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U.S. Plans to Sue Banks Over Bonds

SEC to Warn Several Wall Street Firms of Impending Legal Action Stemming From Financial Crisis

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Federal securities regulators plan to warn several major banks that they intend to sue them over mortgage-related actions linked to the financial crisis, according to people familiar with the matter.

The move would mark a stepped-up regulatory effort to hold Wall Street accountable for its sale of bonds linked to subprime mortgages in 2007 and 2008. At issue is whether the banks misrepresented the poor quality of loan pools they bundled and sold to investors, the people said.

It isn't clear which firms will receive the formal Securities and Exchange Commission enforcement warnings, known as "Wells notices."

Banks whose activities are being examined in the civil investigation include Ally Financial Inc., [Bank of America](#) Corp., [Citigroup](#) Inc., [Deutsche Bank](#) AG and [Goldman Sachs Group](#) Inc., people familiar with the matter say.

Representatives of the banks declined to comment, as did a spokesman for the SEC.

In a meeting with reporters last month, Robert Khuzami, the SEC's enforcement chief, said the agency's mortgage-bond investigation was looking for evidence that firms "failed to disclose important information when selling these securities."

Mr. Khuzami declined further comment on the investigation.

The planned regulatory actions come at a critical juncture. The SEC, Justice Department and state prosecutors are pushing to complete a number of financial-crisis cases by the end of this year, partly to avoid having enforcement action curbed by statutes of limitations, the people said.

Some politicians have pressed federal authorities to hold Wall Street firms more accountable for questionable activity during the crisis.

President Barack Obama last month set up a new financial-crimes unit to pursue mortgage-securities fraud during the financial crisis, involving federal and state prosecutors and the SEC. This week, the SEC hosted a training day for prosecutors and other members of the new unit, the people say.

Wall Street firms have defended their actions, saying they couldn't have predicted a market meltdown, that they acted responsibly in chaotic conditions, and that they shouldn't be prosecuted for bad business decisions.

For years, financial firms had packaged billions of dollars of bonds by pooling subprime mortgages into securities. When those mortgages soured, banks and investors suffered losses and write-downs on mortgage bonds totaling hundreds of billions of dollars, throwing markets into turmoil and triggering losses that toppled

financial giants Bear Stearns Cos. and Lehman Brothers Inc.

The multiple pending investigations have the potential to change the way Wall Street operates, according to financial specialists.

"If the SEC is effective in pursuing these cases, the Street will take notice," said Campbell Harvey, finance professor at the Fuqua School of Business at Duke University.

"But it's not clear if all these disparate investigations will go anywhere. One good question is why these cases are taking such a long time," Mr. Harvey added.

Regulators say the nature of the cases means they are very time-consuming to develop successfully. Any enforcement actions typically center on technical questions of disclosure, rather than simple fraud such as theft.

The SEC has filed civil lawsuits against a total of 95 firms and individuals related to the financial meltdown; it has at least two additional potential enforcement actions in the works involving mortgage-bond deals, known as collateralized debt obligations or CDOs, the people say.

[UBS](#) AG has said the SEC is investigating its valuation, structuring and underwriting of CDOs in 2007, according to regulatory filings. It isn't clear whether UBS will face any regulatory action from the probe. A UBS spokesman declined to comment.

Last week, the SEC alleged that four former [Credit Suisse Group](#) AG investment bankers and traders engaged in conspiracy and securities fraud for allegedly inflating values of mortgage bonds. Two of the men pleaded guilty to criminal charges, marking the first successful criminal case against Wall Street in relation to the financial meltdown. Credit Suisse, which wasn't charged, said at the time it had cooperated in the investigation.

In the mortgage-bond investigation, the SEC has examined more than 25 million pages of documents, interviewed more than 100 witnesses and issued scores of subpoenas, the agency's Mr. Khuzami told reporters last month.

The SEC also is looking at whether any of the banks that received compensation for poor quality loans from the firms that sold them the mortgages passed on these settlement payments to investors, or simply pocketed the money, the people said.

On Monday, the SEC is set to face a rare high-profile courtroom battle in a civil case stemming from the financial crisis, when two former Bear Stearns hedge-fund managers go on trial.

In 2008, the SEC accused Ralph Cioffi and Matthew Tannin, the managers, of misleading investors about the health of two mortgage-heavy funds that imploded in June 2007 as the subprime housing market began to collapse.

The two men were acquitted in 2009 on criminal charges related to similar allegations. Lawyers for Mr. Cioffi and Mr. Tannin declined to comment.

The most recent SEC mortgage-bond investigation centers on alleged activities similar to those included in civil lawsuits filed against 17 banks in September by the federal agency that oversees Freddie Mac and Fannie Mae.

In those suits, the Federal Housing Finance Agency accused the banks of misrepresenting the content of the loan pools that were packaged and sold to the two mortgage giants. The banks have denied the allegations.

A federal inquiry into the crisis last year said it had identified "significant" problems with financial firms failing to perform adequate checks on the quality of the mortgage pools they assembled to sell on to investors.

In a report, the Federal Crisis Inquiry Commission also criticized the SEC for failing to "adequately enforce its disclosure requirements governing mortgage securities."

An SEC spokesman said "the report is incorrect. Most of the mortgage-related securities were sold in offerings not registered with the Commission."

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