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J.P. Morgan Sued on Mortgage Bonds

By JEAN EAGLESHAM And DAN FITZPATRICK

New York's top prosecutor opened a new front in efforts to hold banks accountable for the financial crisis by filing a civil lawsuit against J.P. Morgan Chase & Co., alleging widespread fraud by the company's Bear Stearns unit in the sale of mortgage-backed securities.

The case is the first to be brought under the aegis of a group of federal and state prosecutors and regulators formed by President Barack Obama in January. If successful, the lawsuit could point the way to significantly more financial pain for the big banks, which face threatened government actions and numerous investor lawsuits tied to mortgage securities that soured in the crisis.

Since 2008, state and federal regulators have launched dozens of probes to determine whether banks broke securities laws or were simply guilty of errors of judgment. Regulators have achieved some record-breaking penalties and investors have secured some significant victories. Bank of America Corp. agreed Friday to pay $2.43 billion to settle claims it misled investors about the acquisition of Merrill Lynch & Co., in the largest shareholder class-action settlement tied to the meltdown. BofA didn't admit wrongdoing.

At the same time, regulators have been criticized for their failure to bring enforcement actions in relation to some of the biggest blowups in the crisis, such as the collapse of Lehman Brothers Holdings Inc. William Black, a former bank regulator, said Monday's civil action showed "a continuation of the failure of leading prosecutors to bring a criminal case against any of the elite players."

The complaint filed Monday in New York state court by Eric Schneiderman, the state's attorney general, seeks an unspecified amount of damages related to billions of dollars in losses. It is the first action from the Residential Mortgage-Backed Securities Working Group, which cites some $22.5 billion of losses suffered by investors in securities issued by Bear Stearns Cos. in 2006 and 2007, before the New York investment bank nearly collapsed in March 2008 and was taken over by J.P. Morgan. The lawsuit alleges that Bear Stearns defrauded investors by packaging up and selling on mortgages that it knew—or should have known—were highly likely to default.

J.P. Morgan Chase spokesman Joseph Evangelisti said the bank intends to contest the allegations, and that it is "disappointed" the New York attorney general "decided to pursue its civil action without ever offering us an opportunity to rebut the claims."

Associated Press

Attorney General Eric Schneiderman, left, filed suit over mortgage securities.

Mr. Evangelisti also noted the allegations pertain to the activities of Bear Stearns before J.P. Morgan Chase purchased the securities firm in March 2008.

The New York lawsuit takes the approach of targeting alleged fraud across the firm, rather than restricting the allegations to a single deal, as federal regulators have done in many previous cases related to the financial crisis.

The lawsuit also uses New York State's Martin Act, which doesn't require prosecutors to prove a firm intended to defraud investors to win a case. The suit draws on work by other members of the group, particularly the Justice Department and the Federal Housing Finance Agency's office of inspector general, and the plan had been to jointly announce the action Tuesday, people familiar with the group said.

The task-force is drawing up plans to use Monday's lawsuit as a blueprint to bring other cases on a firm-wide basis, potentially targeting damages totaling tens of billions of dollars, according to one person briefed on the matter.

"We intend to follow up with similar actions against other sponsors and underwriters of" residential mortgage-backed securities, said an official in the attorney general's office.

The suit alleges that losses on residential-mortgage securities issued by Bear Stearns in 2006 and 2007 alone were "astounding," totaling more than a quarter of the original principal balance. The action asks that the company be made to pay an undisclosed amount of damages "caused, directly or indirectly, by the fraudulent and deceptive acts."

New York's attorney general filed a civil complaint against J.P. Morgan Chase alleging widespread fraud in the sale of mortgage-backed securities in the run-up to the financial crisis. WSJ's Francesco Guerrera has the details.

The lawsuit quotes from emails and messages purportedly sent within Bear Stearns that it says showed the bank was aware it was selling poor quality investments. In one, a Bear Stearns employee described one securitization in an internal email as a "sack of s***," according to the lawsuit.

The Campaign for a Fair Settlement called the suit "an encouraging first step to holding Wall Street banks accountable for [their] reckless and deceitful practices."

Many big banks still face a litany of legal challenges stemming from the mortgage meltdown. The top federal housing regulator filed lawsuits in September 2011 against 17 of the world's biggest financial institutions, saying they sold $196 billion of risky home loans over four years to Fannie Mae and Freddie Mac without adequately disclosing the risks. The Federal Housing Finance Agency suits included $33 billion in bond deals involving J.P. Morgan.

The Federal Deposit Insurance Corp. in August sued 11 major banks including J.P. Morgan, alleging they misled failed Colonial Bank when they sold the Alabama mortgage lender $388 million in mortgage-backed securities. Colonial, a Montgomery, Ala., unit of Colonial BancGroup Inc., failed on Aug. 14, 2009, in the biggest U.S. bank failure since the 2008 collapse of Washington Mutual Inc.

J.P. Morgan hasn't previously commented on the FHFA or FDIC actions.

Prosecutors and regulators are battling against time in their renewed drive to bring financial crisis cases, as more potential lawsuits risk running afoul of statutes of limitations in federal and state laws. Firms can seek to have cases thrown out if the allegations relate to conduct before these cutoff points, typically five years for most federal laws.

J.P. Morgan is one of three banks that earlier this year disclosed the SEC had warned them it intended to file civil fraud charges related to these investments. One of those banks, Goldman Sachs Group Inc., said in August the SEC had decided to drop its probe against the firm without filing charges.

J.P. Morgan shares dropped 37 cents, or 0.9%, in after-hours trading Monday to $40.60, after rising 1.2% in regular trading. The shares have traded above $40 in recent weeks for the first time since the company disclosed in May that it faced billions of dollars in losses on a trade placed by London-based employees of its cash-managing Chief Investment Office, including one known as the London whale for his outsize trading positions.

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