

# Jail the *Bankers*

*The great mystery of why more U.S.  
bankers aren't being prosecuted.*

BY DAVID D. HALE

**T**here is now a great populist uproar in Washington about bankers' bonuses and Federal Reserve policy. Members of Congress are outraged that Goldman Sachs may pay \$17 billion in bonuses only one year after it received emergency government funds. Congressman Ron Paul (R-TX) has introduced a bill that would allow the Congress to audit monetary policy. President Obama has denounced bankers and proposed both higher taxes on them and new restrictions on their ability to do business. The public outrage about the government's handling of the financial crisis is understandable. The U.S. government has been lagging far behind previous banking crises in putting financial criminals behind bars. In the late 1980s, 1,043 thrifts with assets of over \$500 billion failed because of commercial real estate loans which often involved fraud and corruption. The government put over 3,500 bankers in jail. One thousand of them were classified as senior insiders.

The savings and loan crisis of the late 1980s cost the U.S. government approximately 2.15 percent of GDP. The current crisis will cost the economy more than 20 percent of GDP. These vastly larger costs suggest that the government should be convicting over 20,000 bankers and mortgage fraudsters. But the process of prosecuting them is lagging badly. The government achieved only 560 mortgage fraud indictments last year and 328 in 2007. None were senior insiders.

The government's efforts have suffered from a lack of enforcement. After the terrorist attacks on New York and Washington in 2001, the FBI transferred over two thousand FBI agents from white-collar crime to anti-terrorism. As a result, there are now only 240 FBI agents focused on mortgage fraud compared to over one thousand working on the savings and loan scandal of twenty years ago. There are also capacity constraints in the courts. The U.S. legal system can only process about

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eight hundred mortgage fraud crimes per annum. At this rate, it would take five years to put just five thousand bankers and mortgage brokers in jail.

As a result of the government's focus on anti-terrorism, the law enforcement process has eroded in other sectors as well. Between 2003 and 2009, the number of federal corporate fraud cases plunged 55 percent, bankruptcy fraud cases declined 44 percent, and securities fraud charges fell 17 percent. The FBI also has 2,800 open mortgage fraud cases.

Banks have filed over 62,000 criminal referrals against their own customers. Nearly half are in California. It will be impossible for California to incarcerate such people because the state's fiscal crisis is already forcing it to release thousands of convicts.

The government did file a case against two Bear Stearns hedge fund managers for allegedly lying about their fund's performance. This case was always very weak. The fund managers merely exchanged e-mails expressing concerns about the market. The government itself showed a lack of confidence by holding the trial in Brooklyn. Serious financial crimes are tried in Manhattan. Brooklyn gets the Mafia cases.

The true criminals in the recent crisis were not hedge fund managers. They were the bankers and brokers who knowingly encouraged poor people to assume mortgage liabilities they could not afford, securitized the loans, and helped Wall Street to market them to naïve investors all over the world. The fact that 20 percent of mortgage brokers in Ohio had criminal records before the crisis testifies to the low quality of people who played a prominent role encouraging high risk lending. What was remarkable was the complicity of more reputable people at major Wall Street firms in taking this defective paper and securitizing it for ignorant investors. The role of the credit rating agencies was also appalling. At the peak in 2006, there were 64,000 collateralized debt obligations with triple-A ratings, while only twelve public companies of all the world's stock exchanges had a triple-A rating.

There are also guilty parties in the crisis who cannot be prosecuted because they are members of Congress. The leading example is Rep. Barney Frank (D-MA). He played a major role encouraging high-risk lending by government-sponsored enterprises in both his public speeches and private life. As an article in *Vogue* magazine during 1994 explained, Rep. Frank's lover and live-in partner during that decade was a senior Fannie Mae official, Herbert Moses, director of housing initiatives. It is very likely that their pillow talk led them to seek new ways of promoting home loans for America's poorest citizens. As result, the cause of the financial crisis was not just banker creed, easy monetary policy, or hyper aggressive securitization. It also was the inadvertent byproduct of a romantic dalliance between a powerful member of Congress and a Fannie Mae official which turned that insti-

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tution into a hedge fund owning more than \$1 trillion in sub-prime or Alt-A property loans. Moreover, the last president of Fannie Mae before the U.S. Treasury seized it, Daniel Mudd, went onto become the CEO of a leading hedge fund. There was a tremendous appetite for risk at Fannie which transformed anything on Wall Street.

The inability of the United States to effectively prosecute and incarcerate its financial criminals suggests that President Obama should seek international help. He should declare that U.S. bankers have committed crimes against humanity by causing twenty-five million people to lose their jobs. He should then ask the G20's English-speaking countries to open their courts and prisons to help the United States prosecute its financial criminals. Australia, Britain, and Canada could allow their courts to hear the cases. Australia has a long convict tradition and would probably welcome them as new citizens. There would be no better confirmation of how far the process of globalization has gone than for executives of Countrywide or Indymac to confront a high court judge in London, or for a thousand California mortgage fraudsters to serve time in an Australian prison.

As a result of the recent Democratic defeat in the Massachusetts Senate election, President Obama is searching for new forms of populism to regain his political standing. It is natural for him to bash bankers' bonuses and risk-taking activities. But he should also be focusing on punishing the people who are guilty of creating the crisis through fraud, deception, and lying to investors. The U.S. legal system has clearly failed to cope with the recent crisis. The government has not convicted any senior insiders, and there is inadequate space in California jails to house new prisoners. Mr. Obama should recognize the fact that the United States is unable to enforce its own laws and ask the G20's other English-speaking countries for help. ◆