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WELLS FARGO AGREES TO PAY $2.09 BILLION PENALTY FOR ALLEGEDLY MISREPRESENTING QUALITY OF LOANS USED IN RESIDENTIAL MORTGAGE-BACKED SECURITIES

WASHINGTON – The Justice Department announced today that Wells Fargo Bank, N.A. and several of its affiliates (Wells Fargo) will pay a civil penalty of $2.09 billion under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) based on the bank's alleged origination and sale of residential mortgage loans that it knew contained misstated income information and did not meet the quality that Wells Fargo represented. Investors, including federally insured financial institutions, suffered billions of dollars in losses from investing in residential mortgage-backed securities (RMBS) containing loans originated by Wells Fargo.

"This settlement holds Wells Fargo accountable for actions that contributed to the financial crisis," said Acting Associate Attorney General Jesse Panuccio. "It sends a strong message that the Department is committed to protecting the nation's economy and financial markets against fraud."

"Abuses in the mortgage-backed securities industry led to a financial crisis that devastated millions of Americans," said Acting U.S. Attorney for the Northern District of California, Alex G. Tse. "Today's agreement holds Wells Fargo responsible for originating and selling tens of thousands of loans that were packaged into securities and subsequently defaulted. Our office is steadfast in pursuing those who engage in wrongful conduct that hurts the public."

FIRREA authorizes the federal government to seek civil penalties against financial institutions that violate various predicate criminal offenses, including wire and mail fraud. The United States alleged that, in 2005, Wells Fargo began an initiative to double its production of subprime and Alt-A loans. As part of that initative, Wells Fargo loosened its requirements for originating stated income loans – loans where a borrower simply states his or her income without providing any supporting income documentation.

To evaluate the integrity of its increasing volume of stated income loans, Wells Fargo subjected a sample of these loans to "4506-T testing." A 4506-T form is a government document signed by the borrower during the loan approval process that allows the lender to obtain the borrower's tax transcripts from the Internal Revenue Service (IRS). 4506-T testing involves comparing the tax transcripts of the borrower with the income stated on the loan application. Wells Fargo implemented 4506-T testing on two of its programs. This testing revealed that more than 70% of the loans that Wells Fargo sampled had an “unacceptable” variance (greater than 20% discrepancy between the borrower’s stated income and the income information reflected in the borrower’s most recent tax returns filed with the IRS), and the average variance was approximately 65%. After receiving these results, Wells Fargo conducted further internal testing. This additional testing, performed by quality assurance analysts, was designed to determine if “plausible” explanations existed for the “unacceptable” variances over 20%. This additional step revealed that nearly half of the stated income loans that Wells Fargo tested had both an unacceptable variance and the absence of a plausible explanation for that variance.

The results of Wells Fargo’s 4506-T testing were disclosed in internal monthly reports, which were widely distributed among Wells Fargo employees. One Wells Fargo employee in risk management observed that the “4506-T results are astounding” yet “instead of reacting in a way consistent with what is being reported WF [Wells Fargo] is expanding stated [income loan] programs in all business lines.”

The United States alleged that, despite its knowledge that a substantial portion of its stated income loans contained misstated income, Wells Fargo failed to disclose this information, and instead reported to investors false debt-to-income ratios in connection with the loans it sold. Wells Fargo also allegedly heralded its fraud controls while failing to disclose the income discrepancies its controls had identified. The United States further alleged that Wells Fargo took steps to insulate itself from the risks of its stated income loans, by screening out many of these loans from its own loan portfolio held for investment and by limiting its liability to third parties for the accuracy of its stated income loans. Wells Fargo sold at least 73,539 stated income loans that were included in RMBS between 2005 to 2007, and nearly half of those loans have defaulted, resulting in billions of dollars in losses to investors.

The settlement was the result of a coordinated effort between the Civil Division’s Commercial Litigation Branch and the U.S. Attorney’s Office for the Northern District of California, with investigative support from the Federal Housing Finance Agency, Office of Inspector General.

The claims resolved by this settlement are allegations only, and there has been no admission of liability.

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