

Take Stock of Your Own House

Proactively Responding to the Subprime Crisis

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Why Take Stock of Your House?

- Crisis involving complex instruments
- Many participants in these transactions
- Most participants have claims to assert and defend
- Huge losses - \$120 billion as of February 2008
- High “buzz”
- Sympathetic plaintiffs



***“Would everyone check to see they have an attorney?
I seem to have ended up with two.”***

Why Take Stock of Your House?

- Who to blame?
- Hot enforcement environment
- If this is like other recent financial “scandals”, consequences could be significant
- Ultimate losses could be multiples of current estimates

Why Take Stock of Your House?

- Action Plan?
 - Be proactive
 - Independent internal investigation
 - Think about Company *and* its officers and directors

The Facts Behind the Subprime Crisis



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The Facts Behind the Subprime Crisis

- We will assume you know the basic facts
- It all stems from the collapse in value of subprime mortgages

The Facts Behind the Subprime Crisis

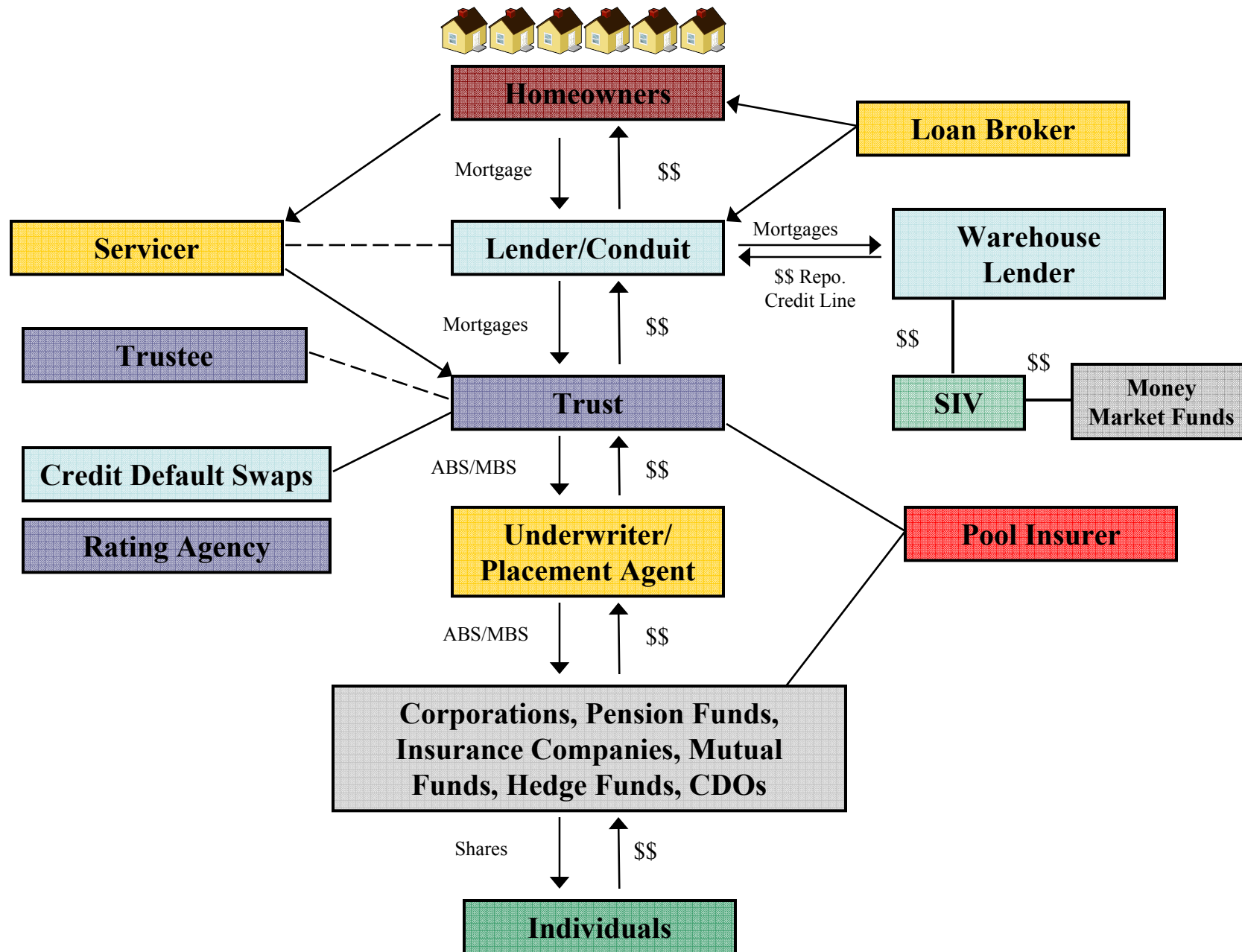
A Perfect Storm: 2005-2006

- Borrowing binge fueled by low interest rates, lax underwriting
- Home prices appreciate wildly
- New loan products such as no verification loans, negative amortization and teaser rates create riskier loan pool
- Refinancing boom creates higher leverage
- Securitization separates originator from risk holder
- Housing prices level off and then deflate

The Facts Behind the Subprime Crisis

You must understand the basics of securitization of these assets, illustrated by the following chart.

Following a Subprime Loan into a Mortgage-Backed Security



The Facts Behind the Subprime Crisis

- Where are you and your organization positioned in the chart?
- Will you be asserting claims?
 - Are you preserving them?
- Will you be defending against claims?
 - Are you prepared?
- This crisis has taken unexpected turns

The Facts Behind the Subprime Crisis

Who would have thought this could affect -


- AAA instruments?
- Money market funds?
- Municipal bond funds?
- Hospitals and universities?

The Facts Behind the Subprime Crisis

Do you know what is coming next?

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Edward F. Wilson



"My insurance company? New England Life, of course. Why?"
Of course, the lower net cost of our new Vanguard Series is a breakthrough, too.

The Facts Behind the Subprime Crisis

**An internal investigation is important protection in
this volatile and uncertain environment**

Conducting Effective Internal Investigations



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Numerous Federal and State Investigations Are Already Underway

Investigations of all variety of players in the subprime arena are continually coming to light.

In January...

- The **FBI** announced an investigation into 14 corporations across the subprime lending industry. The FBI said it is working with the SEC.
- The **SEC** reportedly has opened about three dozen cases into the subprime market collapse.

Numerous Federal and State Investigations Are Already Underway

In February...

- The **US Attorney for the Southern District of New York** sought the SEC's information regarding a particular investment bank.
- The **SEC's** focus is said to be whether the investment bank booked inflated prices of mortgage bonds it held despite knowing that the valuations had dropped.

Numerous Federal and State Investigations Are Already Underway

Starting Last Year and Continuing into the Present...

- Additional investigations reportedly are being conducted by:
 - Other U.S. Attorneys' Offices
 - U.S. Trustee's Office
 - FINRA
 - HUD
 - Numerous States' Attorneys General from New York to California
 - District Attorneys Offices
 - NYSE

Numerous Federal and State Investigations Are Already Underway

- These investigations are probing everything from
 - predatory lending to
 - the packaging and sale of high risk mortgage obligations to
 - inflated appraisals to
 - conflicts of interest.

Criminal Accounting Fraud Sentences Should Serve as a Warning

- Previous crises have spawned:
 - Intensive investigations
 - lengthy trials
 - stiff jail terms and
 - hefty fines.

Criminal Accounting Fraud Sentences Should Serve as a Warning

- Some cautionary accounting fraud cases include:
 - Enron
 - Adelphia
 - Tyco International Limited
 - WorldCom.

Criminal Accounting Fraud Sentences Should Serve as a Warning

- Stock options backdating cases are also instructive:
 - Brocade
 - Converse
 - Monster.com.

Conducting Effective Internal Investigations

Timing/Types of Investigations

- Proactive review
- Response to external events

Conducting Effective Internal Investigations

Investigative Considerations

- Who is the client
- What is the mandate
- Who will handle the investigation

Conducting Effective Internal Investigations

Investigative Considerations

- Document preservation
- Witnesses identification
- Handling the results

Conducting Effective Internal Investigations

Attorney-Client and Work Product Considerations

- The attorney-client privilege:
 - protects against disclosure in litigation of confidential attorney-client communications in connection with the seeking or rendition of legal advice
 - belongs to the client alone
 - is waived if a third party is privy to the communication

Conducting Effective Internal Investigations

Attorney-Client and Work Product Considerations

- The work product doctrine:
 - protects work performed in anticipation of litigation by attorneys and their agents.

Conducting Effective Internal Investigations

Practical tips regarding privilege:

- Handling consultants
- Oral or written report
- Sharing the results with the Board and/or management
- Waiver decisions

Providing a White Collar Defense



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Providing a White Collar Defense

The Corporation

- The first line of criminal defense is the internal investigation.
- Why?
 - The facts are the key to deciding whether to cooperate or defend.

Providing a White Collar Defense

The Corporation

- There is more to the corporation's defense than the internal investigation, however.
- You may face a variety of plaintiffs:
 - Prosecutors
 - Regulatory authorities
 - Individuals.

Providing a White Collar Defense

The Corporation

- You may face a variety of claims:
 - Civil:
 - Section 10(b)(5) and state law cognates
 - Shareholder derivative claims
 - Predatory lending claims
 - Criminal:
 - Mail, Wire and Securities Fraud and state law charges (Blue Sky laws)
 - Perjury
 - Obstruction of Justice
- You may have co-defendant directors, officers and/or employees.

Providing a White Collar Defense

Directors, Officers, and Employees

- A corporation must commit a crime through individuals.
- Key questions therefore are:
 - Did anyone do anything wrong?
 - If so, who?
- Directors, officers and employees with exposure should obtain independent counsel.
- Directors', officers', and employees' concerns include responding to the government and their status at the corporation.
- Advancement or reimbursement of attorneys' fees is typical.

Providing a White Collar Defense

The Cooperation Rub

- Department of Justice's McNulty memo
- The KPMG case
- Pending legislation.

Thank you for joining us

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