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## Criminal Prosecutions and the 2008 Financial Crisis in the U.S. and Iceland: What Can a Small Town Icelandic Police Chief Teach the U.S. about Prosecuting Wall Street?

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CRIMINAL PROSECUTIONS AND THE 2008 FINANCIAL CRISIS IN THE U.S. AND ICELAND: WHAT CAN A SMALL TOWN ICELANDIC POLICE CHIEF TEACH THE U.S. ABOUT PROSECUTING WALL STREET?

JUSTIN REX\*

*Politicians, journalists, and academics alike highlight the paucity of criminal prosecutions for senior financial executives in the United States in the wake of the 2008 financial crisis. One common argument for the lack of prosecutions is that, though industry players behaved recklessly, they did not behave criminally. This Article evaluates this claim by detailing the civil and small number of criminal actions actually taken, and by reviewing leading arguments about whether behavior before the crisis was criminal. Rejecting the “reckless innocence” explanation, this Article provides examples of criminal behavior that could have been prosecuted and reviews the literature on why there were few cases made, despite potential criminal activity. Though scholars identify numerous explanations, this Article argues a combination of inadequate investigatory resources and regulatory capture offers the best explanation. This Article then explains Iceland’s different approach and why it successfully criminally prosecuted senior executives from its three largest banks, among others. Though the size of the two economies and the impact of the crisis for each explain a large part of the different roads taken, the independence and outsider status of Iceland’s prosecutor also contributed to, and is instructive for, how the U.S. could structure its regulatory apparatus, should it want to prioritize prosecutions in the future.*

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Well, first on the issue of prosecutions on Wall Street, one of the biggest problems about the collapse of Lehmans and the subsequent financial crisis and the whole subprime lending fiasco is that a lot of that stuff wasn't necessarily illegal, it was just immoral or inappropriate or reckless . . . I think part of people's frustrations, part of my frustration, was a lot of practices that should not have been allowed weren't necessarily against the law . . . . –Barack Obama<sup>1</sup>

[T]here are two fundamental reforms that we need; one is to get adequate capital, and two, to get far higher levels of enforcement fraud statutes. Existing ones—I'm not even talking about new ones. Things were being done which were certainly illegal and clearly criminal in certain cases, which in fraud is a fact. Fraud creates very considerable instability in competitive markets. If you cannot trust your counterparties, it won't work, and indeed we saw that it didn't. -Alan Greenspan<sup>2</sup>

<sup>1</sup> Press Release, The White House, Office of the Press Sec'y, News Conference by the President (Oct. 6, 2011) [hereinafter Obama Press Release] (on file with Concordia Law Review).

<sup>2</sup> Alan Greenspan, Former Chairman, U.S. Fed. Reserve, Address at A Return to Jekyll Island: The Origins, History, and Future of the Federal Reserve (Nov. 6, 2010).

## INTRODUCTION

In a 2013 poll, 53% of Americans believed the government had not sufficiently prosecuted bankers for their role in the financial crisis.<sup>3</sup> Is a call for prosecutions anything more than uninformed anger at business elites, or did the individuals who played a role in the crisis do so within, and perhaps despite, the existing legal boundaries? This Article weighs in on this debate in the context of the United States and Iceland. While the U.S. failed to prosecute any senior Wall Street executives for their role in the crisis, Iceland jailed executives at its three largest banks, among others. Though the two countries differ in many respects, including their economies, their different responses to financial crisis prosecutions offer an opportunity to consider what lessons, if any, Iceland might offer the U.S.

This Article outlines the criminal and civil actions against firms in the United States following the financial crisis. Despite the frequent use of civil fines and criminal prosecutions of lower level industry players and small firms, there were no criminal prosecutions for senior Wall Street executives. Next, this Article surveys the various reasons why. The simplest answer is that bankers behaved carelessly, but not criminally. Rejecting this “reckless innocence” explanation, this Article provides examples of criminal behavior that could have been prosecuted, followed by several more plausible reasons criminal prosecutions were found wanting. It then suggests that more criminal cases should have been opened, using Iceland as a case study for how this could feasibly have been achieved. An explanation of how and why Iceland was successful follows, along with economic, political, and cultural reasons explaining why the two countries chose such different paths. This Article concludes with a discussion of lessons Iceland offers the U.S. and the implications the lack of prosecutions has for accountability in financial sector governance in the U.S.

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<sup>3</sup> Michael Erman, *Five Years After Lehman, Americans Still Angry at Wall Street: Reuters/Ipsos Poll*, REUTERS (Sept. 15, 2013, 5:03 AM), <http://www.reuters.com/article/us-wallstreet-crisis-idUSBRE98E06Q20130915>.

## I. ACTIONS TAKEN: CRIMINAL PROSECUTION AND CIVIL ENFORCEMENT

A. *Criminal Prosecutions of Individuals*

Before reviewing the reasons why there were so few criminal prosecutions, it is worthwhile to take stock of what actions were taken. Though it is a popular conception that no individual has gone to jail as a result of actions relating to the financial crisis, the claim is misleading, but only mildly so. For example, the special inspector general for the Troubled Assets Relief Program (the primary bank bailout program post financial crisis) reported to Congress in 2016 that 35 bankers were sent to prison as a result of her office's fraud investigations.<sup>4</sup> Though many were individuals at smaller banks, a few top executives at banks with assets upwards of \$10 billion were also convicted. For example, Edward Woodard, the CEO of the Bank of the Commonwealth of Norfolk, was sentenced to 23 years for fraud.<sup>5</sup> However, these cases are from fraud in the use of bailout funds, not for actions that created the financial crisis.

Further, the Federal Bureau of Investigation (FBI) has been active in prosecuting mortgage fraud. According to a report by the Department of Justice (DOJ) Office of Inspector General, the FBI reached 2,760 convictions for mortgage fraud between 2009 and 2011.<sup>6</sup> However, these were relatively low-level individuals, including mortgage brokers, fraudulent buyers and appraisers, and fraudulent loan applicants.<sup>7</sup> A few higher level bankers were jailed in separate cases by the DOJ. Lee Farkas, chairman of Taylor, Bean & Whitaker, the twelfth largest mortgage lender at the time,<sup>8</sup> was convicted of fourteen counts for fraud and conspiracy by the DOJ in a \$2.9 billion scandal that included selling fraudulent loans to government agencies.<sup>9</sup> Additionally, Lorraine Brown, the CEO of a loan processing company, received five years in prison for helping banks with fraudulent paperwork related to subprime

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<sup>4</sup> Chris Isidore, *35 Bankers Were Sent to Prison for Financial Crisis Crimes*, CNN BUSINESS, (Apr. 28, 2016, 6:53 AM), <http://money.cnn.com/2016/04/28/news/companies/bankers-prison/>.

<sup>5</sup> *Id.*

<sup>6</sup> AUDIT DIV., U.S. DEP'T OF JUST., AUDIT REP. 14-12, AUDIT OF THE DEPARTMENT OF JUSTICE'S EFFORTS TO ADDRESS MORTGAGE FRAUD (2014).

<sup>7</sup> See Robert Quigley, *The Impulse Towards Individual Criminal Punishment After the Financial Crisis*, 22 VA. J. SOC. POL'Y & L. 103, 108 (2015).

<sup>8</sup> *Id.*

<sup>9</sup> Floyd Norris, *After Years of Red Flags, a Conviction*, N.Y. TIMES (Apr. 21, 2011), <http://www.nytimes.com/2011/04/22/business/22norris.html>.

home foreclosures in the wake of the crisis.<sup>10</sup> Though U.S. Attorneys considered criminal cases against executives at large failed mortgage lenders and banks, including Countrywide, Indymac, and Washington Mutual, as well as the insurance company American International Group (AIG), these were eventually closed without charges.<sup>11</sup>

On Wall Street, two mid-level traders at Credit Suisse were convicted in 2010 for misrepresenting investments, as well as a trader at Jeffries, LLC, who defrauded the government and investors by misrepresenting the price of mortgage-backed securities.<sup>12</sup> The most senior person for a Wall Street investment bank to go to prison was Kareem Serageldin,<sup>13</sup> who worked for Credit Suisse and was found guilty of falsifying records to his superiors related to mortgage trading.<sup>14</sup> However, his portrayal as a significant prosecution may be overstated. He was only middle management, his crime did not relate much to the crisis, and the victim was his employer, not the public.<sup>15</sup> The focus on Serageldin as the most senior Wall Street official to go to prison misses the point—he got so much attention because there was simply no one else to focus on.<sup>16</sup> In other instances, the DOJ was unsuccessful in its criminal prosecution of individuals, most prominently in the case of two Bear Sterns executives.<sup>17</sup> According to U.S. Attorney General Eric Holder, the DOJ did its best to prosecute, but the cases were too weak.<sup>18</sup>

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<sup>10</sup> Don Mayer et al., *Crime and Punishment (or the Lack Thereof) for Financial Fraud in the Subprime Mortgage Meltdown: Reasons and Remedies for Legal and Ethical Lapses*, 51 AM. BUS. L.J. 515, 516 n.5 (2014).

<sup>11</sup> GREGG BARAK, *THEFT OF A NATION: WALL STREET LOOTING AND FEDERAL REGULATORY COLLUDING* 86–87 (2012); see also Jason M. Breslow, *As Deadlines Loom for Financial Crisis Cases, Prosecutors Weigh Their Options*, PBS: FRONTLINE (Jan. 22, 2013), <http://www.pbs.org/wgbh/frontline/article/as-deadlines-loom-for-financial-crisis-cases-prosecutors-weigh-their-options/>.

<sup>12</sup> Todd Haugh, *The Most Senior Wall Street Official: Evaluating the State of Financial Crisis Prosecutions*, 9 VA. L. & BUS. REV. 153, 168–69 (2015).

<sup>13</sup> Jesse Eisinger, *Why Only One Top Banker Went to Jail for the Financial Crisis*, N.Y. TIMES MAG. (Apr. 30, 2014), [https://www.nytimes.com/2014/05/04/magazine/only-one-top-banker-jail-financial-crisis.html?\\_r=0](https://www.nytimes.com/2014/05/04/magazine/only-one-top-banker-jail-financial-crisis.html?_r=0).

<sup>14</sup> Haugh, *supra* note 12, at 157.

<sup>15</sup> *Id.* at 156.

<sup>16</sup> *Id.* at 157.

<sup>17</sup> See generally Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?*, N.Y. REV. BOOKS (Jan. 9, 2014), <http://www.nybooks.com/articles/2014/01/09/financial-crisis-why-no-executive-prosecutions/>.

<sup>18</sup> Eric Holder, Att’y Gen., National Press Club Luncheon with Attorney General Eric Holder (Feb. 17, 2015). U.S. Attorney General Holder further noted:

In early 2015, Holder gave U.S. Attorneys 90 days to come up with cases to charge individual Wall Street executives, but the deadline passed without any significant action due to the statute of limitations.<sup>19</sup> Based on these results, with only a few exceptions, there have been no significant criminal prosecutions for senior financial executives and their actions related to the financial crisis: “the number of criminal convictions of truly high-level executives related to the financial crisis stands at zero.”<sup>20</sup> This number stands in sharp contrast with Iceland’s aggressive stance, as well as the US’ prosecutorial aggression after the savings and loan crisis in the 1980s, after which over 1,000 individuals and executives who went to prison, despite that crisis being much smaller in magnitude.<sup>21</sup>

#### B. *Criminal Prosecution of Banks*

What about criminal prosecutions of banks rather than the individuals working for them? To punish banks, the DOJ relied primarily on non-prosecution agreements and deferred prosecution agreements, rather than criminal convictions. Non-prosecution agreements are agreements between the company and the DOJ that the company will take action to correct its wrongdoing.<sup>22</sup> Deferred prosecution agreements are stronger in that they

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So I think that what we have done has been appropriate. As I say, we have this ongoing examination of whether individual cases ought to be brought. But to the extent that individuals have not been prosecuted, people should understand it is not for lack of trying. These are the kinds of cases that people come to the Justice Department to make. Young people who want to be assistant U.S. attorneys in the southern district of New York and eastern district of Virginia, San Francisco, live for these big cases. The inability to make them, at least to this point, has not been as a result of a lack of effort.

*Id.*

<sup>19</sup> See Alison Fitzgerald, *Bankers From Major Institutions Still Haven’t Been Held Responsible for Financial Crash*, CTR. FOR PUB. INTEGRITY (May 22, 2015, 5:00 AM), <https://www.publicintegrity.org/2015/05/22/17377/bankers-major-institutions-still-havent-been-held-responsible-financial-crash>.

<sup>20</sup> Haugh, *supra* note 12, at 158.

<sup>21</sup> William D. Cohan, *How Wall Street’s Bankers Stayed Out of Jail*, ATLANTIC, <https://www.theatlantic.com/magazine/archive/2015/09/how-wall-streets-bankers-stayed-out-of-jail/399368/> (last visited Feb. 16, 2019). This Article returns to this point and whether the S&L crisis provides a fair point of comparison, below.

<sup>22</sup> See Len Lyons & Audra Marino, *Deferred Prosecution Agreements, Non-Prosecution Agreements and Monitoring Services*, MARCUM, <http://www.marcumllp.com/insights-news/deferred-prosecution-agreements-non-prosecution-agreements-and-monitoring-services> (last visited Feb. 16, 2019).

involve the DOJ filing criminal charges in court but agreeing to withdraw them pending corporate reforms and the appointment of an outside party to monitor compliance with the terms of the agreement.<sup>23</sup> Both usually include large criminal fines. After being used against banks and financial institutions rarely between 2001 and 2014, the use of non-prosecution agreements jumped dramatically in 2015 to 80.<sup>24</sup> Yet, these agreements rarely target individuals working for the institutions.<sup>25</sup> Further, the rise in recent agreements serves as a poor proxy for actions related to the financial crisis, as most are unrelated to it. Most of the agreements in 2015 instead resulted from a large effort by the DOJ Tax Division to fight illegal tax shelters.<sup>26</sup> The first time the DOJ obtained admissions of guilt for criminal charges after the financial crisis was in 2015, in a case unrelated to the financial crisis.<sup>27</sup> Citicorp, JPMorgan Chase & Co., Barclays Plc, and Royal Bank of Scotland Plc all paid fines of \$5.8 billion for colluding to manipulate currency markets.<sup>28</sup> To see actions by the DOJ and other regulators related to the financial crisis, it is necessary to look to civil, not criminal, penalties.

### C. *Civil Penalties for Individuals and Banks*

Instead of criminal charges, the government has relied primarily on civil penalties to hold banks accountable for their actions related to the financial crisis. According to U.S. Securities and Exchange Commission (SEC) reports, the agency was responsible for settlements against hundreds of individuals and organizations to the tune of several billion dollars in fines.<sup>29</sup> Table 1 below is taken from that SEC report.

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<sup>23</sup> *Id.*

<sup>24</sup> Brandon Garrett, *The Rise of Bank Prosecutions*, 126 YALE L.J.F. 33, 36–37 (2016). Prior to 2010, fewer than non-prosecution agreements were used at a rate of less than 10 per year. *Id.*

<sup>25</sup> *Id.* at 46.

<sup>26</sup> *Id.* at 38.

<sup>27</sup> See Fitzgerald, *supra* note 19.

<sup>28</sup> David McLaughlin et al., *Six Banks Pay \$5.8 Billion, Five Guilty of Market Rigging*, BLOOMBERG (last updated May 20, 2015, 10:56 AM), <https://www.bloomberg.com/news/articles/2015-05-20/six-banks-pay-5-8-billion-five-plead-guilty-to-market-rigging>.

<sup>29</sup> See *SEC Enforcement Actions: Addressing Misconduct That Led To or Arose From the Financial Crisis*, U.S. SECURITIES AND EXCHANGE COMMISSION, <https://www.sec.gov/spotlight/enf-actions-fc.shtml> (last modified Feb. 22, 2017). Interestingly, many of these cases are against repeat offenders who promised not to do the same thing again in past settlements with the SEC; see Edward Wyatt, *Promises Made, and Remade, by Firms in S.E.C. Fraud Cases*, N.Y. TIMES (Nov. 7, 2011),

**Table 1**<sup>30</sup>

Number of Entities and Individuals Charged	204
Number of CEOs, CFOs, and Other Senior Corporate Officers Charged	93
Number of Individuals Who have Received Officer and Director Bars, Industry Bars, or Commissions Suspensions	54
Penalties Ordered or Agreed To	> \$.193 billion
Disgorgement and Prejudgment Interest Ordered or Agreed To	> \$1.47 billion
Additional Monetary Relief Obtained for Harmed Investors	\$418 million
Total Penalties, Disgorgement, and Other Monetary Relief	> \$3.76 billion

According to an analysis that tried to capture fines from all regulators, banks have paid out fines in excess of \$204 billion.<sup>31</sup> A similar analysis found that,

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<http://www.nytimes.com/2011/11/08/business/in-sec-fraud-cases-banks-make-and-break-promises.html>.

<sup>30</sup> *SEC Enforcement Actions: Addressing Misconduct That Led To or Arose From the Financial Crisis*, *supra* note 29 (statistics current as of Oct. 7, 2016). Table was taken directly from source. *Id.* The “Additional Monetary Relief Obtained for Harmed Investors” came from “settlements with Evergreen, J.P. Morgan, State Street, TD Ameritrade, and Claymore Advisors.” *Id.*

<sup>31</sup> Jeff Cox, *Misbehaving Banks Have Now Paid \$204B in Fines*, CNBC (Oct. 30, 2015, 1:58 PM), <http://www.cnbc.com/2015/10/30/misbehaving-banks-have-now-paid-204b-in-fines.html>. This calculation includes all settlements in the financial crisis era since 2009, so it probably overstates the size of settlements related directly to the financial crisis. *Id.* However, the data also does not include settlements under \$100 million, so it understates the total as well. *Id.*

in 100 mortgage-related settlements since 2009, banks have paid \$164 billion in fines.<sup>32</sup> The largest offenders are listed in Table 2.

**Table 2**<sup>33</sup>

Company	Total Settlements	Sums paid (\$billions)
Bank of America	24	\$71.23
JPMorgan Chase	13	\$31.07
Citigroup	9	\$12.26
Wells Fargo	8	\$10.56
Deutsche Bank	2	\$9.13
Morgan Stanley	9	\$7.92
Goldman Sachs	7	\$7.26
Credit Suisse	3	\$6.28

One final way to measure the financial impact of the crisis on firms is the cost of litigation, which for the largest financial firms, hit \$306 billion for the years between 2010 and 2015.<sup>34</sup>

## II. WHY WERE THERE SO FEW CRIMINAL PROSECUTIONS?

### A. *Careless, Not Criminal*

The most consistent answer to this question from most politicians and banks is that executives did not engage in any criminal behavior related to the crisis. In other words, there were few criminal prosecutions because there was little to prosecute. Perhaps executives made poor decisions, but they presented the argument that stupidity, ignorance, recklessness, and

<sup>32</sup> Dealbook, *Where Does the Mortgage Settlement Money Go?*, N.Y. TIMES (Dec. 23, 2016), <http://www.nytimes.com/2016/12/23/business/dealbook/24mortgagelist.html>.

<sup>33</sup> *Id.*

<sup>34</sup> Ben McLannahan, *Banks' Post-Crisis Legal Costs Hit \$300bn*, FIN. TIMES, (June 8, 2015, 12:04 AM), <https://www.ft.com/content/debe3f58-0bd8-11e5-a06e-00144feabdc0>.

decisions that turned out poorly in retrospect cannot be criminalized. This general claim has been made by a variety of people, most notably by the President of the United States, Barack Obama. During a 2011 press conference, the President argued that:

Well, first on the issue of prosecutions on Wall Street, one of the biggest problems about the collapse of Lehmans and the subsequent financial crisis and the whole subprime lending fiasco is that a lot of that stuff wasn't necessarily illegal, it was just immoral or inappropriate or reckless. That's exactly why we needed to pass Dodd-Frank, to prohibit some of these practices.

The financial sector is very creative and they are always looking for ways to make money. That's their job. And if there are loopholes and rules that can be bent and arbitrage to be had, they will take advantage of it. So without commenting on particular prosecutions—obviously that's not my job; that's the Attorney General's job—I think part of people's frustrations, part of my frustration, was a lot of practices that should not have been allowed weren't necessarily against the law, but they had a huge destructive impact. And that's why it was important for us to put in place financial rules that protect the American people from reckless decision-making and irresponsible behavior.<sup>35</sup>

When speaking about his efforts, U.S. Attorney General Eric Holder argued that the prosecutorial effort was there, but the cases were not. “The inability to make [cases], at least to this point, has not been as a result of a lack of effort.”<sup>36</sup> Under Holder, the head of the DOJ Criminal Division, Lanny Breuer, argued similarly by saying “[i]f there had been a case to make, we would have brought it. I would have wanted nothing more, but it doesn't work that way.”<sup>37</sup> Breuer said during a *60 Minutes* interview, “I get it. I find the excessive risk taking to be offensive. . . . I may personally share the same frustration that American people all over the country are feeling, that in and of itself doesn't mean we bring a criminal case.”<sup>38</sup>

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<sup>35</sup> Obama Press Release, *supra* note 1.

<sup>36</sup> Cohan, *supra* note 21.

<sup>37</sup> Ben Protess, *Breuer Reflects on Prosecutions That Were, and Weren't*, N.Y. TIMES (Feb. 28, 2013, 8:49 PM), <https://dealbook.nytimes.com/2013/02/28/breuer-reflects-on-prosecutions-that-were-and-werent>.

<sup>38</sup> *60 Minutes*, *Prosecuting Wall Street*, CBS NEWS (Dec. 5, 2011), <http://www.cbsnews.com/news/prosecuting-wall-street/>.

Further, many of the transactions during the housing bubble were between sophisticated investors in which one party made a bad bet.<sup>39</sup> Trades that large Wall Street banks made where they handpicked bad assets and packaged them in investments and sold them to investors are cases of poor decisions on the investors who bought them, not illegal transactions. Because both parties were sophisticated, the idea that one party was duped by another is suspect. Rather, the sophisticated parties had different views about the future performance of particular securities.<sup>40</sup> Referring to a case that Citibank settled, one commentator argued “even really bad deals like Citigroup’s, aren’t illegal. They’re not criminal. They’re not inherently fraudulent. If Citigroup’s clients, all of them sophisticated institutional investors, were foolish or careless enough to buy what Citigroup sold them, then arguably they deserved their losses.”<sup>41</sup> Simply put, under current law, alleged “negligence, recklessness, [and] failure to supervise for those who control the levers of financial institutions” are not serious crimes.<sup>42</sup>

Similarly, more theoretically-driven arguments from academics make the case that the crisis was not a product of criminal behavior; hence, criminal prosecutions should not be expected. According to U.S. Circuit Judge Richard Posner, misaligned incentives encouraged the reckless behavior that led to individually rational decisions that in turn led to collectively irrational and disastrous outcomes.<sup>43</sup> For example, though the deterioration of lending

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<sup>39</sup> Samuel W. Buell, *Is the White Collar Offender Privileged?*, 63 DUKE L.J. 823, 847 (2014).  
<sup>40</sup> *Id.*

<sup>41</sup> James B. Stewart, *Few Avenues for Justice in the Case Against Citi*, N.Y. TIMES (Dec. 2, 2011), <https://www.nytimes.com/2011/12/03/business/few-avenues-for-justice-in-the-citi-case.html?mtrref=www.bing.com&gwh=2B41B1843AFD303B40FD02649FF594DB&gwt=pay>. Lanny Breuer argues the same when discussing similar transactions:

In a criminal case...I have to prove not only that you made a false statement but that you intended to commit a crime, and also that the other side of the transaction relied on what you were saying. And frankly, in many of the securitizations and the kinds of transactions we’re talking about, in reality you had very sophisticated counterparties on both sides. And so even though one side may have said something was dark blue when really we can say it was sky blue, the other side of the transaction, the other sophisticated party, wasn’t relying at all on the description of the color.

Rakoff, *supra* note 17.

<sup>42</sup> See Buell, *supra* note 39, at 853. Others argue that there are laws that criminalize these very things. See *infra* notes 48–75.

<sup>43</sup> See RICHARD A. POSNER, *A FAILURE OF CAPITALISM: THE CRISIS OF ‘08 AND THE DESCENT INTO DEPRESSION* (2009). Posner does not actually link his argument to the debate about financial crisis prosecutions, but the link follows logically from his primary explanatory

standards was collectively dangerous, it was individually rational for lenders to continue or be driven out of business.<sup>44</sup> Others argue that the crisis was a product of mistaken beliefs, cognitive failures,<sup>45</sup> and flawed human psychology that explained away signs of a brewing crisis, combined with irrational exuberance that the housing market would not collapse.<sup>46</sup> The crisis can also be explained as a “normal accident” that resulted from complex and tightly-coupled technology and relationships in the financial sector, rather than fraud or weak regulation.<sup>47</sup> Though these theorists explain the crisis in a way that minimizes the role of illegal behavior, others argue fraud is not possible in an efficient market. According to legal and economic scholars, who take the “fraud minimalist position,” fraud cannot exist for long in a competitive market because competitive pressures would unearth fraudulent information and force duplicitous actors and firms out of business.<sup>48</sup> This view may go as far as to suggest we may not even need laws for fraud.<sup>49</sup>

The argument that there were no prosecutions because the conduct was not criminal has been critiqued by a wide variety of scholars. For U.S. District Judge Jed Rakoff, the claim is suspicious on its face. Before the crisis, reports of mortgage fraud skyrocketed, and in 2004, the FBI issued warnings of a growing mortgage fraud epidemic; and these fraudulent loans spread throughout the financial system.<sup>50</sup> Additionally, Judge Rakoff argues that the

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mechanism for the crisis; people behaving rationally within a system of misaligned incentives can cause a crisis without engaging in criminal behavior.

<sup>44</sup> For a discussion of the system’s perverse incentives, see *id.* ch. 1–2.

<sup>45</sup> See generally Arnold Kling, *The Financial Crisis: Moral Failure or Cognitive Failure*, 33 HARV. J.L. & PUB. POL’Y 507 (2010). Kling argues key actors in the market believed things that turned out to be wrong. *Id.* at 508. Regulators believed the same things, and thus did not crack down more on risky industry practices. *Id.*

<sup>46</sup> Quigley, *supra* note 7, at 145–47.

<sup>47</sup> See Donald Palmer & Michael W. Maher, *The Mortgage Meltdown as Normal Accidental Wrongdoing*, 8 STRATEGIC ORG. 83, 88 (2010). Though others have treated normal accidents and moral wrongdoing as mutually exclusive, they do not think they need to be treated as such. *Id.* Wrongdoing can contribute to normal accidents, and normal accidents can encourage wrongdoing, which can lead law enforcement to be more attentive to cracking down on wrongdoing. *Id.* For a contrasting perspective from the originator of the concept of normal accidents, see Charles Perrow, *The Meltdown Was Not an Accident*, in 30A MARKETS ON TRIAL: THE ECONOMIC SOCIOLOGY OF THE U.S. FINANCIAL CRISIS: PART A 309 (Paul M. Hirsch & Michael Lounsbury eds., 2010).

<sup>48</sup> Henry N. Pontell et al., *Too Big to Fail, Too Powerful to Jail? On the Absence of Criminal Prosecutions After the 2008 Financial Meltdown*, 61 CRIME, LAW AND SOCIAL CHANGE 1, 5 (2014) [hereinafter *Too Big to Fail, Too Powerful to Jail?*].

<sup>49</sup> *Id.*

<sup>50</sup> Rakoff, *supra* note 17.

Financial Crisis Inquiry Commission's official report on the causes of the crisis mentions fraud frequently.<sup>51</sup> Given evidence of billowing smoke throughout the housing market and financial system, can one not find fire?

Moreover, attempts to undertake criminal prosecutions were mitigated due to inadequate resources and competing priorities at the FBI and DOJ.<sup>52</sup> Put differently, resources and prioritization of other types of cases, rather than the absence of criminal behavior, could explain under prosecution of criminal behavior related to the crisis. Prosecutors also make decisions about whether to pursue civil or criminal cases. White-collar criminologists do not make a strong distinction between civil and criminal cases.<sup>53</sup> Prosecutors may pursue civil actions for a variety of reasons unrelated to the criminal substance of the offender's actions: from ease and lack of resources, to the desire to inspire public confidence with swift civil action. Thus, the large civil penalties were a choice, not necessarily an indication that criminal conduct was minimal.<sup>54</sup>

These general arguments beg for more specificity. Based on the available evidence, can the case be made that particular financial industry actions violated criminal fraud statutes at the time? A variety of scholars have made this case.<sup>55</sup> The arguments are too many to detail here, but a few will suffice to make the point that there is substantial evidence of cases that could have been pursued.

One area many scholars have pointed to for criminal behavior is investment banks' sale of mortgage securities called Collateralized Debt Obligations (CDO).<sup>56</sup> For example, as the crisis began to unfold, Goldman

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<sup>51</sup> *Id.*

<sup>52</sup> *Id.* For more detailed discussion on this point, see *infra* Section II(F).

<sup>53</sup> See EDWIN H. SUTHERLAND, WHITE COLLAR CRIME: THE UNCUT VERSION (1983).

<sup>54</sup> JOHN HAGAN, WHO ARE THE CRIMINALS? THE POLITICS OF CRIME POLICY FROM THE AGE OF ROOSEVELT TO THE AGE OF REAGAN 44–46 (rev. ed. 2012).

<sup>55</sup> See *infra* notes 56–76.

<sup>56</sup> See generally FINANCIAL CRISIS INQUIRY COMMISSION, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES (2011). CDOs are a tiered financial product divided into tranches, according to level of risk. *Id.* at 43. In the case of the financial crisis, CDO tranches were composed of pools of Mortgage Backed Securities, which were in turn composed of pools of mortgages. *Id.* at 117–18. The top tranche was composed of the safest mortgages or mortgage pools (usually rated AAA by the rating agencies, a rating only a few companies and US government treasury bonds enjoyed), and lower tranches rated BBB and below, according to the risk of the mortgages the tranche contained. *Id.* at 71. The lower the tranche, the higher the interest payment to investors. *Id.* The monthly payments of homeowners were funneled through the security tranches to investors. *Id.* at 13. If

Sachs realized it had a lot of soon-to-be worthless housing assets that it wanted to unload (such as the Hudson CDO, which it was able to sell to investors).<sup>57</sup> Though it included assets on Goldman's books, the CDO prospectus describing the product explicitly stated in the sales statement that it was not composed of assets on the firm's balance sheet.<sup>58</sup> This statement is important because, at that point in time, buyers were wary of buying assets that were being unloaded by institutions, suggesting that a more accurate disclosure may have prevented Goldman from making the sale.<sup>59</sup> This omission violates Rule 10b-5 of the 1934 Securities Exchange Act.<sup>60</sup> The Hudson deal had the essential elements of the offense: "it must be a misstatement of omission that is sufficiently material to affect an investor's opinion; that it is made intentionally; that the investor relied upon in making his decision; and that directly caused actual losses."<sup>61</sup>

Others have made similar cases against Goldman for securities deals as well as similar securities sold by other large banks.<sup>62</sup> Securities fraud statutes could be used to go after mortgage-related securities and actors all along the securitization chain, from mortgage originators, who misrepresented the assets when they sold loans to securitizers, to those who packaged these mortgaged backed securities into more complex mortgage securities (CDOs), and the misrepresentations related to the sale of insurance on these CDOs.<sup>63</sup>

Another missed opportunity was criminal prosecution of Angelo Mozilo, the head of Countrywide, one of the largest subprime lenders before the crisis. Mozilo's civil settlement with the SEC resulted in a \$22.5 million fine, though it was small in comparison to his \$500 million salary while

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homeowners began to default, those in the bottom tranches were first to stop receiving payments. *Id.* at 43, 145.

<sup>57</sup>See U.S. S. PERMANENT SUBCOMM. ON INVESTIGATIONS, WALL STREET AND THE FINANCIAL CRISIS: ANATOMY OF A FINANCIAL COLLAPSE 7–11 (2011), [http://hsgac.senate.gov/public/\\_files/Financial\\_Crisis/FinancialCrisisReport.pdf](http://hsgac.senate.gov/public/_files/Financial_Crisis/FinancialCrisisReport.pdf).

<sup>58</sup> CHARLES H. FERGUSON, PREDATOR NATION: CORPORATE CRIMINALS, POLITICAL CORRUPTION, AND THE HIJACKING OF AMERICA 133–34 (2012).

<sup>59</sup> *Id.*

<sup>60</sup> *Id.* at 191.

<sup>61</sup> *Id.*

<sup>62</sup> *Id.* at 133, 192 (discussing Goldman's Hudson and Timberwolf deals); *see also* Mayer et al., *supra* note 10, at 552 (arguing that Goldman's Abacus deal is a clear example of securities fraud); *see also* Rakoff, *supra* note 17 (arguing Deutsche Bank committed securities fraud in the sale of some of its CDOs).

<sup>63</sup> FERGUSON, *supra* note 58, at 191–92.

working for the company between 2000 and 2008.<sup>64</sup> According to the SEC settlement, Mozilo misled investors by not disclosing the inherent risk of Countrywide's mortgage products; a risk he acknowledged privately, but not publicly.<sup>65</sup> In emails, Mozilo described the products as "toxic" and said there was no way to accurately predict their performance, though he heralded these products publicly.<sup>66</sup> A variety of scholars and legal professionals argue this conduct was worthy of criminal prosecution.<sup>67</sup>

Scholars also argue for prosecutions for a variety of other actors, including Lehman,<sup>68</sup> AIG,<sup>69</sup> the ratings agencies,<sup>70</sup> various loan securitizers,<sup>71</sup> and a variety of executives who lied during congressional testimony.<sup>72</sup> Charles Ferguson, Mary Kreiner Ramirez, and Steven Ramirez make the most comprehensive case, documenting potential crimes related to: securities fraud, accounting fraud, mail fraud, bribery, perjury, Sarbanes-Oxley certifications of false statements, RICO offenses, antitrust violations, federal

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<sup>64</sup> See Colin Maher, *Crisis Not Averted: Lack of Criminal Prosecutions Leave Limited Consequences for Those Responsible for the Financial Crisis*, 39 NEW ENG. J. ON CRIM. & CIV. CONFINEMENT 459, 463 (2013).

<sup>65</sup> *Id.* at 472.

<sup>66</sup> *Id.* at 472–73.

<sup>67</sup> See HAGAN, *supra* note 54 (arguing that this behavior qualifies under even the most basic definitions of criminal fraud); see also Maher, *supra* note 64, at 463–65 (arguing the DOJ could use the same provisions in the Securities and Exchange Act the SEC used in its settlement); see also Marty Robins, *Why Have Top Executives Escaped Prosecution?*, N.Y. REV. BOOKS at *Jed S. Rakoff replies* (April 3, 2014) (agreeing that Mozilo could be prosecuted under securities fraud statutes and adds that statutes for bank fraud, mail fraud, and wire fraud also criminalize false statements about mortgage-backed securities); but see Matthew Goldstein, *Angelo Mozilo Will Not Face U.S. Charges for Mortgage Fraud*, N.Y. TIMES (June 17, 2016), [https://www.nytimes.com/2016/06/18/business/angelo-mozilo-will-not-face-us-charges-for-mortgage-fraud.html?\\_r=0](https://www.nytimes.com/2016/06/18/business/angelo-mozilo-will-not-face-us-charges-for-mortgage-fraud.html?_r=0) (arguing the DOJ obviously decided not to pursue criminal prosecution); *contra* Michael Levi, *Commentary*, 42 CONTEMP. SOC. 683–86 (2013) (arguing that Mozilo was responding to pressures of the market to keep him in business, albeit in a reckless way).

<sup>68</sup> See Ben Protess & Susanne Craig, *Inside the End of the U.S. Bid To Punish Lehman Executives*, N.Y. TIMES (Sept. 8, 2013, 8:57 PM), <https://dealbook.nytimes.com/2013/09/08/inside-the-end-of-the-u-s-bid-to-punish-lehman-executives/>.

<sup>69</sup> See YVES SMITH, *ECONNED: HOW UNENLIGHTENED SELF INTEREST UNDERMINED DEMOCRACY AND CORRUPTED CAPITALISM* (2010).

<sup>70</sup> HAGAN, *supra* note 54, at 208.

<sup>71</sup> Quigley, *supra* note 7, at 140–41.

<sup>72</sup> HAGAN, *supra* note 54. In trying to refute the claim they bet against their clients, Goldman CEO Lloyd Blankfein said Goldman did not in fact bet against its clients and did not have massive short position, when there is abundant documentation these claims are false from the SEC's settlement. Further, Goldman's own documents refer to being short thousands of times.

aid disclosure regulations, and a variety of personal conduct offenses, like drug use.<sup>73</sup> These actions all took place within what white-collar crime scholars call a criminogenic environment at particular banks<sup>74</sup> and the broader mortgage lending and securitization industry.<sup>75</sup> Perhaps the most blatant example of crime, and a telling example of the government's unwillingness to pursue even the most straightforward case, is the foreclosure crisis that followed the housing crisis. Despite being a relatively easy case to make, the government backed down and settled with major banks involved. According to Mayer et al.,:

[T]he February 2012 fraudulent mortgage foreclosure settlement—well within any statute of limitations—is sufficient evidence that the government is not all that serious about pursuing criminal charges against any major bank or high-level bank employee: robo-signing and false affidavits made to the courts are historically the stuff of which perjury convictions are made. That is, there are enough smoking guns in the HUD Inspector General's report to signal a firestorm of fraud. Yet it appears that when the stakes are high to the banking industry, even though the fraud is clear, manifest, and easily documented, the federal government will yield to lobbying and highly paid lawyering, declare victory for the public, and move on.<sup>76</sup>

One might counter-argue that the above accounts amount to little more than “armchair prosecution,” which elides the difficult realities of gathering evidence, making a detailed case before a jury, and meeting the high burden of proof for criminal cases, beyond a reasonable doubt. To some extent this criticism is fair, and this Article returns to this question in more detail below. However, a similar argument could be made in response; without actually attempting more criminal cases against financial executives, the argument that prosecutions are too difficult is untested as well and amounts to “armchair non-prosecution.” In previous white-collar crime cases, prosecutors were able to gather the necessary evidence to convict

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<sup>73</sup> FERGUSON, *supra* note 58, at 190. See also MARY KREINER RAMIREZ & STEVEN A. RAMIREZ, *THE CASE FOR THE CORPORATE DEATH PENALTY: RESTORING LAW AND ORDER ON WALL STREET* (2017).

<sup>74</sup> Mayer et al., *supra* note 10, at 537–48 (arguing that Ameriquest and Countrywide were committing fraud on a daily basis, making it part of their organizational culture and practice).

<sup>75</sup> *Too Big to Fail, Too Powerful to Jail?*, *supra* note 47, at 3.

<sup>76</sup> Mayer et al., *supra* note 10, at 573.

white-collar criminals; doing so is more a function of effort than the particularities of the case.<sup>77</sup> Regardless, the above examples suggest that many market actors went beyond acting rationally within the scope of existing law, stepping outside it to enhance their own gains. Perhaps these cases would not stick in court, but we will never know because so many of them were not pursued, were dropped, or were punished through civil suits. Together, these suggest the reckless innocence excuse is weaker than its proponents suggest. If cases were actually there to be litigated, but were not, it is necessary to probe further into why there were few prosecutions because the argument for reckless innocence is an insufficient explanation.

#### B. *Prosecutorial Choice*

There are several reasons prosecutors may prefer civil over criminal cases, even in cases of suspected criminal wrongdoing. Suits related to mortgage fraud may be filed in civil rather than criminal courts to get restitution for victims, rather than stigmatize actors with criminal penalties.<sup>78</sup> Additionally, civil cases are easier to pursue, and can be brought more often.<sup>79</sup> The higher burden of proof for criminal cases may deter risk-averse prosecutors who want to make an easier, quicker case to impose civil fines.<sup>80</sup> Civil cases do not need a unanimous jury,<sup>81</sup> and juries tend to be more sympathetic to victims in civil cases where money, rather than jail time, is the punishment.<sup>82</sup> Additionally, in a civil case, the victim and her claims are the central issue, rather than being sidelined as a witness for a criminal case. Further, defendants must testify in a civil case because they cannot exercise their Fifth Amendment privilege against self-incrimination.<sup>83</sup> Lastly, as a practical matter, it is not clear whether criminal prosecutions for white-collar offenders are the best approach to deter crime. Some scholars argue we do not have the evidence to answer whether criminal prosecution is an effective deterrent for white-collar crime.<sup>84</sup> Other scholars are less ambivalent, arguing

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<sup>77</sup> Daniel C. Richman, *Corporate Headhunting*, 8 HARV. L. & POL'Y REV. 265, 269 (2014).

<sup>78</sup> HAGAN, *supra* note 5454, at 198.

<sup>79</sup> Sally S. Simpson, *Commentary*, 42 CONTEMP. SOC. 674, 675 (2013).

<sup>80</sup> BARAK, *supra* note 11, at 126.

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

<sup>84</sup> Simpson, *supra* note 79, at 675 ("White-collar crime scholars presume that punishment works, that criminal punishment works best, and that corporate criminals are particularly sensitive to criminal legal sanctions. This is an empirical question that has not been

for or against effective deterrence, but the claims either way admittedly lack strong empirical evidence.<sup>85</sup>

### C. *Statute of Limitations*

Another constraint for prosecutions is the statute of limitations. There is a five-year statute of limitations for most relevant federal criminal provisions.<sup>86</sup> Under the Securities and Exchange Act of 1934, as amended by Sarbanes-Oxley in 2002, prosecutors have two years after discovery to act or five years after the violation (whichever is earlier) to file charges.<sup>87</sup> Most of the potential criminal behavior happened in 2005 and 2006, so by the time the federal government started seriously investigating mortgage fraud in 2012, the five-year window had passed.<sup>88</sup> There is a ten-year statute of limitations for fraud and false statements related to financial institutions for mail, wire, and bank fraud statutes if the fraud affects a financial institution.<sup>89</sup> The time has run out for these as well. The statute of limitations is much longer for organized crime statutes,<sup>90</sup> but few have argued for prosecutions using them.<sup>91</sup> Consequently, going forward there may be a need to change the statute of limitations for bank prosecutions.<sup>92</sup>

### D. *Too Big to Jail*

Attorney General Eric Holder worried that some financial institutions were too big to prosecute criminally given the potential detrimental macroeconomic impacts. During congressional testimony, Holder argued, “[i]t does become difficult for us to prosecute them when we are hit with

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adequately answered.”); *see also* HAGAN, *supra* note 54, at 689 (“[W]e have much to learn about the relationship between financial crimes and their deterrence through criminal law enforcement.”).

<sup>85</sup> *See* Tristan R. Brown, *Nobody Goes to Jail: The Economics of Criminal Law, Securities Fraud, and the 2008 Recession*, 41 *NEW ENG. J. ON CRIM. & CIV. CONFINEMENT* 343 (2015) (using a law and economics approach and cost benefit analysis to argue that criminal prosecutions would be an effective deterrent in the cases of financial crisis); *see also* IAN AYRES & JOHN BRAITHWAITE, *RESPONSIVE REGULATION: TRANSCENDING THE DEREGULATION DEBATE* (1992) (commenting on responsive regulation as an alternative to criminal punishment to achieve corporate reforms for white-collar deviance).

<sup>86</sup> Richman, *supra* note 77, 265–66.

<sup>87</sup> BARAK, *supra* note 11, at 96.

<sup>88</sup> *See* Cohan, *supra* note 21.

<sup>89</sup> Haugh, *supra* note 12, at 194.

<sup>90</sup> Richman, *supra* note 77, at 265–66.

<sup>91</sup> FERGUSON, *supra* note 58, at 190, 202 (making a brief case for using RICO provisions).

<sup>92</sup> Garrett, *supra* note 24, at 47.

indications that if you do prosecute—if you do bring a criminal charge—it will have a negative impact on the national economy, perhaps even the world economy.”<sup>93</sup> His view dates back to a 1999 memorandum, since labeled the Holder Doctrine, where he argued that prosecutors need to consider the collateral consequences for prosecuting large financial firms.<sup>94</sup> Lanny Breur, the head of the DOJ Criminal Division, echoed this sentiment in 2012 when he said in a speech that prosecutors must consider the risks to the company, industry, and to the U.S. economy.<sup>95</sup> Holder later retracted these comments during congressional testimony in 2013, stating that banks are not above prosecution if the circumstances warrant.<sup>96</sup>

This fear of prosecution also has roots in the failure of the accounting firm Arthur Anderson, which collapsed after a DOJ criminal prosecution for its role in the Enron scandal during the early 2000s.<sup>97</sup> Also, no major financial firm has ever survived such criminal charges.<sup>98</sup> Additionally, relatively innocent parties, like workers who would lose their jobs, and shareholders, may pay the consequences of corporate criminal prosecution.<sup>99</sup> It is not clear whether these fears and the doctrine based on them are considered to be a well-founded excuse in the case of large financial institutions, though one analysis thought JP Morgan could withstand a criminal charge.<sup>100</sup> Further, critics counter that this worry may apply to prosecuting *institutions*, but not *individuals* working for these institutions.<sup>101</sup> Criminal prosecutions of executives would likely not bring down the institution,<sup>102</sup> and financial regulators suspend or bar individuals from participating in the financial industry regularly. Regardless, in part as a result of these concerns, the DOJ

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<sup>93</sup> Rakoff, *supra* note 17; *cf.* SIMON JOHNSON & JAMES KWAK, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN (2010) (noting that the reason these banks are so large is that elected officials of both political parties spent the past several decades passing deregulatory legislation that allowed financial institutions to grow ever larger).

<sup>94</sup> Cohan, *supra* note 2121.

<sup>95</sup> *Id.*

<sup>96</sup> See Court E. Golumbic & Albert D. Lichy, *The “Too Big to Jail” Effect and the Impact on the Justice Department’s Corporate Charging Policy*, 65 HASTINGS L.J. 1293, 1323 (2014).

<sup>97</sup> *Id.* at 1306.

<sup>98</sup> *Too Big to Fail, Too Powerful to Jail?*, *supra* note 48, at 9.

<sup>99</sup> See Jessica Silver-Greenberg & Ben Protess, *Criminal Action is Expected for JPMorgan in Madoff Case*, N.Y. TIMES (December 11, 2013, 10:01 PM), <https://nyti.ms/2FY5qVi>.

<sup>100</sup> *Id.*

<sup>101</sup> Rakoff, *supra* note 17.

<sup>102</sup> See *id.*

has adopted alternative practices for handling corporate criminals, as discussed in the next section.

E. *DOJ Alternatives to Criminal Prosecution*

Since the early to mid-2000s, the DOJ has increasingly relied on deferred prosecution agreements (DPAs) and non-prosecution agreements (NPs) as alternatives to prosecuting individuals or firms criminally.<sup>103</sup> Historically, the DOJ prioritized criminal prosecutions of individuals until the 1980s.<sup>104</sup> Recognizing the changing way prosecutors were approaching mafia cases, which attempted to bring down an entire criminal organization rather than individual mafia members, the shift to go after whole institutions, rather than individuals, was thought of as a step up in terms of the severity of the punishment and the magnitude of the case.<sup>105</sup> Similar to the development of the Holder Doctrine, the failure of Arthur Anderson and other major corporate prosecutions from the early 2000s led officials to worry that the DOJ was being too aggressive, and internal memos shifted the approach.<sup>106</sup> As an attempt to find a middle ground between an indictment and no charges, the DOJ increasingly relied on DPAs.<sup>107</sup> This approach allowed the DOJ to extract big settlements and use the threat of an indictment to require internal changes to the corporation, while allowing firms to avoid criminal prosecution as long as they follow through on the stipulated reforms.<sup>108</sup> Typically, the DOJ will do enough research and investigation to find behavior that appears criminal, and use this as leverage to extract a fine from the institution.<sup>109</sup> Take, for example, the case of J.P. Morgan's DPA in 2013, the first for a major Wall Street bank, which stemmed from its role in facilitating Bernie Madoff's Ponzi scheme.<sup>110</sup> The bank agreed to the government's facts, but the DOJ did not push for a guilty plea.<sup>111</sup> J.P. Morgan agreed to pay several billion dollars in fines, \$1 billion of which went to compensate Madoff's victims.<sup>112</sup> Supporters of this approach argue these agreements

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<sup>103</sup> For a detailed discussion of these agreements, *see supra* Section I(B).

<sup>104</sup> *See* Eisinger, *supra* note 13.

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

<sup>108</sup> *See* Cohan, *supra* note 21.

<sup>109</sup> *Id.*

<sup>110</sup> *See* Silver-Greenberg & Protess, *supra* note 100.

<sup>111</sup> *Id.*

<sup>112</sup> *Id.*

allow the DOJ to reach a settlement to achieve corporate reforms that mitigate the likelihood of future crimes, all without the risk of firms failing.<sup>113</sup>

There are several downsides to the approach, however. First, because the cases do not go to trial, the DOJ prevents further details from reaching the public record.<sup>114</sup> Instead, the public gets only a brief overview of facts that led to the settlement.<sup>115</sup> Second, these agreements require different types of investigations, and because the case never goes to trial, attorneys never develop the skills to prosecute individuals.<sup>116</sup> In other words, they fail to develop the needed expertise to make criminal cases against individuals and firms. Third, the terms of DPAs allow institutions to investigate themselves because firms hire former prosecutors to do an internal investigation, and then report to the DOJ with changes the firm promises to make.<sup>117</sup> Put differently, the worry here is there may be too cozy a relationship between the contracted party and the firm—though others have worried that DPAs are ripe for prosecutorial overreach and are in need of reigning in.<sup>118</sup> Fourth, and most importantly for the argument in this Article, is these agreements hold the wrong people responsible.<sup>119</sup> The firm, employees, and shareholders ultimately pay the cost, rather than the individual executives responsible for the behavior in the first place. Consequently, individuals are rarely held responsible for their actions. In DPAs and NPs that name individuals (which is rare), the individuals are typically low-level employees who receive little jail time, if any.<sup>120</sup>

#### F. *Competing Priorities and Inadequate Resources*

White-collar criminal convictions are in part a product of the criminal justice system's capacity to find, label, and prosecute crimes.<sup>121</sup> Financial frauds strain the system's capacity because they are complex, difficult to

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<sup>113</sup> Golumbic & Lichy, *supra* note 97, at 1314.

<sup>114</sup> See Rakoff, *supra* note 17.

<sup>115</sup> Rakoff, *supra* note 17.

<sup>116</sup> See Eisinger, *supra* note 13.

<sup>117</sup> See Rakoff, *supra* note 17.

<sup>118</sup> Golumbic & Lichy, *supra* note 97, at 1342.

<sup>119</sup> See Rakoff, *supra* note 17.

<sup>120</sup> Garrett, *supra* note 24, at 44–45.

<sup>121</sup> See Henry N. Pontell et al., *Corporate Crime and Criminal Justice System Capacity: Government Response to Financial Institution Fraud*, 11 JUST. Q. 383, 391–93 (1994) [hereinafter *Corporate Crime*] (arguing that despite successes of the savings and loan crisis era, there were more crimes committed than could be punished).

prosecute, and require a lot of resources to pursue.<sup>122</sup> In the years post crisis, key government agencies faced competing priorities about where to allocate limited agency resources, which affected their ability to pursue cases aggressively. The SEC gave more attention to Ponzi schemes and misallocation-of-assets cases than mortgage fraud, the former being much easier to take on and prove.<sup>123</sup> The SEC was also severely underfunded to the point where it had difficulty carrying out its mandate.<sup>124</sup> Further, its travel restrictions limit on-site visits to firms to investigate cases, and its limited resources hindered its ability to hire enough expert witnesses for cases.<sup>125</sup>

Similarly, the FBI had divided attention because the 9/11 attacks shifted its priorities toward terrorism.<sup>126</sup> In subsequent years, the FBI reduced its employees dealing with white-collar crime by 36% and the number of criminal cases by more than 25% between 2001 and 2008.<sup>127</sup> This was part of an overall 50% reduction in white-collar crime prosecutions under the Bush Administration.<sup>128</sup> In absolute numbers, and for comparative purposes, the FBI had 120 agents tasked with investigating mortgage fraud in 2007, compared to over 1,000 agents investigating fraud during the Savings and Loan (S&L) crisis, a crisis much smaller in magnitude than the crisis of 2008.<sup>129</sup> Though FBI Director Robert Mueller approved a plan to allocate more agents to mortgage fraud investigations in 2008, the plan was scrapped after pushback from the DOJ, which worried that staff reallocation would harm other investigations.<sup>130</sup>

The DOJ also had competing priorities. In the years following the crisis, the U.S. Attorney's Office had the most expertise in finance in the Southern District of New York under Preet Bharara, and they focused primarily on

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<sup>122</sup> *Id.*

<sup>123</sup> See Rakoff, *supra* note 17.

<sup>124</sup> See Chad Johnson, *Too Big to Fail or Too Big to Change*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (June 25, 2011), <https://corpgov.law.harvard.edu/2011/06/25/too-big-to-fail-or-too-big-to-change/>.

<sup>125</sup> *Id.*

<sup>126</sup> See Rakoff, *supra* note 17.

<sup>127</sup> *Too Big to Fail, Too Powerful to Jail?*, *supra* note 48, at 2.

<sup>128</sup> *Id.*

<sup>129</sup> William K. Black, *Why CEOs Are Able to Loot with Impunity—and Why It Matters*, in HOW THEY GOT AWAY WITH IT: WHITE COLLAR CRIMINALS AND THE FINANCIAL MELTDOWN 171, 173 (Susan Will et al. eds., 2012).

<sup>130</sup> See Gretchen Morgenson & Louise Story, *In Financial Crisis, No Prosecutions of Top Figures*, N.Y. TIMES (Apr. 14, 2011).

insider trading cases.<sup>131</sup> These cases were more straightforward.<sup>132</sup> There was also a risk aversion to losing cases and a desire to win headline-grabbing ones related to insider trading, while banks were given a low priority.<sup>133</sup> Though the DOJ had the makings of a case against Lehman, it chose not to pursue it.<sup>134</sup> In part this risk aversion was driven by the acquittal of two Bear Sterns mid-level executives by a jury that “put a chill” on further investigations according to one prosecutor.<sup>135</sup>

Attorney General Michael B. Mukasey also pushed against allocating resources toward bank fraud. In spring 2008, after Bear Sterns collapsed, Mukasey considered creating a task force to investigate mortgage fraud.<sup>136</sup> At the time, he said the DOJ was trying to determine whether there was a “larger criminal story” to be told about the financial crisis.<sup>137</sup> By the summer he decided against doing so, despite pressure from some Democrats.<sup>138</sup> When comparing the need for a task force to the early 2000s task force for the Enron scandal, he said in public comments, “[t]his isn’t that type of phenomena,” arguing instead the crisis amounted to smaller “white collar street crimes.”<sup>139</sup>

More broadly, under President Obama’s administration, there was no “collective government effort” to investigate and prosecute financial institutions.<sup>140</sup> Under the Fraud Enforcement Recovery Act in 2009, additional money was allocated to the DOJ for financial fraud, but only a small portion of the allocation made it to the agency.<sup>141</sup> By executive order in

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<sup>131</sup> Eisinger, *supra* note 13.

<sup>132</sup> *Id.*

<sup>133</sup> *Id.* According to one prosecutor he interviewed, “Am I going to chase after crimes I don’t know were committed and don’t know who by, or do we go after crimes we do know were committed and by whom?” *Id.*

<sup>134</sup> *Id.*

<sup>135</sup> *Id.*

<sup>136</sup> See Morgenson & Story, *supra* note 131.

<sup>137</sup> Eric Lichtblau, *Mukasey Declines to Create a U.S. Task Force to Investigate Mortgage Fraud*, N.Y. TIMES (JUNE 6, 2008), <http://www.nytimes.com/2008/06/06/business/06justice.html>.

<sup>138</sup> *Id.*

<sup>139</sup> *Id.*

<sup>140</sup> See Morgenson & Story, *supra* note 131.

<sup>141</sup> Richman, *supra* note 77 at 274. According to Richman:

[The] Fraud Enforcement and Recovery Act of 2009 authorized \$165 million for the Justice Department for fiscal years 2010 and 2011 to pursue financial fraud. But although the U.S. Attorneys’ Offices and Main Justice’s Criminal Division were authorized to receive \$70 million in 2010 and \$70 million in 2011, Congress end[ed] up actually appropriating \$9.3

2009, President Obama also created the Financial Fraud Enforcement Task Force to investigate financial crimes. Despite big expectations, one former DOJ official referred to it as “the turtle” because of how slowly it moved.<sup>142</sup> In a 2010 press release, the DOJ announced: “To date, the operation has involved enforcement actions against 343 criminal defendants and 189 civil defendants for fraud schemes that harmed more than 120,000 victims throughout the country.”<sup>143</sup> Despite these purported successes, it went after low targets, and many of its purported accomplishments were started before the initiative began, and several did not actually lead to criminal cases, despite DOJ’s claims otherwise.<sup>144</sup> In 2012, the task force had 55 attorneys, FBI agents, and support staff—a small number compared to hundreds of FBI agents assigned to investigate Enron and about a thousand agents assigned to investigate the S&L crisis.<sup>145</sup> That so few resources were “allocated to investigate and prosecute those responsible for an \$8 trillion dollar event suggests not merely under-prioritization, but no prioritization at all.”<sup>146</sup>

#### G. *High Burden of Proof*

DOJ officials also argued they were constrained by the difficulty of meeting the high burden of proof for criminal cases, proof of guilt beyond a reasonable doubt.<sup>147</sup> According to one former FBI official, going after financial misdeeds is “better left to regulators” with their power to level civil

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million in 2010 and \$0 in 2011. The FBI, authorized by the Act to receive \$75 million in 2010 and \$65 million in 2011, was actually appropriated \$25.5 million in 2010 and \$20.2 million in 2011.

*Id.*

<sup>142</sup> Eisinger, *supra* note 13.

<sup>143</sup> *Operation Broken Trust in Action*, DOJ ARCHIVES (Dec. 6, 2010), <https://www.justice.gov/archives/opa/blog/operation-broken-trust-action>.

<sup>144</sup> See Johnson, *supra* note 125.

<sup>145</sup> BARAK, *supra* note 11, at 15.

<sup>146</sup> Haugh, *supra* note 12, at 174. This analysis fits with other research that argues the Obama Administration was uninterested in going after high-level executives and did not make a strong effort to do so. See also JEFF CONNAUGHTON, *THE PAYOFF: WHY WALL STREET ALWAYS WINS* (2012); GLENN GREENWALD, *The Untouchables: How the Obama Administration Protected Wall Street From Prosecutions*, GUARDIAN (Jan. 23, 2013, 7:27 AM), <https://www.theguardian.com/commentisfree/2013/jan/23/untouchables-wall-street-prosecutions-obama>; *Frontline: The Untouchables* (PBS television broadcast Jan. 22, 2013), <http://www.pbs.org/wgbh/frontline/film/untouchables/>.

<sup>147</sup> MARIAN WANG, *Why No Financial Crisis Prosecutions? Ex-Justice Official Says It's Just Too Hard*, PROPUBLICA (Dec. 6, 2011, 3:08 PM), <https://www.propublica.org/article/why-no-financial-crisis-prosecutions-official-says-its-just-too-hard>.

finer.<sup>148</sup> Part of the difficulty was convincing a jury that financial executives were behaving criminally when dealing with complex financial products.<sup>149</sup> The failure to convict two mid-level executives from Bear Stearns hardened the belief in the DOJ that the burden was too high to convince juries.<sup>150</sup> Further, prosecutors needed to prove criminal intent, which is difficult to do. Here the argument was similar to the “reckless innocence” explanation for the crisis: it is often difficult to distinguish between a crime and normal business practices.<sup>151</sup> Untangling these can be particularly difficult with financial fraud. For example, mortgage fraud is more difficult to prove than other crimes because a prosecutor must establish a market price and show that executives intentionally overvalued the products, rather than simply acted with bad business judgment.<sup>152</sup>

This line of argument is weak for several reasons. First, prosecutors regularly meet the burden of proof beyond a reasonable doubt for white-collar criminal cases.<sup>153</sup> Second, the idea that there is a lack of strong evidence to show intent and prove guilt beyond a reasonable doubt runs counter to the fact that “evidentiary strength is generally a function of prosecutorial effort, priorities, and institutional commitment.”<sup>154</sup> Similarly, former financial regulator Bill Black argues that one lesson of successful S&L prosecutions is that you find fraud if you look for it, but too often the DOJ was not looking for fraud among executives.<sup>155</sup> Third, it is not clear whether the Bear Stearns case was a clear signal that criminal cases were unwinnable. The case was poorly tried by the government,<sup>156</sup> and the government may have overreacted to one failed conviction and gone too far in the other direction of not pursuing these cases.<sup>157</sup>

Fourth, prosecutors may have more success if they used laws that allowed for easier cases. The statute pertaining to penalties in the Securities and Exchange Act provides for a standard of willfulness that would be easier

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<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> See Eisinger, *supra* note 13.

<sup>151</sup> BARAK, *supra* note 11, at 35.

<sup>152</sup> Maher, *supra* note 64, at 467.

<sup>153</sup> Richman, *supra* note 77, at 269.

<sup>154</sup> *Id.*

<sup>155</sup> Black, *supra* note 130, at 173.

<sup>156</sup> Rakoff, *supra* note 17.

<sup>157</sup> *Id.*

for the government to meet to show criminal intent.<sup>158</sup> The willfulness standard does not require specific intent; rather, intent can be inferred from reckless behavior.<sup>159</sup> In fact, many of the civil cases the SEC successfully pursued has laid the groundwork for the DOJ to pursue the reckless behavior argument.<sup>160</sup> Under other federal fraud statutes, some circuits have held that recklessness is enough to satisfy the burden to prove intent as well.<sup>161</sup> Alternatively, prosecutors could use the well-established doctrine of willful blindness to show that executives have been actively ignoring evidence of bad mortgages at their company.<sup>162</sup> This doctrine allows prosecutors to ask juries to infer intent through executive decisions to shield themselves from fraudulent actions in their company, and the Supreme Court has upheld the doctrine.<sup>163</sup>

#### H. *Bank Regulators Did Not Refer Cases to DOJ*

Given the competing priorities and constrained resources discussed above, the DOJ could use some help building criminal cases for white-collar crime. Though the DOJ could build a case from scratch, one natural place for cooperation is from financial regulators. The DOJ “depend[s] heavily” on regulator expertise to help find and build strong cases.<sup>164</sup> In the years before the crisis, there were four federal banking regulators, each supervising certain segments of the market: the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve, the Treasury Department, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision (OTS).<sup>165</sup> Bank examiners from these regulators examined banks at least every 18 months, writing an examination report that detailed each bank’s risk level using a variety of criteria, which included asset quality, management quality, and liquidity.<sup>166</sup> For the largest financial institutions, bank examiners engaged in continuous supervision, having their own office at the bank itself.<sup>167</sup>

<sup>158</sup> Maher, *supra* note 64, at 467.

<sup>159</sup> *Id.*

<sup>160</sup> *Id.* at 474.

<sup>161</sup> *Id.* at 470.

<sup>162</sup> Rakoff, *supra* note 17.

<sup>163</sup> *Id.*

<sup>164</sup> Morgenson & Story, *supra* note 131.

<sup>165</sup> Mark Jickling & Edward V. Murphy, *Who Regulates Whom? An Overview of U.S. Financial Supervision*, CONGRESSIONAL RESEARCH SERVICE, 14–18 (2010), <https://fas.org/sgp/crs/misc/R40249.pdf>.

<sup>166</sup> *Id.* at 23–24.

<sup>167</sup> *Id.*

Regulators also rely on Suspicious Activity Reports (SARs), which are reports made by banks or their employees when they notice suspicious or potentially fraudulent activity at their own institution, or in firms they interact with, such as appraisers or mortgage brokers.<sup>168</sup> One major constraint on their ability to refer cases was the Bush Administration's elimination of criminal referral coordinators at federal agencies who served as liaisons between agencies and law enforcement.<sup>169</sup>

Despite having eyes on the ground, and despite documenting the major problems that contributed to the crisis in the years leading up to it in their examination reports,<sup>170</sup> the regulators made few criminal referrals to the DOJ.<sup>171</sup> The number of referrals declined substantially from the S&L crisis.<sup>172</sup> For example, the Office of the Comptroller of the Currency referred only three cases between 2001 and 2011,<sup>173</sup> none of which were related to the 2008 crisis.<sup>174</sup> Likewise, the Federal Reserve referred zero cases related to the 2008 crisis.<sup>175</sup> The OTS makes for a good example here: during the aftermath of the S&L crisis, the OTS made over 30,000 criminal referrals.<sup>176</sup> However, despite the 2008 crisis being 70 times as large as the S&L crisis, the OTS made zero referrals,<sup>177</sup> and had not referred a criminal case since the year 2000.<sup>178</sup> Countrywide, for which there is a reasonable criminal case to be made, was supervised by the OTS on the eve of the crisis. Despite pressure

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<sup>168</sup> See generally FinCEN, *Mortgage Loan Fraud: An Update of Trends based Upon an Analysis of Suspicious Activity Reports*, (2008),

[http://www.fincen.gov/news\\_room/tp/files/MortgageLoanFraudSARAssessment.pdf](http://www.fincen.gov/news_room/tp/files/MortgageLoanFraudSARAssessment.pdf).

<sup>169</sup> DAVID DAYEN, *An Idiot's Guide to Prosecuting Corporate Fraud*, INTERCEPT (Feb. 4, 2016, 8:17 AM), <https://theintercept.com/2016/02/04/an-idiots-guide-to-prosecuting-corporate-fraud/>.

<sup>170</sup> See, e.g., Gillian G.H. Garcia, *Failing Prompt Corrective Action*, 11 J. BANKING REG. 171, 179 (2010).

<sup>171</sup> *Too Big to Fail, Too Powerful to Jail?*, *supra* note 48, at 6.

<sup>172</sup> Morgenson & Story, *supra* note 131. Data "indicates that in 1995, bank regulators referred 1,837 cases to the Justice Department. In 2006, that number had fallen to 75. In the four subsequent years, a period encompassing the worst of the crisis, an average of only 72 a year have been referred for criminal prosecution." *Id.*

<sup>173</sup> Morgenson & Story, *supra* note 131.

<sup>174</sup> William K. Black, Opinion, *Bolster Regulators to Build Criminal Cases Against Banks*, N.Y. TIMES (last updated Jan. 17, 2014, 1:05 PM), <https://www.nytimes.com/roomfordebate/2013/11/10/prosecuting-executives-not-companies-for-wall-street-crime/bolster-regulators-to-build-criminal-cases-against-banks>.

<sup>175</sup> *Id.*

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*

<sup>178</sup> Morgenson & Story, *supra* note 131.

from consumer advocates to force the OTS director to regulate the company more closely and set up a hotline for whistleblowers, the director refused to do so.<sup>179</sup> Thus, a “primary reason”<sup>180</sup> for a lack of financial crisis criminal prosecutions is that, instead of helping gather the raw material to build criminal cases, the regulators were “not pointing the Justice Department in the right direction—or any direction—to prosecute wrongdoing.”<sup>181</sup>

### I. *Capture*

For some scholars, the above explanations are insufficient to explain the lack of prosecutions. The lack of criminal referrals played a role, but why were there so few criminal referrals from regulators in the first place? While lack of prioritization played a role, what explains the priorities chosen by agencies and elected officials? To answer these questions, it is necessary to probe deeper into the relationships underlying the political and economic order that fundamentally shifted power toward the financial industry and pushed government to be favorable toward it. These arguments range in the severity of capture posited between government and the financial industry.

The weak-capture version of this argument is that, at a time of potential economic collapse, the government prioritized the health of the financial system over prosecutions.<sup>182</sup> Making sure the country avoided a debilitating depression required shoring up the health of financial institutions and making sure they could cooperate to stabilize markets. A basic fact of a capitalistic economy is that the government relies on private markets for performing certain public functions, so some degree of cooperation between

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<sup>179</sup> *Id.*

<sup>180</sup> *Too Big to Fail, Too Powerful to Jail?*, *supra* note 48, at 9. Pontell notes:

The virtual absence of referrals from regulators who are the first line of defense against major financial fraud is a primary reason for the lack of elite prosecutions. If the savings and loan crisis demonstrated anything, it was that regulatory expertise was critical to understanding and identifying complex frauds. Without it, prosecutors would be faced with long odds of winning cases, much less discovering and investigating them in the first place.

*Id.*

<sup>181</sup> Haugh, *supra* note 12, at 185.

<sup>182</sup> *Too Big to Fail, Too Powerful to Jail?*, *supra* note 48, at 7–8.

the two should be expected,<sup>183</sup> which does not mean the government is necessarily captured.

A stronger version of the capture argument is that the government did not want to implicate itself by aggressively prosecuting the industry. The government, after all, had a significant role in fostering the circumstances that led to the financial crisis, including: deregulation that created “Too Big To Fail” (TBTF) banks,<sup>184</sup> deregulation and lax regulation by financial regulators, encouragement of homeownership and subprime lending, low interests rates, as well as a large role in the messy cleanup after the crisis.<sup>185</sup> Because few in government believed the early warning signs of a brewing financial crisis and fraud epidemic, action after the crisis hit was difficult.<sup>186</sup> After the crisis, the primary concern was in making sure the system was returned to health, not going after bad actors.<sup>187</sup> Though these actions do not necessarily mean the government engaged or sanctioned fraud in the market, prosecutors may be worried that financial firms and their employees could credibly claim that the government encouraged their behavior and they are therefore not culpable.<sup>188</sup> Lending some line of credence to this argument, during a civil fraud trial against mid-level Citigroup managers, a jury voted to acquit in part based on the defense that government and industry were all engaging in risky behavior before the crash.<sup>189</sup> However, the jury seemed willing to look beyond this argument in a statement asking why senior bank executives were not on trial for their role in the bank’s behavior.<sup>190</sup>

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<sup>183</sup> See CHARLES E. LINDBLOM, *POLITICS AND MARKETS: THE WORLD’S POLITICAL ECONOMIC SYSTEMS* (1977); see also C. E. Lindblom, *The Market as Prison*, 44 J. POLITICS 324, 326 (1982) (on the privileged place of business in a market economy).

<sup>184</sup> FINANCIAL CRISIS INQUIRY COMMISSION, *THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES* 37 (2011).

<sup>185</sup> Rakoff, *supra* note 17.

<sup>186</sup> *Too Big to Fail, Too Powerful to Jail?*, *supra* note 48, at 8.

<sup>187</sup> *Id.* at 7–8.

<sup>188</sup> *Id.* Interestingly, IndyMac used this argument against the Office of Thrift Supervision when the bank used illegal capital backdating to make their firm retroactively meet capital requirements and mislead the public about the health of the firm. *Id.* IndyMac pointed to the OTS’s allowing the backdating to occur as their defense. *Id.*; see also Louise Story & Gretchen Morgenson, *Financial Finger-Pointing Turns to Regulators*, N.Y. TIMES (Nov. 22, 2011), <http://www.nytimes.com/2011/11/23/business/economy/financial-finger-pointing-turns-to-regulators.html>.

<sup>189</sup> Haugh, *supra* note 12, at 175–76.

<sup>190</sup> *Id.*

The strongest version of the capture argument is that government was captured by the financial industry, meaning key governmental actors ceased to serve the broad public interest and instead made policy and regulatory decisions that served primarily the interests of the financial industry.<sup>191</sup> Part of the capture story is the capture of Congress through lobbying and campaign donations.<sup>192</sup> As the financial services industry became one of the leaders in campaign contributions and lobbying expenditures,<sup>193</sup> both major U.S. political parties supported financial deregulation,<sup>194</sup> leading to 2009 seeing the highest level of financial deregulation in the previous century.<sup>195</sup> Deregulation also allowed the creation of mega banks that engaged in deposit taking, speculative trading, and insurance, which eliminated previous industry divisions that caused infighting over legislation. These in turn allowed the financial industry to lobby government with a consistent voice for deregulation.<sup>196</sup> Even after the crisis, during debate over financial reform, when public antipathy toward large financial institutions was high, there were only a few small organizations lobbying for more regulation of the financial sector,<sup>197</sup> leading one lawmaker to opine, in reference to Congress, that the financial industry “own[s] the place.”<sup>198</sup> Several decades of deregulation coincided with efforts by elected officials, beginning with President Reagan, to reframe the approach to regulating crime in a way that grew increasingly adversarial and draconian toward blue collar street criminals while

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<sup>191</sup> JOHNSON & KWAK, *supra* note 94; *see also*, Adam J. Levitin, *The Politics of Financial Regulation and the Regulation of Financial Politics: A Review Essay*, 127 HARV. L. REV. 1991, 1994 (2014).

<sup>192</sup> Deniz Igan et al., *A Fistful of Dollars: Lobbying and the Financial Crisis*, in 26 NBER MACROECONOMICS ANNUAL 2011, 195, 195 (Daron Acemoglu & Michael Woodford eds., 2012).

<sup>193</sup> Levitin, *supra* note 192, at 2044; *see also* Atif Mian et al., *The Political Economy of the Subprime Mortgage Credit Expansion*, 8 Q. J. POL. SCI. 373 (2013).

<sup>194</sup> JACOB S. HACKER & PAUL PIERSON, WINNER-TAKE-ALL POLITICS: HOW WASHINGTON MADE THE RICH RICHER AND TURNED ITS BACK ON THE MIDDLE CLASS 274 (Simon & Shuster, 2010) (reflecting bipartisan consensus, only five percent of bills pushing for stronger financial regulation became law); *see* Jeff Madrick & Frank Portnoy, *Should Some Bankers Be Prosecuted?*, N.Y. REV. BOOKS, Nov. 10, 2011.

<sup>195</sup> Thomas Philippon & Ariell Reshef, *Wages and Human Capital in the U.S. Finance Industry: 1909–2006*, 127 Q.J. ECONOMICS 1551, 1578 (2012).

<sup>196</sup> Levitin, *supra* note 192, at 2062–63.

<sup>197</sup> HACKER & PIERSON, *supra* note 195, at 274–75.

<sup>198</sup> Glenn Greenwald, *Top Senate Democrat: Bankers “Own” the U.S. Congress*, SALON (April 30, 2009, 9:35 AM), <http://www.salon.com/2009/04/30/ownership>.

simultaneously normalizing white-collar crime through deregulation and championing risk taking.<sup>199</sup>

In addition to elected officials, the financial industry also captured regulatory agencies. The FBI's approach to investigating white-collar crime precluded the possibility of executive level financial fraud, suggesting its investigations were too protective of industry executives.<sup>200</sup> The federal banking regulators were consistently lax in protecting consumers from predatory lending,<sup>201</sup> and in reining in risky behavior.<sup>202</sup> The SEC had a revolving door problem where its employees moved between the agency and high-paying law firms that represented financial industry clients before the SEC,<sup>203</sup> illegally destroying a decade's worth of documentation about investigations into Wall Street corruption.<sup>204</sup> The SEC was also lax in monitoring capital at investment banks before the crisis.<sup>205</sup> These behaviors reflect a problem of the status of the financial industry in regulators' eyes,<sup>206</sup> stemming in part from the fact that regulators and industry players tend to run in the same cultural circles and view the industry as part of their "in-group," with whom they have a relationship.<sup>207</sup>

Scholar Gregg Barak weaves these strands into a theoretical argument that he calls a system of "bourgeois legality," characterized by inadequate criminal prosecutions.<sup>208</sup> The regulatory structure lacks the system capacity

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<sup>199</sup> HAGAN, *supra* note 54.

<sup>200</sup> William K. Black, *The Department of Justice Chases Mice While Lions Roam the Campsite: Why the Department Has Failed to Prosecute the Elite Frauds That Drove the Financial Crisis*, 80 UMKC L. REV. 987, 988 (2012).

<sup>201</sup> Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 85 (2008).

<sup>202</sup> ERIC DASH, *Post-Mortems Reveal Obvious Risk at Banks*, N.Y. TIMES (Nov. 18, 2009), [http://www.nytimes.com/2009/11/19/business/19risk.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2009/11/19/business/19risk.html?pagewanted=all&_r=0).

<sup>203</sup> PROJECT ON GOV'T OVERSIGHT, *DANGEROUS LIAISONS: REVOLVING DOOR AT SEC CREATES RISK OF REGULATORY CAPTURE 2* (2013),

<http://pogoarchives.org/ebooks/20130211-dangerous-liaisons-sec-revolving-door.pdf>.

<sup>204</sup> MATT TAIBBI, *Is the SEC Covering Up Wall Street Crimes?*, ROLLING STONE (August 17, 2011, 12:00 PM), <http://www.rollingstone.com/politics/news/is-the-sec-covering-up-wall-street-crimes-20110817>.

<sup>205</sup> Stephen Labaton, *S.E.C. Concedes Oversight Flaws Fueled Collapse*, N.Y. TIMES (Sept. 26, 2008), <http://www.nytimes.com/2008/09/27/business/27sec.html>.

<sup>206</sup> *Too Big to Fail, Too Powerful to Jail?*, *supra* note 48, at 10–11.

<sup>207</sup> James Kwak, *Cultural Capture and the Financial Crisis*, in PREVENTING REGULATORY CAPTURE: SPECIAL INTEREST INFLUENCE AND HOW TO LIMIT IT 71, 80 (Daniel Carpenter & David Moss eds., 2013).

<sup>208</sup> BARAK, *supra* note 11, at 84. "Having penetrated the three branches of government, Wall Street has in effect established an apparatus of regulatory collusion where criminal prosecutions of securities fraud are out of bounds." *Id.* at 76.

to prosecute cases.<sup>209</sup> Government “corruption” through campaign contributions and lobbying resources, combined with widespread financial control fraud<sup>210</sup> by major institutions, led to a system unable and unwilling to criminally prosecute major players in the financial industry.<sup>211</sup>

#### J. *Synthesis*

What are the strongest reasons for a lack of prosecutions of senior financial executives? Though the capture argument has some merit, a host of other more benign reasons also contributed to the lack of prosecutions. Without financial regulators referring cases, and with competing priorities and resources spread thin at the FBI and DOJ, the agencies certainly faced administrative challenges. Further, the Justice Department’s approach to handling corporate crime through deferred prosecution agreements was decades in the making, suggesting it did not make an abrupt turn toward being overly deferential to financial institutions in the wake of the crisis. Ironically, the shift toward criminally prosecuting corporations instead of individuals was intended to be an even tougher approach on corporate crime and was scaled back somewhat after the corporate scandals of the early 2000s, when the DOJ and others worried it was being too tough after the collapse of Arthur Anderson.<sup>212</sup>

Yet, there is still reason to criticize the approach, despite any constraints. Even granting that the DOJ genuinely and correctly worried about collateral consequences of prosecuting TBTF institutions, prosecuting individuals does not come with the same risks.<sup>213</sup> And when it comes to individuals, there are simply too many cases left on the table, particularly in

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<sup>209</sup> *Id.* at 77.

<sup>210</sup> *Id.* at 76–78. *See also* Black, *supra* note 130, at 173–75. Control fraud refers to the CEO using his control of the company for his own fraudulent purposes. This is often done through accounting. For example, CEOs can boost short term profits, which provides compensation for themselves in the form of things like stock bonuses, even as the institution collapses soon after. Other tactics include shifting business to deregulated markets and products where it is hard to determine true value, like mortgage securities. In the S&L crisis and the current crisis, CEOs made bad loans that boosted short-term value, and their compensation, while failing to set aside capital to offset eventual losses.

<sup>211</sup> BARAK, *supra* note 11, at 78. So in his formulation, we do not simply have laws on the books and a neutral regulatory apparatus that determines whether the laws were broken. *Id.* These laws, and the people who choose whether to enforce them, are in flux, and a product of elite interaction and relationships to produce “crimes beyond incrimination.” *Id.*

<sup>212</sup> Eisinger, *supra* note 13.

<sup>213</sup> Rakoff, *supra* note 17.

light of the fact that the strength of the case and the evidence to determine that strength is often a function of actually pursuing the case.<sup>214</sup>

Here is where capture theory has some merit. The capture argument has been criticized, particularly the revolving door argument that most closely pertains to the DOJ officials who are making decisions about pursuing cases. Critics argue that the interest in being friendly toward industry in hopes of securing more lucrative employment after leaving the government is offset by the desire to make a name for oneself as a prosecutor, one of the best ways being to bring a high-level person to justice.<sup>215</sup> If self-interest rules the day, then there are competing self-interests at play: both favorable signaling to the industry to achieve post-government employment and negative signaling by pursuing strong cases. Preet Bharara, the U.S. Attorney for the Southern District of New York, argues that the revolving door argument is:

Ridiculous. It's actually worse—it's idiotic. Because when people are in government and they are responsible for prosecutions or for enforcing regulations, every single one of them knows that the bigger case they make, the bigger person they become and the bigger opportunities they have. That's not a good reason to go do these things. But some people speculate that human nature being what it is, that's how it works. . . . [Big cases against the industry] don't ever hurt anybody's career! And so for people to suggest that people like me or career prosecutors in this office are holding back from bringing a case against a bank president because that would hurt their career prospects, that's idiotic.<sup>216</sup>

Yet, these interests are not mutually exclusive. There is no reason a law firm, or the financial industry for that matter, will shy away from hiring former prosecutors who have shown themselves capable, regardless of the substance of the case brought. Further, if such a strong incentive existed, why were there so few U.S. Attorneys and DOJ officials trying to make a name for themselves by trying criminal cases against top financial executives, particularly when there seemed to be cases left on the table?<sup>217</sup> Following the crisis, public sentiment toward Wall Street was unfavorable, so the lack of Wall Street

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<sup>214</sup> Richman, *supra* note 77, at 269.

<sup>215</sup> Rakoff, *supra* note 17.

<sup>216</sup> Richard Bradley, *The Power of Attorney*, WORTH (Oct. 1, 2014), <http://www.worth.com/the-power-of-attorney/>.

<sup>217</sup> *See infra* Section II(A).

prosecutions after the crisis seems odd at best. Even key Wall Street insiders thought the government would be more aggressive in prosecuting at least a few executives to make an example and placate an angry public.<sup>218</sup> Is there not a deep contradiction in the argument that prosecutors are fearlessly willing to resist the pull of the revolving door by making a name for themselves with a big case, and the risk aversion to pursuing further cases that the DOJ showed after the Bear Stearns acquittals? These problems suggest that even if key regulators were not completely compromised by industry influence, as the strongest capture critics would suggest, the regulators were certainly not operating completely independent of some weaker forms of industry influence.<sup>219</sup> A culture of deference toward the financial industry,<sup>220</sup> developed in Washington, D.C. over the past several decades, explains why there was so little willingness to be tough on the financial industry post crisis. Without insights from capture theory, the above explanations leave some of the story left unexplained.

This Article now turns to Iceland, where the story of financial crisis prosecutions differs greatly from the United States. To what extent does it represent a possible alternative course for criminal prosecutions for individuals involved in the financial crisis? Are there any lessons for the United States? This next section gives an overview of Iceland's financial crisis and how it combated fraud and abuse within its financial sector.

### III. THE CASE OF ICELAND

#### A. *Iceland's Financial Crisis*

The drivers of Iceland's crisis paralleled those in the United States. Through the early 1980s, Iceland's government had heavy involvement in the economy through regulation and state ownership of key industries, including

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<sup>218</sup> *Frontline*, *supra* note 147.

<sup>219</sup> For evidence of revolving door influence, *see generally* Sophie A. Shive & Margaret M. Forster, *The Revolving Door for Financial Regulators*, REV. FINANCE 1445 (2017). For a discussion of the distinction between strong and weak capture, *see* PREVENTING REGULATORY CAPTURE: SPECIAL INTEREST INFLUENCE AND HOW TO LIMIT IT 59 (Daniel Carpenter & David Moss eds. 2013). Strong capture means industry influence over regulation is so pervasive that the public would be better off if regulation was abolished. *Id.* Weak capture means regulators are influenced by the regulated industry, but targeted reforms can mitigate this influence and push regulators in the direction of the public interest. *Id.*

<sup>220</sup> Simon Johnson, *The Quiet Coup*, ATLANTIC (May 2009), <http://www.theatlantic.com/magazine/archive/2009/05/the-quiet-coup/7364/>.

state-run major banks.<sup>221</sup> Beginning in the late 1980s, and accelerating in the 1990s and 2000s, Iceland adopted neo-liberal policies with “an almost blind faith in the virtues of the free market.”<sup>222</sup> The economy went through a rapid period of privatization, deregulation, and financialization, coupled with tax reduction.<sup>223</sup> More specifically, in the late 1990s, the government privatized key state assets, in industries including construction, telecommunications, and its three major banks.<sup>224</sup> The growth and importance of the financial sector grew as the privatized banks grew tremendously, increasing nine-fold to approximately 865% of the country’s GDP (the second highest in the world behind Switzerland<sup>225</sup>), and with the establishment of Iceland’s Stock Exchange in the early 1990s and entry into the European Economic Area Agreement in 1994.<sup>226</sup> These changes brought an influx of foreign investment as banks borrowed abroad and the Icelandic central bank was unable to adequately control the flow of money across newly porous borders.<sup>227</sup> Further, capital gains were taxed at a low rate, income taxes were cut, corporate taxes were reduced, as were property taxes, allowing investment and wealth to expand more quickly and helping the construction and housing sectors boom.<sup>228</sup>

Politicians and regulators encouraged these trends through deregulation and little oversight of the financial sector, convinced, like American regulators, in the efficient market hypothesis that financial markets could self-correct.<sup>229</sup> One of the most consequential deregulatory decisions was to relax mortgage lending, where borrowers could borrow up to 90% of the loan, which added fuel to an economy already experiencing bubble

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<sup>221</sup> JÓN GUNNAR BERNBURG, *ECONOMIC CRISIS AND MASS PROTEST: THE POTS AND PANS REVOLUTION IN ICELAND* 23 (2016).

<sup>222</sup> Helgi Gunnlaugsson, *The Causes of The Icelandic Banking Collapse In 2008 and the Road to Recovery Since*, BRATISLAVA LEGAL F. 91, 93 (2013), [http://www.lawconference.sk/archiv/bpf\\_2013/sprava/files/zborniky/Session%20of%20Financial%20Law.pdf#page=91](http://www.lawconference.sk/archiv/bpf_2013/sprava/files/zborniky/Session%20of%20Financial%20Law.pdf#page=91).

<sup>223</sup> ROGER BOYES, *MELTDOWN ICELAND: LESSONS ON THE WORLD FINANCIAL CRISIS FROM A SMALL BANKRUPT ISLAND* 28–44 (2009).

<sup>224</sup> BERNBURG, *supra* note 222, at 25.

<sup>225</sup> Robert Wade & Silla Sigurgeirsdottir, *Lessons from Iceland*, 65 *NEW LEFT REV.* 5, 5 (2010) [hereinafter *Lessons from Iceland*].

<sup>226</sup> *Id.* at 12.

<sup>227</sup> EIRIKUR BERGMANN, *ICELAND AND THE INTERNATIONAL FINANCIAL CRISIS: BOOM, BUST AND RECOVERY* 76–79 (2014).

<sup>228</sup> *Id.* at 77.

<sup>229</sup> Gunnlaugsson, *supra* note 223, at 93.

dynamics.<sup>230</sup> Regulatory capture played a strong role as government officials pushed pro-business policies and the private sector rewarded them in return.<sup>231</sup> Approximately 90% of the Chamber of Commerce's proposals became legislation.<sup>232</sup> These relationships were already strong given Iceland's history of state-owned assets and patronage relationships with Iceland's major political parties that permeated throughout the economy, epitomized by the power held by 14 of the most powerful families, known colloquially as "The Octopus."<sup>233</sup> Iceland's history of corporatism, in which major industries largely controlled themselves and received backing from the government, extended to the major banks, which were sold off to private parties with close political ties to the ruling political parties.<sup>234</sup> Even on the eve of the crisis, the ruling government parties trumpeted the financial system's soundness in public events along with the key regulator, the Financial Supervisory Authority, publicly announcing confidence in key banks.<sup>235</sup> Moreover, the regulators had no expertise in international banking, and were reliant on banks for financial and economic information.<sup>236</sup> The regulatory agencies were underfunded and could not keep up with the rapid growth of the financial sector.<sup>237</sup> International regulation was weak as well, and Iceland's banks received little oversight as they branched out; buying assets overseas and international investors poured money into the Iceland banks.<sup>238</sup> Overall regulation failed on three fronts: "Three potential sources

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<sup>230</sup> *Lessons from Iceland*, *supra* note 226, at 13.

<sup>231</sup> *Id.* at 28.

<sup>232</sup> *Id.*

<sup>233</sup> Robert H. Wade & Silla Sigurgeirsdottir, *Iceland's Rise, Fall, Stabilisation and Beyond*, 36 CAMBRIDGE J. OF ECON. 127, 131 (2012) [hereinafter *Iceland's Rise*].

<sup>234</sup> *Id.* at 135.

<sup>235</sup> *Lessons from Iceland*, *supra* note 226, at 20.

<sup>236</sup> See BERGMANN, *supra* note 228 at 65. Rapid changes in the banking sector gave regulators little time to catch up. Notes Bergmann:

Thanks to a neo-liberal deregulation strategy, Iceland was in one decade – from Iceland's entry into the Single European Market in the mid 1990's until the privatization of financial institutions in the first years of the 21<sup>st</sup> century – transformed from being amongst the most heavily regulated and backward banking regimes to one of the most liberal and international in the world.

*Id.*

<sup>237</sup> Snorri Örn Árnason, *Greed and the Grey Area; Theoretical and Methodological Considerations for Economic Crime Research and Investigation*, SCANDINAVIAN RESEARCH COUNCIL FOR CRIMINOLOGY 55TH RESEARCH SEMINAR 29, 34 (May 13–15, 2013).

<sup>238</sup> *Id.* at 29.

of prudential regulation—firms' self-regulatory risk management, Icelandic governmental regulation, and international regulatory processes—failed to decrease banks' exposure and Iceland's vulnerability to crisis."<sup>239</sup>

In this environment, banks and individuals took on massive debt along with exotic loans which resulted in lending money beyond the borrower's ability to repay.<sup>240</sup> Between 2003 and 2004, Iceland's stock market grew by 900% and the average wealth of citizens grew by 300%.<sup>241</sup> Its average income was the fifth highest in the world, well above that of the United States.<sup>242</sup> Icelandic banks borrowed large sums of money from foreign investors, subsequently lending that money to private equity firms that were owned by friends of bankers, or even by the bankers themselves, with minimal collateral.<sup>243</sup> This money was used to buy firms throughout Europe before channeling that money back to themselves and Iceland.<sup>244</sup> Their financial relationships grew "incestuous" to the point where the failure of one would bring down the others.<sup>245</sup> They took on extra risk, because they combined investment and commercial banking, the latter giving the former activities an implicit guarantee of government backing (though unlike the U.S., Iceland did not bail out its failed banks using taxpayer funds).<sup>246</sup> Despite this rapid growth, leading banks hid their vulnerability from the public through corrupt loans and stock sales to each other, and misleading statements to the public.<sup>247</sup> These actions were part of a larger shift in corporate culture in Iceland.<sup>248</sup> The decade from when the major banks privatized until after the Iceland financial crisis (between 2002 and 2012), saw a significant increase in financial crimes.<sup>249</sup> Also, the creation of a criminogenic environment, in which corporate incentive schemes pushed risk taking, companies searched for ways to stay within the letter of the law, but

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<sup>239</sup> Erik Larson, *Demand for Credit, International Financial Legitimacy, and Vulnerability to Crises: Regulatory Change and the Social Origins of Iceland's Collapse*, REG. & GOVERNANCE 185, 194 (2013).

<sup>240</sup> BOYES, *supra* note 224, at 90.

<sup>241</sup> *Id.*

<sup>242</sup> *Iceland's Rise*, *supra* note 234, at 129.

<sup>243</sup> *Id.* at 131.

<sup>244</sup> *Id.*

<sup>245</sup> BERGMANN, *supra* note 228, at 108–09.

<sup>246</sup> *Iceland's Rise*, *supra* note 234, at 138.

<sup>247</sup> Gunnlaugsson, *supra* note 223.

<sup>248</sup> Árnason, *supra* note 238, at 30–34, 35.

<sup>249</sup> *Id.* at 29.

avoid its spirit, by aggressively searching for ways to circumvent it.<sup>250</sup> By 2008, Iceland's banks collapsed, along with its economy,<sup>251</sup> in what was estimated as the third largest bankruptcy in world history.<sup>252</sup>

In short, many of the same dynamics that led to the 2008 financial crisis in the U.S., occurred in Iceland, but only amplified.<sup>253</sup>

#### B. *Criminal Convictions for Banking Executives*

Iceland created the Office of Special Prosecutor (OSP) to investigate financial crimes that caused the crisis. Iceland had three major banks and the OSP brought charges against top executives at each. Most prominently, charges were brought against executives at Kaupthing Bank, known as the Kaupthing Four: its Chairman, CEO, a former CEO, and the second largest stockholder.<sup>254</sup> They were convicted of market manipulation and making fraudulent loans.<sup>255</sup> Each were involved in a deal that gave a Qatari Sheik millions of dollars in loans to invest back in the bank to shore up public confidence on the eve of the bank's collapse.<sup>256</sup> Though the Kaupthing Four touted the investment publicly, the fact that the bank was essentially investing its own money in itself was not disclosed.<sup>257</sup> All received sentences that ranged between four and five and one-half years.<sup>258</sup> The CEO of Landsbanki and the CEO of Glitnir bank were sentenced to a year in prison and three and

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<sup>250</sup> *Id.* at 34.

<sup>251</sup> BOYES, *supra* note 224, at ch. 11.

<sup>252</sup> BERGMANN, *supra* note 228, at 4.

<sup>253</sup> Robert Wade, *Iceland as Icarus*, 52 CHALLENGE 5, 14 (2009). Argues Wade:

There is also no doubt that what the Icelandic bankers were doing was just an extreme version of what bankers in the United States, the UK, and other parts of the Anglo-American world were doing; and that what the Icelandic regulators were not doing was just an extreme version of what regulators in those other countries were not doing.

*Id.*

<sup>254</sup> Edward Robinson & Omar Valdimarsson, *This Is Where Bad Bankers Go to Prison*, BLOOMBERG (March 30, 2016, 10:01 PM), <https://www.bloomberg.com/news/features/2016-03-31/welcome-to-iceland-where-bad-bankers-go-to-prison>.

<sup>255</sup> *Id.*

<sup>256</sup> *Id.*

<sup>257</sup> *Id.*

<sup>258</sup> Alistair Scrutton & Ragnhildur Sigurdardottir, *Iceland Convicts Bad Bankers and Says Other Nations Can Act*, REUTERS (Feb. 21, 2015, 1:43 AM), <https://uk.reuters.com/article/uk-iceland-bankers/iceland-convicts-bad-bankers-and-says-other-nations-can-act-idUKKBN0LH0OC20150213>.

one-half years, respectively, for their involvement in loans to other companies to buy stocks in the bank, which violated breach of trust laws in Iceland.<sup>259</sup> By the end of 2015, Iceland jailed 26 bankers, handing down sentences reaching 74 years in total (with cases still pending).<sup>260</sup> In 2017, several of the bankers who were found guilty began to appeal their convictions to the European Court of Human Rights to argue they did not receive fair trials.<sup>261</sup>

There was some accountability for political officials as well. Iceland's ruling government was the first to resign in connection to the global financial crisis, in part because of the well-organized and effective protest movement in Iceland that arose as a response to the crisis.<sup>262</sup> A commission created to investigate the causes of Iceland's financial collapse accused the prime minister, finance minister, minister of banking and commerce, and three governors at the central bank of gross negligence, and recommended the latter to face criminal charges along with the head of the Financial Supervisory Authority.<sup>263</sup> However, the state prosecutor declined to press charges.<sup>264</sup> The head of the Financial Supervisory Authority was eventually fired for using inside information to sell bank shares on the eve of the financial collapse.<sup>265</sup> Parliament convened a special court to hold former Prime Minister Ger Haarde accountable for breach of ministerial responsibility. Though he was ultimately sentenced on charges of neglecting to hold meetings on the eve of the crash to keep the government informed, the punishment was suspended.<sup>266</sup>

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<sup>259</sup> *Former Landsbanki CEO Gets 3.5 Years in Prison*, ICE. REV. (last updated Oct. 9, 2015, 14:57), <http://icelandreview.com/news/2015/10/09/former-landsbanki-ceo-gets-35-years-prison>; see also *Three Icelandic Bankers to Prison*, ICE. REV. (Dec. 22, 2015, 11:30), <http://icelandreview.com/news/2015/12/22/three-icelandic-bankers-prison>.

<sup>260</sup> Ian Birrell, *Iceland Has Jailed 26 Bankers, Why Won't We?*, INDEPENDENT (Nov. 15, 2015, 18:59), <http://www.independent.co.uk/voices/iceland-has-jailed-26-bankers-why-wont-we-a6735411.html>.

<sup>261</sup> *Iceland's Jailed Bankers Say They Were Scapegoats For the Financial Crisis*, THE JOURNAL (Apr. 1, 2017, 8:30 AM), <http://www.thejournal.ie/iceland-bankers-financial-crisis-3314709-Apr2017/>.

<sup>262</sup> Wade, *supra* note 254, at 7; see also BERNBURG, *supra* note 222, at 4–7.

<sup>263</sup> *Lessons From Iceland*, *supra* note 226, at 25–26.

<sup>264</sup> *Id.*

<sup>265</sup> *Id.*

<sup>266</sup> BERGMANN, *supra* note 228, at 170–71.

### C. *Comparing Iceland and the U.S.*

Why was Iceland more successful in prosecuting financial executives than the United States?<sup>267</sup> First, there are key differences between the judicial systems. Iceland does not use juries and instead uses independent experts who assist judges in understanding the case.<sup>268</sup> In theory, this difference aids Iceland in white-collar prosecutions given that judges may be better able to understand the complexities of financial crimes than juries, particularly with the aid of independent experts. However, juries have convicted plenty of white-collar criminals in the U.S., including bank executives during the S&L crisis. The theory that financial crimes during the 2008 crisis were too complex for juries to understand is untested in the U.S., given that no cases against senior executives were even attempted. Further, there are mitigating factors that made prosecutions in Iceland more difficult. Icelandic courts have not been favorable to white-collar crime prosecutions in the past.<sup>269</sup> Additionally, the country's small population made finding people with the expertise to prosecute difficult, such that, as the OSP grew, the likelihood of staff knowing and even being related to the top bankers was highly likely, risking a lack of independence.<sup>270</sup>

Second, key cultural and political-economic differences drove divergent responses. Iceland's status as a post-colonial country informed its cultural values and shaped its political economy. On one hand, it had an impulse toward independence and sovereignty, while on the other, it sought to be integrated with the EU's economy and its banks to pursue foreign investment and assets.<sup>271</sup> The crisis forced a profound psychological shock and reckoning with this national identity,<sup>272</sup> in which the behavior of bankers became entangled. Financial behavior that may have been placed in a legal gray area before the crisis was recast as illegal post-crisis,<sup>273</sup> whereas U.S. officials maintained the distinction between immoral and illegal behavior. In

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<sup>267</sup> Robinson & Valdimarsson, *supra* note 255.

<sup>268</sup> Robinson & Valdimarsson, *supra* note 255.

<sup>269</sup> William Black, *Iceland's Supreme Court Upholds Jail Sentences of Four Banking Executives*, NEW ECONOMIC PERSPECTIVES (Feb. 24, 2015), <http://neweconomicperspectives.org/2015/02/icelands-supreme-court-upholds-jail-sentences-of-four-banking-executives.html>.

<sup>270</sup> *Id.*

<sup>271</sup> BERGMANN, *supra* note 228, at 59.

<sup>272</sup> *Id.* at 3.

<sup>273</sup> Árnason, *supra* note 238, at 36.

contrast, the U.S. has more difficulty reckoning with and stepping outside the national identity that defines its politics. According to Louis Hartz, despite political crises throughout its history, the U.S. has never strayed far from its commitment to Lockean libertarian individualism, which makes the U.S. hostile territory for political choices and movements that challenge business, capital, and limited government.<sup>274</sup>

These differences drove a third factor; the diverging political protests and governmental changes in the aftermath of the crisis. In Iceland, in the weeks after the banks collapsed, a grassroots protest broke out that eventually grew into the “pots and pans revolution,” which drew a large cross-section of the population.<sup>275</sup> Though the movement strategically united around the broadly shared belief that political corruption was a major cause of the crisis, a survey of Icelanders showed that they placed the most blame on bankers for causing the crisis.<sup>276</sup> Eventually, the center-right parties that were in power before the crisis lost seats and the country was governed by a coalition of left-wing parties for four years. This political context provided more sustained support and a more hospitable environment for pursuing bankers criminally.<sup>277</sup> The U.S. also had grassroots protest movements, but both the Occupy Wall Street and the Tea Party had stark ideological differences.<sup>278</sup> Though the left-wing Occupy Wall Street movement helped change the national dialogue around inequality, it suffered from internal divisions and a lack of engagement with institutional politics,<sup>279</sup> whereas the right-wing Tea Party movement had more lasting institutional changes in Republican primaries by pulling the Republican Party to the right.<sup>280</sup> Additionally, though the U.S. saw a change in presidential administrations and political party control shortly after the financial crisis, the changes were less substantial, given the two-party system in the U.S. and the relatively small differences in their governing philosophies. Furthermore, the Obama Administration

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<sup>274</sup> LOUIS HARTZ, *THE LIBERAL TRADITION IN AMERICA* (1955).

<sup>275</sup> BERNBURG, *supra* note 222, at chs. 3–5.

<sup>276</sup> *Id.* at 97.

<sup>277</sup> Robinson & Valdimarsson, *supra* note 255.

<sup>278</sup> Todd Gitlin, *The Left Declares Its Independence*, *THE NEW YORK TIMES* (Oc. 8, 2011), <https://www.nytimes.com/2011/10/09/opinion/sunday/occupy-wall-street-and-the-tea-party.html>. The Tea Party was composed of older, whiter, more conservative Republicans. See Vanessa Williamson et al., *The Tea Party And The Remaking Of Republican Conservatism*, 9 *PERSP. ON POL.* 25, 25 (2011).

<sup>279</sup> Todd Gitlin, *Reply to Craig Calhoun*, 64 *BRIT. J. SOCIOLOGY* 39, 42–43 (2013).

<sup>280</sup> Williamson et al., *supra* note 279, at 25.

received criticism for retaining many of the financial regulatory officials who served in the previous administration, who oversaw and implemented policies that led to the crisis, as well as orchestrated the initial bailout.<sup>281</sup> Given bifurcated protest movements and a moderate presidential administration, the political context in the U.S. was a less welcoming environment than Iceland for the radical idea of prosecuting bankers.

Fourth, the relative size and scope of the crisis in Iceland narrowed the range of responses. At the time of the crisis, Iceland had a population of approximately only 300,000. Despite a small economy, Iceland's nominal bank assets had ballooned to 10 times the size of Iceland's GDP.<sup>282</sup> The effects of the crash were staggering: 85% of the banking system failed and 50,000 residents lost all of their savings (constituting nearly 17% of the population).<sup>283</sup> In contrast to the U.S., Iceland's banks were too big to bail out and were not so integrated with external economies that others needed Iceland's banks to survive.<sup>284</sup> Thus, the U.S. approach of concentrating on banks' financial stability using bailouts<sup>285</sup> was not a viable option for Iceland.<sup>286</sup> In short, while key American officials argued that banks were too big to fail, Iceland's banks were too big to rescue.<sup>287</sup> Moreover, Eric Holder's worry that there would be collateral economic consequences for prosecuting TBTF institutions was not operative in Iceland because the banks had already failed. Together, these made prosecutions a more viable option.

Fifth, Iceland made a significantly stronger investment in human capital and resources to investigate and prosecute crime. Iceland's Office of Special Prosecutor started small, and struggled to find a director initially, but by 2012 it had a staff of 100 employees, a caseload of around 200 cases, and 40 indictments against banking executives.<sup>288</sup> Comparing that to the U.S. on

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<sup>281</sup> See, ROBERT KUTTNER, *A PRESIDENCY IN PERIL: THE INSIDE STORY OF OBAMA'S PROMISE, WALL STREET'S POWER, AND THE STRUGGLE TO CONTROL OUR ECONOMIC FUTURE* (2010).

<sup>282</sup> Stephan Faris, *Iceland Prosecutor Investigates, Convicts Bankers for Financial Crimes*, BLOOMBERG (September 12, 2013, 2:57 PM), <https://www.bloomberg.com/news/articles/2013-09-12/iceland-prosecutor-investigates-convicts-bankers-for-financial-crimes>.

<sup>283</sup> BOYES, *supra* note 224.

<sup>284</sup> Paul Krugman, *The Path Not Taken*, N.Y. TIMES (Oct. 27, 2011), <https://www.nytimes.com/2011/10/28/opinion/krugman-the-path-not-taken.html>.

<sup>285</sup> *Too Big to Fail, Too Powerful to Jail?*, *supra* note 48, at 5.

<sup>286</sup> Krugman, *supra* note 285.

<sup>287</sup> BERGMANN, *supra* note 228, at 191.

<sup>288</sup> Gunnlaugsson, *supra* note 223, at 94.

a per capita basis, the size of the OSP is equivalent to the U.S. creating a task force of “about 90 thousand employees and a case load of about two hundred thousand cases.”<sup>289</sup> Obviously, that large of a task force was not politically feasible or perhaps desirable, but Iceland’s investment provides a stark counterpoint to the United States’ lack of interest, and underinvestment, in investigating fraud.<sup>290</sup>

Sixth, the nature of Iceland’s prosecutorial investment is different. Whereas the U.S. invested in people in the DOJ and FBI, Iceland relied on an outsider named Ólafur Hauksson to head the OSP, a small town police chief who had no prior experience with financial crimes.<sup>291</sup> Hauksson did have expertise in pursuing criminal networks and used these tactics effectively to gather evidence and to turn witnesses at Icelandic banks.<sup>292</sup> Perhaps his best asset seemed to be that he was willing to take the job; when the job was first advertised, nobody applied and only two applied after applications were sought a second time.<sup>293</sup>

What he lacked in expertise, he compensated with more independence from political and financial elites and a populist sensibility.<sup>294</sup> He grew up middle class, having a sense of hard work and thrift from working jobs from the time he was a young kid.<sup>295</sup> Though he tried to move beyond being a police chief, he was turned down for the job equivalent to the U.S. Attorney General.<sup>296</sup> This independence was important because he brought a fresh, and different, perspective to the banks’ behavior. Whereas key elected officials in the U.S. and key figures in the DOJ adopted the reckless innocence framework to understanding bank executive actions, which treated the actions leading to the crisis as normal (though sometimes immoral) business

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<sup>289</sup> Gunnlaugsson, *supra* note 223, at 94.

<sup>290</sup> See *infra* Section II(F).

<sup>291</sup> Faris, *supra* note 283.

<sup>292</sup> *Id.*

<sup>293</sup> *Id.*

<sup>294</sup> Cf. MICHAEL PERINO, THE HELLHOUND OF WALL STREET: HOW FERDINAND PECORA'S INVESTIGATION OF THE GREAT CRASH FOREVER CHANGED AMERICAN FINANCE (2011) (providing a good U.S. historical parallel for Hauksson is Ferdinand Pecora, who was an outsider with little experience or expertise on Wall Street working as a District Attorney in New York City, but drew national attention to elite financial misbehavior preceding the great depression as chief counsel for hearings of the U.S. Senate's Committee on Banking and Currency in 1933).

<sup>295</sup> Faris, *supra* note 283.

<sup>296</sup> *Id.*

practices,<sup>297</sup> Hauksson drew a clear distinction between business practices and wrongdoing, using this understanding to drive his investigations.<sup>298</sup> The aggressiveness and results speak for themselves.

Seventh, the nature of the crimes in Iceland may have made it easier to prosecute banking executives. Some of Iceland's bankers committed crimes that would have resulted in a conviction in the U.S. as well, while U.S. bankers escaped such punishment.<sup>299</sup> This argument is a variation of the careless, but not criminal account of the U.S. financial crisis. Some of Iceland's bankers' actions would have made for much more straightforward prosecutions in the U.S., such as tax evasion and insider trading. For example, it is highly likely bankers could be jailed for the Kaupthing Bank case if the same actions were performed in the U.S. It is important to note this argument also presumes a willingness to extend these laws to financial executives, but this may be a good assumption given the aggressiveness and success of the U.S. Attorney's Office in the Southern District of New York against insider trading.<sup>300</sup> Yet, this argument misses the parallel between Iceland's banking elite misleading the public about the health of their company, while evidence suggests internally they were much less optimistic and engaging in practices to mask their capital fragility.<sup>301</sup> For example, though the specific accounting practices differed, the accounting gimmicks Lehman used to mask its weakness on the eve of its collapse offer a good parallel, and the DOJ decided to not pursue what could have been a strong case.<sup>302</sup>

Weighing the importance of these potential explanations is an imprecise endeavor, but some have more plausibility than others. Judicial system differences, cultural values, and the nature of the crimes are the weakest of the above explanations. At the macro level, the relative size of the countries and size of the crises left Iceland with a narrower range of responses to the crisis. Since Iceland had no chance to leave its banks largely intact, prosecuting bankers had little economic downside and some political upside, given the anger of the protestors and the broader public. At a micro level, the

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<sup>297</sup> See *infra* Section II(A).

<sup>298</sup> Faris, *supra* note 283.

<sup>299</sup> Tim Worstall, *If Iceland Can Jail Bankers For The Crash Then Why Can't America?*, FORBES (Oct. 24, 2015, 12:51 PM), <https://www.forbes.com/sites/timworstall/2015/10/24/if-iceland-can-jail-bankers-for-the-crash-then-why-cant-america/#58e71cdb2b30>.

<sup>300</sup> Eisinger, *supra* note 13.

<sup>301</sup> Worstall, *supra* note 300.

<sup>302</sup> See Protess & Craig, *supra* note 68.

choices of political actors outside government, and the politicians they elected, created environments that made prosecutions more palatable in the case of Iceland, and less so in the case of the United States. Within government, the choice in Iceland to prioritize prosecutions and the choice of an independent outsider made serious investigation into crime more likely. This latter option suggests a promising place for reform, as discussed in the conclusion that follows.

#### CONCLUSION

What lessons can be learned about increasing the future likelihood of criminal prosecutions for senior banking executives? First, lessons from the U.S. suggest the statute of limitations may need to be lengthened for certain financial crimes to give law enforcement the necessary time to research and build cases.<sup>303</sup> This is particularly important, given the complexity of the financial instruments that contributed to the recent crisis and the need to give regulators and law enforcement the time to understand industry practices.<sup>304</sup> Second, Iceland suggests the importance of appropriately balancing law enforcement's need for expertise about, and connections to, the industry, with a healthy independence from, and skepticism of, it. It is noteworthy that Iceland successfully prosecuted executives despite the economic power and political interconnections of the banking industry that permeated Icelandic politics and society before the crisis. To the extent it can be said that the financial industry had meaningfully captured the political system in the U.S., the same could be said for Iceland, but even more so.<sup>305</sup> Would U.S. law enforcement have been more aggressive if a small town police chief had been put in charge of investigating and prosecuting Wall Street? This is not clear. The aggressiveness of prosecutors after the S&L crisis, which is often held up as a good model to contrast with the 2008 crisis, did so with existing law enforcement agencies. To the extent U.S. officials want to encourage existing regulators and law enforcement agencies to be more aggressive next time, a group of former regulators and banking officials have put together a plan

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<sup>303</sup> Garrett, *supra* note 24, at 47.

<sup>304</sup> See, e.g., Jake Bernstein & Jesse Eisinger, *SEC Just Now Seeking Key Information On Meltdown*, PROPUBLICA (Dec. 16, 2009, 10:30 AM), <http://www.propublica.org/article/years-later-sec-looks-for-basic-information-about-players-in-meltdown-1216> (providing an example of how far key regulators were behind in understanding the crash).

<sup>305</sup> *Lessons From Iceland*, *supra* note 226, at 28.

under a group called the Bank Whistleblowers United.<sup>306</sup> Their recommendations include stricter requirements on conflicts of interest for agency leadership, increased hiring of expert staff, and restoring criminal referral coordinators at financial regulatory agencies.<sup>307</sup>

These lessons presume that the criminal justice system's focus on punishment is the best deterrent for the kind of behavior that produces financial crises. Jail may be a better deterrent for white-collar criminals than other classes of offenders.<sup>308</sup> Yet, even after the aggressiveness in Iceland, there are still suspicious transactions in the newly emerging banking sector that cast doubt on the deterrent effects.<sup>309</sup> Others worry that too strong of a focus on retribution will prevent the needed attention on creating the appropriate regulatory structure that can foresee and forestall the next crisis.<sup>310</sup> Yet, these two priorities are not mutually exclusive; focusing on both could reinforce one another. Given the lack of criminal referrals from U.S. financial regulators, more attention to criminal actions could be part of the vigilance that is expected for them to have over the industry. A strengthened approach to criminal accountability signals to the financial industry that law enforcement also plays a part in oversight of the industry that compliments the regulatory apparatus. To the extent that incarceration is still the dominant mode of punishment for blue-collar criminals in the U.S., extending this model for their white-collar counterparts is appropriate as a matter of fairness, and to make true Eric Holder's promise "that there is no bank, there's no institution, there's no individual who cannot be investigated and prosecuted by the United States Department of Justice."<sup>311</sup>

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<sup>306</sup> DAYEN, *supra* note 270.

<sup>307</sup> *Id.*

<sup>308</sup> John Braithwaite, *Diagnostics of White-Collar Crime Prevention*, 9 CRIM. & PUB. POL'Y 621, 623 (2010).

<sup>309</sup> Robinson & Valdimarsson, *supra* note 255.

<sup>310</sup> Richman, *supra* note 77, at 281.

<sup>311</sup> Mark Gongloff, *Eric Holder: Actually, I Meant to Say No Banks Are Too Big to Jail*, HUFFPOST (last updated May 15, 2013), [http://www.huffingtonpost.com/2013/05/15/eric-holder-too-big-to-jail\\_n\\_3280694.html](http://www.huffingtonpost.com/2013/05/15/eric-holder-too-big-to-jail_n_3280694.html).