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Credit Suisse Agrees to Pay $5.28 Billion in Connection with Its Sale of Residential Mortgage-Backed Securities

DENVER – The Justice Department announced today a $5.28 billion settlement with Credit Suisse related to Credit Suisse's conduct in the packaging, securitization, issuance, marketing and sale of residential mortgage-backed securities (RMBS) between 2005 and 2007. The resolution announced today requires Credit Suisse to pay $2.48 billion as a civil penalty under the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA). It also requires the bank to provide $2.8 billion in other relief, including relief to underwater homeowners, distressed borrowers and affected communities, in the form of loan forgiveness and financing for affordable housing. Investors, including federally-insured financial institutions, suffered billions of dollars in losses from investing in RMBS issued and underwritten by Credit Suisse between 2005 and 2007.

"Today's settlement underscores that the Department of Justice will hold accountable the institutions responsible for the financial crisis of 2008," said Attorney General Loretta E. Lynch. "Credit Suisse made false and irresponsible representations about residential mortgage-backed securities, which resulted in the loss of billions of dollars of wealth and took a painful toll on the lives of ordinary Americans. Under the terms of this settlement, Credit Suisse will pay $2.48 billion as a fine for its conduct. And Credit Suisse has pledged $2.8 billion in relief to struggling homeowners, borrowers, and communities affected by the bank's lending practices. These sums reflect the huge breach of public trust committed by financial institutions like Credit Suisse."

"Credit Suisse claimed its mortgage backed securities were sound, but in the settlement announced today the bank concedes that it knew it was peddling investments containing loans that were likely to fail," said Principal Deputy Associate Attorney General Bill Baer. "That behavior is unacceptable. Today's $5.3 billion resolution is another step towards holding financial institutions accountable for misleading investors and the American public."

"Resolutions like the one announced today confirm that the financial institutions that engaged in conduct that jeopardized the nation's fiscal security will be held accountable," said Principal

Deputy Assistant Attorney General Benjamin C. Mizer, head of the Justice Department's Civil Division. "This is another step in the Department's continuing effort to redress behavior that contributed to the Great Recession."

"Credit Suisse's mortgage misconduct hurt people, including in Colorado," said Acting United States Attorney for the District of Colorado Bob Troyer. "Unscrupulous lenders knew they could get away with shoddy underwriting when making mortgage loans, because they knew Credit Suisse would buy those defective mortgage loans and put them into securities. When those mortgages went into foreclosure, many people got hurt: families lost their homes, communities were blighted by empty houses, and investors who had put their trust in Credit Suisse's supposedly safe securities suffered huge losses. Our office led this investigation into Credit Suisse to protect homeowners, communities, and investors across the country, including here in Colorado. Credit Suisse is paying a hefty penalty and acknowledging its misconduct, but that is not all. Years after the Great Recession, many families still struggle to afford a home, so we also crafted an agreement to bring needed housing relief to such families, including specifically in Colorado."

This settlement includes a statement of facts to which Credit Suisse has agreed. That statement of facts describes how Credit Suisse made false and misleading representations to prospective investors about the characteristics of the mortgage loans it securitized. (The quotes in the following paragraphs are from that agreed-upon statement of facts, unless otherwise noted.):

- Credit Suisse told investors in offering documents that the mortgage loans it securitized into RMBS "were originated generally in accordance with applicable underwriting guidelines," except where "sufficient compensating factors were demonstrated by a prospective borrower." It also told investors that the loans "had been originated in compliance with all federal, state, and local laws and regulations, including all predatory and abusive lending laws."

- Credit Suisse has now acknowledged that "Credit Suisse repeatedly received information indicating that many of the loans reviewed did not conform to the representations that would be made by Credit Suisse to investors about the loans to be securitized." It has acknowledged that in many cases, it purchased and securitized loans into its RMBS that "did not comply with applicable underwriting guidelines and lacked sufficient factors" and/or "w[ere] not originated in compliance with applicable laws and regulations." Credit Suisse employees even referred to some loans they securitized as "bad loans," "'complete crap' and '[u]tter complete garbage.'"

- Credit Suisse acquired some of the mortgage loans it securitized by buying, from other loan originators, "Bulk" packages containing numerous loans. For example, in December 2006, Credit Suisse purchased a "Bulk" pool of approximately 10,000 loans originated by Countrywide

Home Loans. Credit Suisse selected fewer than 10 percent of these loans for due diligence review. "Reports from Credit Suisse's due diligence vendors showed that approximately 85 percent of the loans in this sample violated Countrywide's underwriting guidelines and/or applicable law," but "Credit Suisse securitized over half of the loans into various RMBS it then sold to investors." Credit Suisse did not review the remaining unsampled 90 percent of the pool to determine whether those loans had similar problems. Instead, it "securitized an additional $1.5 billion worth of unsampled—and therefore unreviewed—loans from this pool into various RMBS it then sold to investors." A Credit Suisse manager wrote to another manager who was reviewing these loans, "Thanks for working thru this mess. If it helps, it looks like we will make a killing on this trade."

- Credit Suisse acquired other mortgage loans for securitization through its "Conduit" channel. Through this channel, Credit Suisse bought loans from other lenders one-by-one or in small packages, and also itself extended loans to borrowers as "Wholesale" loans. Approximately 25-35 percent of the loans Credit Suisse acquired from 2005 to 2007 were acquired through its mortgage "Conduit."

- Credit Suisse employees discussed in internal emails that for Conduit loans, the loan review and approval process was "'virtually unmonitored.'" For loans Credit Suisse purchased through its Conduit, Credit Suisse told investors, ratings agencies and others, "'Credit Suisse senior underwriters make final loan decisions, not contracted due diligence firms.'" Credit Suisse has now acknowledged, "For Conduit loans, these representations were false."

- Credit Suisse has acknowledged that "[a] September 2004 audit by Credit Suisse's audit department gave the Conduit a C rating on an A-D scale (the second worst possible rating) and a level 4 materiality score on a 1-4 scale (the highest possible score)," and that a March 2006 evaluation by Credit Suisse of one of the third-party vendors it used to review Conduit loans "similarly reported that 'There are serious concerns as to compliance[.]'"

- Between 2005 and 2007, Credit Suisse managers made comments in emails about the quality of Conduit loans and its process for reviewing those loans. For example, a top Credit Suisse manager wrote to senior traders, "'Of course we would like higher quality loans. That's never been the identity of our [mortgage] conduit, and we're becoming less and less competitive in that space.'" A senior Credit Suisse trader, discussing the "fulfillment centers" Credit Suisse used to review Conduit loans, stated in an email: 'we make these underwriting exceptions and then we have liability down the road when the loans go bad and people point out that we violated our own guidelines. . . . The fulfillment process is a joke.'"

- For example, in one instance Credit Suisse approved, through its Conduit, a purchase of over $700 million worth of loans originated by Resource Bank. Credit Suisse senior traders "referr[ed] to Resource Bank loans as 'complete crap' and '[u]tter complete garbage.'" Despite this, “Credit Suisse provided Resource Bank with financial ‘incentives’ in exchange for loan volume [and] securitized Resource Bank loans into various RMBS it then sold to investors.”

- Credit Suisse has acknowledged that it also “received reports from vendors that it might have been acquiring and securitizing loans with inflated appraisals” and that its approach for reviewing the property values associated with the mortgage loans “could lead to the acceptance of inflated appraisals.” In August 2006, a Credit Suisse manager wrote to two senior traders, “How would investors react if we say that 20 percent of the pool have values off by 15 percent? If we are comfortable buying these loans, we should be comfortable telling investors.”

- Credit Suisse used vendors to conduct quality control on a small subset of loans it acquired. Credit Suisse has now acknowledged that its quality control review vendors reported that “more than 25 percent of the loans that they reviewed for quality control were designated ‘ineligible’ because of credit, compliance, and/or property defects.”

- Credit Suisse has now acknowledged that its “Co-Head of Transaction Management expressed concern that the quality control results could serve as a written record of defects, and sought to avoid documented confirmation of these defects.” In May 2007, a top Credit Suisse manager met with others “to discuss implementing this reduction of quality control review.” Credit Suisse’s Co-Head of Transaction Management wrote that “this change was to ‘avoid the previous approach by which a lot of loans were QC’d . . . creating a record of possible rep/warrant breaches in deals . . . .’”

- In another example, in May 2007, a Credit Suisse employee identified two wholesale loans Credit Suisse itself had originated and wrote, “‘I would think that we would want to see loans like these that seem to represent confirmed problems, especially on our own originations. Why do we have an appraisal watch list and broker oversight group if we aren’t going to review the bad ones and take action appropriately? . . . I just see so many of these cross my desk, fraud, value, etc., it’s hard to just let them go by and not do something.’” Credit Suisse’s Co-Head of Transaction Management responded, “‘I think the idea is that we don’t want to spend a lot of $ to generate a lot of QC results that give us no recourse anyway but generate a lot of negative data, so no need to order QC on each of these loans.’” The employee then stated, “‘I think the lack of interest in bad loans is scary.’”

- As another example, in June 2007, a Credit Suisse employee identified 44 Wholesale loans Credit Suisse had itself originated that had gone 60 days delinquent. Credit Suisse’s Co-Head of Transaction Management wrote in response, “‘if we already know: that the loans aren’t performing . . . the only thing QC will tell us is that there were compliance errors, occupancy misreps etc. I think we already know we have systemic problems in FC/UW [fulfillment centers/underwriting] re both compliance and credit. The downside of QC’ing these 44 loans is, after we get the QC results, we will be obligated to repurchase a fair chunk of the loans from deals, assuming the loans are securitized and the QC results look like the QC we've done in the past. So based on a wholesale QC historical fail rate of over 35 percent (major rep defects), the avg bal of wholesale loans and the loss severities, it is reasonable to expect this QC may cost us a few million dollars.'" Credit Suisse has now acknowledged that it "did not inform investors or ratings agencies that its Wholesale loan channel had a 'QC historical fail rate of over 35 percent (major rep defects).'"

- Credit Suisse commented about the mortgage loans that accumulated in its inventory. For example, Credit Suisse's Co-Head of Transaction Management wrote to another Credit Suisse manager that "loans with potential defects 'pile up in inventory . . . . So my theory is: we own the risk 1 way or another. . . . I am inclined to securitize loans that are close calls or marginally non-compliant, and take the risk that we'll have to repurchase, if we can't put them back, rather than adding to sludge in inventory. . . .' One of the senior traders responded, 'Agree.'" In another instance, a Credit Suisse senior trader commented in 2007 that "'we have almost $2.5B of conduit garbage to still distribute.'" In another instance, a Credit Suisse trader wrote to a top manager, discussing another bank to which Credit Suisse was seeking to sell loans from its inventory, and stated, "'[The other bank] again came back with an embarrassing number of diligence kicks this month. . . . If their results are in any way representative of our compliance with our reps and warrants, we have major problems.' But rather than holding these loans in its own inventory, Credit Suisse securitized certain of these loans into its RMBS."

Assistant U.S. Attorneys Kevin Traskos, Hetal J. Doshi, Shiwon Choe, Ian J. Kellogg, Lila M. Bateman, and J. Chris Larson of the District of Colorado investigated Credit Suisse's conduct in connection with RMBS, with the support of the Federal Housing Finance Agency's Office of the Inspector General (FHFA-OIG).

"Credit Suisse knowingly put investors at risk, and the losses caused by its irresponsible behavior deeply affected not only financial institutions such as the Federal Home Loan Banks, but also taxpayers, and contributed significantly to the financial crisis," said Special Agent in Charge Catherine Huber of the Federal Housing Finance Agency-Office of Inspector General's (FHFA-OIG) Midwest Region. "This settlement illustrates the tireless efforts put forth toward bringing a resolution to this chapter of the financial crisis. FHFA-OIG will continue to work with our law enforcement partners to hold those who have engaged in misconduct accountable for their actions."

The $2.48 billion civil monetary penalty resolves claims under FIRREA, which authorizes the federal government to impose civil penalties against financial institutions that violate various predicate offenses, including wire and mail fraud. The settlement expressly preserves the government's ability to bring criminal charges against Credit Suisse or any of its employees. The settlement does not release any individuals from potential criminal or civil liability. As part of the settlement, Credit Suisse has agreed to fully cooperate with any ongoing investigations related to the conduct covered by the agreement.

Credit Suisse will pay out the remaining $2.8 billion in the form of relief to aid consumers harmed by its unlawful conduct. Specifically, Credit Suisse agrees to provide loan modifications, including loan forgiveness and forbearance, to distressed and underwater homeowners throughout the country. It also agrees to provide financing for affordable rental and for-sale housing throughout the country. This agreement represents the most substantial commitment in any RMBS agreement to date to provide financing for affordable housing—a crucial need following the turmoil of the financial crisis.

The settlement is part of the ongoing efforts of President Obama's Financial Fraud Enforcement Task Force's RMBS Working Group, which has recovered tens of billions of dollars on behalf of American consumers and investors for claims against large financial institutions arising from misconduct related to the financial crisis. The RMBS Working Group brings together attorneys, investigators, analysts and staff from multiple state and federal agencies, including the Department of Justice, U.S. Attorneys' Offices, the FBI, the U.S. Securities and Exchange Commission (SEC), the Department of Housing and Urban Development (HUD), HUD's Office of Inspector General, the FHFA-OIG, SIGTARP, the Federal Reserve Board's OIG, the Recovery Accountability and Transparency Board, the Financial Crimes Enforcement Network and multiple state Attorneys General offices around the country. The RMBS Working Group is led by Director Joshua Wilkenfeld and four co-chairs: Principal Deputy Assistant Attorney General Mizer, Assistant Attorney General Leslie R. Caldwell of the Justice Department's Criminal Division, Director Andrew Ceresney of the SEC's Division of Enforcement, and New York Attorney General Eric Schneiderman. This settlement is the latest in a series of major RMBS settlements announced by the Working Group.