulatory (e.g., SEC) action and sanctioning.

In getting on board with these standards, it appears a few firms that have been in the recent headlines for compliance failures have finally decided to enhance their compliance departments and control staff. HSBC, which was fined $1.9 billion USD by the U.S. Justice Department for anti-money laundering and sanctions violations (that led to the laundering of around $881 million USD in drug proceeds), recently announced its intention to hire thousands of compliance staff.[92] Although the firm's total global workforce has declined by over 40,000 in the past two years, with these additions, the firm's total compliance staff will be over 5,000 or 2% of its total global workforce.[93]

JPMorgan Chase, whose infamous $6 billion USD "London Whale" trading loss has led the bank to be the subject of four regulatory enforcement actions and seven separate Department of Justice investigations, also seems to now believe that enhancing its compliance and "control staff" is "good business."[94] The Company announced its intentions to spend $4 billion on compliance and risk management, which is to be spent increasing risk-control staff by 30% and providing 750,000 hours of compliance training.[95] Considering JPMorgan will pay a total of approximately $920 million in penalties for its internal control failures,[96] on top of the $18 billion USD it has spent on legal fees since 2008,[97] one wonders if the compliance additions are too little too late.

EXCHANGE COMMISSION (Oct. 17, 2011), *available at* http://www.sec.gov/news/speech/2011/spch101711cvd.htm. di Florio explained:

> In my first speech here at the SEC I outlined ten elements I believe make an effective compliance and ethics program. These elements reflect the compliance, ethics and risk management standards and guidance noted above. They also reflect the U.S. Federal Sentencing Guidelines (FSG), which were revised in 2004 to explicitly integrate ethics into the elements of an effective compliance and ethics program that would be considered as mitigating factors in determining criminal sentences for corporations.

Id.

92. Aruna Viswanatha & Brett Wolf, *HSBC to pay $1.9 billion U.S. fine in money-laundering case*, REUTERS, (Dec 11, 2012 6:15 PM EST), http://www.reuters.com/article/2012/12/11/us-hsbc-probe-idUSBRE8BA05M20121211.

93. Jaclyn Jaeger, *HSBC to Hire Thousands More Compliance Employees*, COMPLIANCE WEEK, (Sept. 30, 2013), http://www.complianceweek.com/hsbc-to-hire-thousands-more-compliance-employees/article/313908/.

94. Jaclyn Jaeger, *JPMorgan to Spend $4 Billion on Compliance and Risk Efforts*, COMPLIANCE WEEK, (Sept. 13, 2013), http://www.complianceweek.com/jpmorgan-to-spend-4-billion-on-compliance-and-risk-efforts/article/311619/.

95. *Id.*

96. Press Release, SECURITIES & EXCHANGE COMM'N, *JPMorgan Chase Agrees to Pay $200 Million and Admits Wrongdoing to Settle SEC Charges* (Sept. 19, 2013) *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539819965.

97. Jaeger, *supra* note 94.

B. *Ethics*

What is ethics? "Ethics" has multiple definitions, but it is generally understood to be *the principles of conduct governing an individual or group.* In an organizational setting, business ethics applies the "ethical principles" to operational activities and relationships between businesses, clients, and other stakeholders. In addition to ethical duties, many industries are further subject to "fiduciary duties." Someone with a fiduciary responsibility is a person "who owes to another the duties of good faith, trust, confidence, and candor."[98] When subject to a fiduciary duty, one must act for the benefit of the person to whom he/she owes such duty, to the exclusion of any contrary interest. From a conceptual viewpoint, there is a strong correlation between ethics and fiduciary duty, both of which are integral to sound and legal financial practices. But this is not new insight. As di Florio points out,[99] the U.S. Supreme Court stated almost five decades ago:

> A fundamental purpose, common to [the federal securities] statutes, was to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry . . . "It requires but little appreciation . . . of what happened in this country during the 1920's and 1930's to realize how essential it is that the highest ethical standards prevail" in every facet of the securities industry.[100]

Yet unethical practices persist. Significant corollaries between the stock market crash of 1929 and contemporary economic crises are blatantly evident, suggesting that the Supreme Court's concerns continue to be applicable today. Di Florio argues:

> Of course, what has happened through the financial crisis I believe is yet another reminder of the fundamental need for stronger ethics, risk management and regulatory compliance practices to prevail. Congress has responded once again, as it did after the Great Depression, with landmark legislation to raise the standards of business ethics in the banking and securities industries.[101]

It is easy to conclude that understanding business standards and setting ethical behavior parameters within companies and industries remains of utmost priority to facilitate an efficient and legally-operating financial system.

Consistent with the techniques of neutralization discussed in Part II,[102] there are a variety of reasons someone might act unethically: sometimes it is hard to do what we know is right (courage), we all make mistakes, too many pressures, cultural norms differ, "everyone else does

---

98. *Fiduciary*, Black's Law Dictionary 702 (9th ed. 2009).
99. Di Florio, *supra* note 91.
100. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186-87 (1963) (quoting Silver v. New York Stock Exchange, 373 U.S. 341, 366 (1963)).
101. Di Florio, *supra* note 91.
102. Sykes & Matza, *supra* note 80.

it" mentality, small favors turn into larger problems, and, the belief that management does not care about course of action so long as you are producing. This latter "pressure to perform" rationale is also common in many fast-paced industries: "[w]hen confronted with a clear choice between right and wrong, people are five times more likely to do the right thing if they have time to think about it than if they are forced to make a snap decision."[103] The organization may also structure incentives to deviate from conventional practices when the focus in on short-term performance or unrealized gains in tight timeframes.

Ethical principles can be the basis for regulation in a number of ways. Explicit references include the requirement for investment advisors and public companies to adopt a written code of ethics. Other rules and regulations may be based implicitly on an ethical foundation, such as the rules adopted and enforced by self-regulatory organizations such as FINRA, the National Association of Realtors, American Medical Association, and the New York Stock Exchange. The anti-fraud provisions included in many bodies of law are also based on ethical foundations, as well as in areas of law that enforce a fiduciary duty standard (see above).

Many have said that "good ethics is good business." In light of the recent financial crisis this catch-phrase has been used even more, and standard-standard setting organizations, such as the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), the Ethics Resource Center ("ERC"), the Open Compliance and Ethics Guidelines ("OCEG"), and the Ethics & Compliance Officer Association, have published more guidance. Expectations of ethical behavior have risen around the world, both from regulators as well as the general public. COSO, which is responsible for the standards of Internal Control and Enterprise Risk Management, argues:

> An entity's strategy and objectives and the way they are implemented are based on preferences, value judgments and management styles. Management's integrity and commitment to ethical values influence these preferences and judgments, which are translated into standard of behavior. Because an entity's good reputation is so valuable, the standards of behavior must go beyond mere compliance with the law. Managers of well-run enterprises increasingly have accepted the view that ethics pays and ethical behavior is good business.[104]

COSO also stated:

> Management integrity is a prerequisite for ethical behavior in all aspects of an entity's activities. The effectiveness of enterprise risk management cannot rise above the integrity and ethical values of the people who create, administer, and monitor entity activities.

---

103. Brian C. Gunia, Long Wang, Li Huang, Jiunwen Wang & J. Keith Murnighan, *Contemplation and Conversation: Subtle Influences on Moral Decision Making*, 55 ACAD. MGMT. J. 1, 13–33 (2012).

104. COMM. OF SPONSORING ORG. OF THE TREADWAY COMM'N, ENTERPRISE RISK MANAGEMENT FRAMEWORK: EXECUTIVE SUMMARY 22.

> Integrity and ethical values are essential elements of [an entity's] internal environment, affecting the design, administration and monitoring of other enterprise risk management components.[105]

This final remark by COSO is quite telling. It is clear from a culture of resistance and even a normalized deviance[106] perspective that the organizational ethos permeates the rank and file from the top levels on down. Thus, the C-suite[107] is originally *and* ultimately responsible for setting and role-modeling the ethical and compliance expectations of the company.

C. *Tone at the Top*

> *A demonstrated corporate culture that supports and provides appropriate norms and incentives for professional responsible behaviour is an essential foundation of good governance. In this regard, the board should take the lead in establishing the "tone at the top" and in setting professional standards and corporate values that promote integrity for itself, senior management and other employees.*[108]

"Tone at the top" is a phrase utilized frequently when discussing an effective corporate compliance program, but it can be difficult to define. It is easy to say, but hard to do, and even harder to prove—especially for larger organizations where the "top" is further removed from the day-to-day operations.[109] Visualizing the hierarchical structure of the tone at the top concept can help to demonstrate that various levels of involvement are necessary to have an effective tone. As the graphic in Figure 2 depicts, all levels of an organization need to be involved in risk management, ethical decision making, and professional business practices in order for the tone itself to inspire and influence a culture and climate of compliance with all employees *throughout* the organization.

---

105. *Id.*

106. Coleman, *supra* note 20.

107. The C-suite is "[a] widely-used slang term used to collectively refer to a corporation's most important senior executives. C-Suite gets its name because top senior executives' titles tend to start with the letter C, for chief, as in chief executive officer, chief operating officer and chief information officer." *See C-Suite*, INVESTOPEDIA, http://www.investopedia.com/terms/c/c-suite.asp (last visited Apr. 25, 2014).

108. BASEL COMM. ON BANKING SUPERVISION, CONSULTATIVE DOCUMENT: PRINCIPLES FOR ENHANCING CORPORATE GOVERNANCE 1, 16-17 (2010), *available at* http://www.bis.org/publ/bcbs168.pdf. For an example of a negative corporate "tone at the top," see in Kristie Xian, Note, *The Price of Justice: Deferred Prosecution Agreements in the Context of Iranian Sanctions*, 28 NOTRE DAME J.L. ETHICS & PUB. POL'Y 631, 632 (2014).

109. ASSOC. OF CERTIFIED FRAUD EXAMINERS, TONE AT THE TOP: HOW MANAGEMENT CAN PREVENT FRAUD IN THE WORKPLACE, *available at* http://www.acfe.com/uploadedFiles/ACFE_Website/Content/documents/tone-at-the-top-research.pdf.

FIGURE 2: TONE AT THE TOP

If the proper tone is not set, it is generally only a matter of time before a company self-destructs or, simply, *gets caught.* Think of Enron, WorldCom, Tyco, Bernard L. Madoff Investment Securities, and Galleon Group—all companies who appeared to be at the height of their game—until the walls came crashing down. In fact, since the economic bust of 2008, scores of public and privately-held companies and their chief executive officers ("CEOs") have been charged with regulatory violations and white collar crimes. If the heads of these organizations' C-suites had been unconcerned with or negligent in doing the right thing or setting the proper tone, their mindset and behavior likely had a trickledown effect of normalizing deviance, resulting in serious financial and legal issues, and ultimately for some, putting them out of business.

As implied above, while "setting" an ethical tone at the top is necessary for a compliance and ethics program to be successful (e.g., as indicated in the U.S. Sentencing Guideline that high level personnel must be involved in oversight), it is not enough on its own. Part of setting the tone at the top is ensuring that the tone is being received and respected throughout the organization. As the old adage states, "Trust but Verify." Meaning, the company needs to control the circumstances that would allow for unethical behavior (suitable targets; lack of guardianship) and test that unethical behavior is not occurring. Claiming that you want employees to act ethically and that the company holds itself to the highest ethical standards only goes so far—talk is cheap. Employees need to know that they are being monitored and will be held accountable to high behavioral standards.

When establishing an effective compliance program, industry specific practices are necessary to incorporate and are required by the Guidelines: "An organization's failure to incorporate and follow applicable industry practice or the standards called for by any applicable governmental regulation weighs against a finding of an effective compliance and ethics program."[110] While the size of the organization may impact what resources are available to dedicate to compliance, the Guidelines take this into consideration by allowing the formality and scope of a compliance program to be tailored to the size of the organization.[111] However, irrespective of industry (e.g., mortgage financers, investment advisors, banks, health care) or company size, any credible compliance program would include the following elements:

- *Proper hiring* – Before adding any new employees, a company should vet candidates to ensure they are fit for the firm's compliance culture. This can include incorporating compliance personnel in the hiring process, requiring candidates to see an industrial psychologist, completing full background and reference checks, all to review for signs/history of unethical behavior.
- *Proper incentives* – Compensation and other incentives should be tied to long-term performance of the firm to avoid employee decisions from being based on trying to make a "quick buck." Compliance personnel should also be involved in setting compensation guidelines, or at minimum, should be able to review the guidelines for any conflicts. Including compliance as an element of an employee's performance evaluation can also help promote ethical behavior.
- *Internal controls* – To control the opportunities for bad behavior, proper internal controls such as dual authorizations, segregation of duties, and suitable reporting structures. These controls need to be based on a company's operations, but every type of company should have some form of controls in place.
- *Internal audit program* – Internal controls only work if they are being followed. An internal audit program, which is required by Guideline (5), can help confirm that internal controls are properly functioning and find areas that are in need of improvement. Review of internal controls should be completed by someone who is not responsible for completing the original task.
- *Open dialogue* – Open lines of communication throughout the organization are necessary to set a proper tone at the top. Employees need to feel comfortable bringing up issues or asking questions or they are more likely to make mistakes and make the wrong decision. A company's compliance program also, as required by Guideline (5), needs to provide, and publicize, a way for employees to confidentially report information without fear of retaliation (i.e., "whistleblower" policies).
- *Empowered compliance staff* – It is not enough just to say a company has compliance staff to be compliant. Compliance staff, particularly the head of compliance, needs to truly be empowered to implement and independently enforce the company's policies and procedures, without unnecessary interference from the "business staff."

110. *See* U.S. Sentencing Guidelines Manual § 8B2.1, comment 2(B) (2013).
111. *Id.* at comment 2(C).

- *Formal and informal training* – If employees are unaware of the rules, how can they be expected to follow them? Training should start on an employee's first day and continue on a regular basis—such as an annual training of the most important rules, to informal training on a new or updated policy. Training can take many forms, including a simple email reminder, to a formalized presentation, and can be tailored to an employee's job duties.

After implementing a compliance program, and regularly thereafter, companies need to assess whether the actions they have taken are setting the appropriate tone at the top. To do this, it can help to begin with several basic questions:

- What quantitative measures are being used to complement qualitative evaluation of the tone at the top?
- Is the entity's internal audit function performing assessments of "soft controls" that could be used to help evaluate the tone at the top?
- How do the entity's processes for evaluating the tone at the top compare to those of other entities that are viewed as leaders in this area?
- Are employees' perceptions of the tone at the top trending up, trending down or flat? How do they compare with employee perceptions at similar or "leading" entities?
- Are there operating units or functions where employees' perceptions of the tone at the top are much weaker than others? If so, why, and what remediation may be appropriate?[112]

Based on the answer to these questions, a company should determine what gaps exist, and how to improve the compliance program and culture to develop a stronger tone at the top. As demonstrated by JPMorgan, HSBC, and a multitude of other companies, spending the resources to have an appropriate compliance and control system in place can save a lot of pain when something does go wrong.

D. *Mortgage Finance Reform*

Concern for legally-compliant and ethical business behavior and practices has blossomed in the wake of the subprime mortgage crisis. So too has regulation. Specifically, "Reforms stemming from the Dodd-Frank Act will fundamentally change every aspect of the mortgage business."[113] Provisions of the Dodd-Frank Act, as articulated by the Consumer Financial Protection Bureau (CFPB),[114] have culminated in

112. *10 Ways to Measure the Tone at the Top*, RISK & COMPLIANCE J., U.S., *available at* http://deloitte.wsj.com/riskandcompliance/2013/04/11/10-ways-to-measure-the-tone-at-the-top/ (adapted from the *Wall Street Journal*).

113. AMERICAN BANKERS ASSOC., ABA BACKGROUNDER: MORTGAGE REFORM INTO 2014, at 1 (2013). The ABA adds: "Overall, ABA believes that the new regulations go a long way in adding protections for consumers, but these reforms should aim to promote stable and accessible mortgage markets that are predominantly supported by private investment with reduced government involvement." *Id.*

114. The CFPB was created in 2011 following the passage of the Dodd–Frank Wall Street Reform and Consumer Protection Act.

rules and regulatory amendments as well as time frames in which banks must come into compliance. The final mortgage rules are generally centered within eight categories:[115]

1. Ability to Repay and "Qualified Mortgages"
2. Servicing (e.g., with respect to provisions of Regulation Z and Regulation X)[116]
3. High Cost Mortgage Provisions
4. Higher-Risk Mortgage Appraisal Documentation
5. Appraisal Disclosure
6. Loan Originator Compensation
7. RESPA [Real Estate Settlement Procedures Act of 1974] -TILA [Truth in Lending Act] Reforms
8. Fair Lending

The abundance of articulated and clarified housing finance regulation should come as no surprise. They are appropriate responses to many of the deviant practices revealed throughout investigations into the mortgage crisis. Narrative from the *New York v. JPMorgan Chase* case provides a vivid illustration of how deception and intentional inattention to risk became systemically problematic:

> Even Defendants' watered-down due diligence review could not help but identify a large number of problematic loans. Rather than rejecting or replacing those loans, however, the Defendants routinely ignored the defects . . . even when the QC [Quality Control] department did identify serious problems [during post-settlement reviews], it failed to remove defective loans from the securitizations . . . Indeed, far from making an effort to improve their due diligence review – and thereby improve the scrutiny of the loans they were purchasing—Defendants, as early as February 2005, began to *reduce* the amount of due diligence conducted "in order to make us more competitive on bids with larger sub-prime sellers."[117]

Certain mortgage companies, including Ally Financial and its subsidiaries (including GMAC Mortgage and Residential Capital), have been ordered to improve their compliance programs and control procedures in response to the mortgage crisis.[118] The Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation issued an Order to Ally Financial demanding it:

> submit to the Reserve Bank an acceptable compliance program and timeline for implementation to ensure that the operations of

115. AMERICAN BANKERS ASSOC., *supra* note 113.

116. 12 C.F.R. § 1026 (2013): "Regulation Z [ ] implements the Truth in Lending Act (TILA). Regulation Z currently prohibits a creditor from making a higher-priced mortgage loan without regard to the consumer's ability to repay the loan."

117. Complaint at 21-23, People v. JPMorgan Chase Bank, N.A. ., No. 2768-2012 (N.Y. Sup. Ct. Feb. 3, 2012).

118. Ally Financial Inc., GMAC Mortgage, LLC and Residential Capital, LLC: *Mortgage Compliance Program, Prepared for the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation* 1 (Dec. 8, 2011), *available at* http://www.federalreserve.gov/newsevents/press/enforcement/ally-plan-sect8-mortgage-compliance-program.pdf.

> the Mortgage Servicing Companies, including, but not limited to, residential mortgage loan servicing, Loss Mitigation, and foreclosure, comply with the Legal Requirements, as well as the Mortgage Servicing Companies' internal policies, procedures, and processes and are conducted in a safe and sound manner.[119]

As part of this order, the Reserve Bank stated specific elements Ally Financial needed to adopt, including outlining staff's duties and responsibilities regarding compliance, developing communication practices regarding compliance-related items, developing procedures to comply with various legal requirements, and setting up independent testing for compliance with various requirements.

In addition to structural, policy, and procedural changes, the Reserve Bank has also provided Ally Financial with guidance in four critical areas: (1) firm-wide approach to compliance risk/management, (2) independence of compliance staff, (3) sound practices for compliance and testing, and, (4) responsibility of Board and senior management for risk management and oversight.[120] The concept of "culture" is also mentioned in this Mortgage Compliance Program enhancement plan, but specific guidance on how to implement or establish this more compliant culture is arguably absent—suggesting that the tone at the top is indeed, easy to say, hard to do, and even harder to prove.

IV. Controlling Opportunities For Deviance

> *Our job is to set a tone at the top to incent people to do the right thing and to set up safety nets to catch people who make mistakes or do the wrong thing and correct those as quickly as possible. And it is working. It is working.*
>
> —Charles O. Prince III[121]

Between the Dodd-Frank legislation, new mortgage rules, increased regulatory and industry attention to compliance and ethics, and the direct/vicarious learning provided through legal actions (such as the Ally Financial consent decree), reform in the way of decreased mortgage fraud should be experienced within the U.S. housing finance industry. Yet based on the "wisdom" of Mr. Prince (whose bank, within a year of this statement, was nearly brought down by $65 billion in losses, with more than half of that due to its investment in MBSs, lax controls, and incentive plans that promoted unwarranted risk taking), one might conclude that rogue employees were specifically responsible for the demise of the housing finance industry, and more generally, all corporate malfeasance and white collar crime. It has been demonstrated and argued throughout this Article that this viewpoint could not be further from the truth. Despite the axiom from an unknown author

119. *Id.* at 3.

120. *Id.* at 5.

121. Eric Dash & Julie Creswell, *The Reckoning: Citigroup Saw No Red Flags Even as It Made Bolder Bets*, N.Y. Times, Nov. 23, 2008, at 34, *available at* http://www.nytimes.com/2008/11/23/business/23citi.html?pagewanted=all&_r=0.

that "*the ethical man knows it is wrong when he does it . . . the moral man would not do it*," even moral men might be pressured into or succumb to deviance under certain circumstances.[122]

Granted, motivated offenders are a critical element in ensuring that a criminal event comes to fruition, but systemic crime in occupational and organizational settings (illegalities which benefit, or are untaken at the behest of, an organization) is unlikely in the absence of a culture or subculture of normalized deviance. As such, a *reactive* corporate/industry control tactic of setting traps to catch people and correct their mistakes as Prince suggests, without attention to the deviant opportunities presented to them, may simply perpetuate misguided and ineffective compliance, ethics, or crime control strategies and programming.

Furthermore, the demands of an organization often subordinate individual intention, so punishing individuals will not be a sufficient deterrent to corporate crime.[123] Etzioni advances a communitarian perspective consistent with this view of corporate or organization responsibility for wrongdoing.[124] Under this view, corporations should face legitimate punishment when failing to fulfill their mandated responsibilities; it is inappropriate to punish an individual for corporate wrongdoing. In fact though, a common defense strategy routinely targets an individual (e.g., scapegoat) for corporate liability through the "plausible deniability" of others. The Sarbanes-Oxley Act[125] and the Dodd-Frank Act go a long way in attenuating these types of concerted ignorance claims.

As demonstrated above, in addition to regulation and corporate accountability, the adequate control of deviance requires a robust system of ethics and compliance programming, and a tone at the top which instills a normative culture of compliance. Price and Norris summarize these essentials:

> Protective factors include a reliable auditing system, a strong independent board of directors with monitoring functions, outside qualified directors and working committees, an organizational culture stressing ethical conduct, strict enforcement of ethics, a rigorous corporate compliance program, and senior leadership commitment to ethical conduct.[126]

The other necessary ingredient in a more *proactive* crime prevention strategy (especially when the essentials above might be absent or weak) is the control of the *opportunities* for employees, managers, and

122. *See e.g.*, PHILIP ZIMBARDO, THE LUCIFER EFFECT: UNDERSTANDING HOW GOOD PEOPLE TURN EVIL 17 (1st ed. 2007).

123. Braithwaite & Fiss, *supra* note 70, at 342.

124. Etzioni & Mitchell, *supra* note 56, at 187-88 (arguing this view calls for achieving an appropriate balance between rights and responsibilities to stakeholders and the community at large).

125. *See generally* A GUIDE TO THE SARBANES-OXLEY ACT, http://www.soxlaw.com/ (last visited Apr. 25, 2014).

126. Price & Norris, *supra* note 65, at 542.

executives to engage in criminal, resistant, or otherwise deviant behavior in the first place. For as Hurley and colleagues note:

> Indeed, virtually all companies that have experienced major trust violations had *some*, and often *extensive*, systems and processes in place to produce trustworthy behavior (for example, compliance procedures, quality checks, codes of conduct and ethics training). However, as important as these systems and processes may be, other elements undermined the companies' ability to deliver on their core responsibilities to stakeholders.[127]

The final mortgage finance rules outlined in the previous section, along with risk retention requirements and GSE reforms,[128] are indicative of this type of attitude and subsequent situational approach to prevent and control opportunities for deviance in the housing finance industry.

Current mortgage reforms encompass products (e.g., subprime no/low documentation loans) and activities available and occurring at vital points in the mortgage finance process that have been previously identified as susceptible to fraud (suitable targets; no guardianship; "hotspots"). As designed, the developments tend to outline and clarify required methods to ascertain homebuyer qualifications, improve accountability and transparency, and facilitate a more symmetrical structure of risk. This mixture of regulation and restructuring is bound to disrupt the criminal opportunities within home financing that were so evident in the housing industry of the past two decades. Targets are less suitable (e.g., with more complete disclosure to consumers and investors; when risk must be retained) and guardianship is improved (e.g., more informed clientele; record documentation and retention requirements). Note that these changes do not directly target the "motivated offender," which is postulated as a necessary component of a criminal event under Routine Activities Theory. However, this is consistent with other environmental crime-specific prevention strategies that attempt to harden *targets* and/or improve guardianship to alter the opportunity structure of crime. By making targets less attractive and/or less accessible, potential offenders are forced to reassess their perceptions on the viability of pursuing a given course of action or "opportunity,"[129] thereby indirectly influencing their motivation.

It is encouraging to note that there was a 25% decrease in mortgage loan fraud Suspicious Activity Reports (SARs) from 2011 to 2012, with a higher percentage of the 2012 total being credited to the category of application fraud (the distribution of frauds was trending to a concentration at the consumer level rather than within the finance

---

127. Robert F. Hurley, Nicole Gillespie, Donald L. Ferrin & Graham Dietz, *Designing Trustworthy Organizations*, 54 MIT SLOAN MGMT. REV. 75, 77 (Summer 2013).

128. U.S. Sentencing Guidelines Manual § 8B2.1, comment (c) (2013). Propositions requiring "securitizers retain portions of the credit risk of securitized assets" are under debate.

129. Coleman, *supra* note 20, at 405.

industry itself).[130] For example, in 2009, appraisal fraud and/or misrepresentation compensated for 34% of the total mortgage fraud SARs, and had fallen to 9% through 2012.[131] This suggests that opportunities for deviance within the mortgage industry (e.g., at the appraisal level) may be less attractive to would-be offenders.

Conclusion

Even though Routine Activities Theory was originally applied to direct-contact predatory crimes, it has also shown increased utility for examining and explaining indirect-contact crimes, such as those found in the housing finance industry. Its consistency with the opportunity perspective provides a rich framework for examining how individuals and aggregates might take advantage of occupational, organizational, and industrial routines and their potentially rewarding crime opportunities, and in turn how these very opportunities may ultimately be restructured to *diminish* the likelihood of crime. General deterrent strategies offered through ethics training, compliance programming, and regulation can only go so far. Deterrence is not only un-measurable (based on something that does not occur), but the ability of offenders to avoid detection and punishment unnecessarily emboldens would-be offenders.[132]

When an industry or business can create barriers to offending (e.g., target hardening), the ability of individuals to capitalize on potentially rewarding crime opportunities is decreased. Although there is the possibility of the unintended consequence of crime displacement (e.g., reverse mortgage fraud) with a situational approach to crime prevention, it trumps efforts to "un-motivate" potential offenders with corporate programming, jargon, and slogans (motivated offenders will *always* seek opportunities via suitable targets in the absence of capable guardianship). Simply focusing on individuals, while ignoring the deviant opportunities that the structures, processes, and social systems of industries and organizations create, will not improve fiscal accountability, ensure fiduciary duties are met, or reduce occupational or organizational crime.

---

130. LexisNexis, The LexisNexis 15th Annual Mortgage Fraud Report 10 (2013), *available at* http://mortgagefraudblog.com/wp-content/uploads/2013/09/15th-Annual-Mortgage-Fraud-Report-LexisNexis.pdf.

131. *Id.* at 11. Also, even though consumer fraud is damaging, every adequately structured and functional industry should have mechanisms in place to effectively monitor and detect customer/clientele crime.

132. Mark C. Stafford & Mark Warr, *A Reconceptualization of General and Specific Deterrence*, 30 J. Res. in Crime & Delinquency 123, 123–135 (1993), who argue that directly *or* vicariously experiencing *punishment avoidance* is as critical, if not more than, experiencing punishment.