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FINANCIAL FRAUD

Understanding FIRREA's Reach: When Does Fraud 'Affect' a Financial Institution?

BY ANDREW W. SCHILLING

Recently, the Justice Department has made increasing — and increasingly aggressive — use of FIRREA, a civil penalty statute that it had all but ignored for more than two decades. Enacted in response to the S&L crisis, the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) authorizes the United States to bring a civil lawsuit whenever any person violates or conspires to violate any of fourteen enumerated criminal statutes, including not only bank fraud but also mail fraud, wire fraud, and making false statements.[1] Although rarely used from 1989 to 2009, the Department of Justice (DOJ) seems to have recently rediscovered the statute. In the last two years, the DOJ has filed FIRREA claims against numerous financial institutions (in some cases, naming their top officers) in civil lawsuits that collectively seek potentially billions of dollars in civil penalties.[2]

Andrew W. Schilling, a partner at BuckleySandler LLP, leads the New York office's government enforcement practice. He represents entities and individuals facing government enforcement actions and complex civil litigation, and his practice includes the defense of False Claims Act matters, white-collar criminal matters, and internal investigations. Prior to joining BuckleySandler, Mr. Schilling served as Chief of the Civil Division at the U.S. Attorney's Office for the Southern District of New York where he established that office's Civil Frauds Unit, which supervised several nationally significant financial fraud lawsuits against major financial institutions. He may be reached at aschilling@buckleysandler.com.

With prosecutors armed with this powerful tool, financial institutions and their counsel must understand FIRREA's scope and limitations. While broad in reach, one of the few limitations on the statute is the requirement that certain frauds are actionable under the statute only if the conduct ''affects'' a federally insured financial institution. Therefore, *when* a fraud ''affects'' a financial institution has become a key question.

I. Why Did DOJ Dust Off FIRREA?

FIRREA is a valuable weapon in the DOJ's arsenal against financial fraud for several reasons. First, and perhaps most obviously, while FIRREA incorporates a number of criminal statutes — including mail and wire fraud — it authorizes only civil remedies, not criminal punishment. Accordingly, the United States can prove its case under the ''preponderance of the evidence'' civil standard, not the more exacting ''beyond a reasonable doubt'' standard applicable in criminal cases. In financial fraud cases, in which evidence of criminal intent can be difficult to establish, FIRREA offers the government a way to take aggressive enforcement action in response to financial misconduct that does not necessarily rise to the level of a crime.

Second, the reach of FIRREA is far broader than other civil fraud statutes available to the DOJ. As noted

[1] 12 U.S.C. § 1833a(c).

[2] *See, e.g., United States v. Bank of Am. Corp. et al.*, No. 1:12-cv-00361 (D.D.C. filed Mar. 12, 2012); *United States v. CitiMortgage, Inc.*, No. 1:11-cv-05473 (S.D.N.Y. filed Feb. 16, 2012); *United States v. Allied Home Mortg. Corp.*, No. 1:11-cv-05443 (S.D.N.Y. filed Nov. 4, 2011); *United States v. The Bank of New York Mellon Corp.*, No. 1:11-cv-06969 (S.D.N.Y filed Oct. 4, 2011); *United States v. Luce*, No. 1:11-cv-05158 (N.D. Ill. filed July 29, 2011); *United States v. Buy-a-Home, LLC et al.*, No. 1:10-cv-09280 (S.D.N.Y. filed Dec. 13, 2010).

previously, the statute authorizes a civil lawsuit where there is evidence of a violation of any of fourteen different criminal statutes. While the False Claims Act (FCA) has long been viewed as the principal weapon in DOJ's civil enforcement arsenal, FIRREA authorizes the pursuit of civil remedies in fraud cases even when the fraud does not involve government money. In this way, FIRREA reaches more broadly than the FCA and other common law remedies, which are generally limited to frauds in which the United States Government (and thus the taxpaying public) is the victim. Accordingly, FIRREA provides the DOJ with a civil hook to investigate and prosecute bank fraud and other financial fraud, including mortgage fraud. Indeed, in 2009 Congress amended the definition of ''financial institution'' as used in the criminal code to ensure that FIRREA reached frauds affecting mortgage lending businesses.[3] Given the DOJ's focus on financial fraud — particularly mortgage fraud — following the 2008 financial crisis,[4] FIRREA's reach neatly fits the DOJ's current enforcement priorities.

Third, the monetary penalties available to the government under FIRREA are potentially huge, making the statute particularly attractive as a means of deterring corporate and individual financial fraud. DOJ can seek civil penalties up to $1 million per violation, or up to $5 million for a continuing violation.[5] Significantly, however, where the person derives pecuniary gain from the violation, or where the violation results in pecuniary loss to any person, the amount of the civil penalty can exceed these limits, reaching as high as the amount of the gain to the perpetrator or loss to the victim.[6] Given the magnitude of some financial frauds revealed during the financial crisis, FIRREA makes possible a 'punishment' that fits the financial crime in the eyes of the DOJ.

Fourth, on a practical level, FIRREA is one of the few federal statutes that confers subpoena authority directly upon the DOJ's civil lawyers.[7] While federal prosecutors in criminal investigations enjoy broad power to issue grand jury subpoenas, only a handful of statutes empower civil prosecutors to issue compulsory process for purposes of a civil investigation. And while Civil Investigative Demands (CIDs) are now available to United States Attorneys in certain FCA investigations,[8] CIDs issued under the FCA may not be used outside the context of a FCA investigation, which as noted previously require some nexus to federal dollars. In contrast, FIRREA broadly authorizes the DOJ's civil lawyers to issue compulsory process in civil FIRREA investigations.[9] Specifically, the statute authorizes the DOJ's civil attorneys to compel the production of documents and to take depositions — in other words, to engage in civil discovery pre-suit. This broad subpoena authority has been delegated to local United States Attorneys. Consequently, FIRREA subpoenas can be issued by civil prosecutors in civil fraud investigations almost as easily as grand jury subpoenas may be issued by criminal prosecutors in criminal cases.

Fifth, the disclosure of grand jury material to civil prosecutors is authorized, without a court order, for use in a civil FIRREA investigation.[10] Accordingly, FIRREA provides a mechanism for attorneys handling civil investigations to consider evidence that was originally developed in the context of a criminal investigation where, for whatever reason, a criminal prosecution is not warranted. This express authorization to share grand jury materials for civil FIRREA cases may facilitate both parallel criminal-civil proceedings, and civil investigations subsequent to criminal investigations.

II. When Does the Fraud 'Affect' the Bank?

Given these benefits to the government of using FIRREA to investigate and prosecute financial fraud, it is imperative that financial institutions understand this law and its reach. That reach, in short, is potentially quite broad, although its contours are not yet fully determined by the courts.

The breadth of the statute derives in part from its adoption of the federal mail and wire fraud statutes, 18 U.S.C. §§ 1341 and 1343, which have been broadly construed to reach a wide range of fraudulent activity.[11] Significantly, however, FIRREA does not reach all fraudulent activity that would qualify as mail or wire fraud. Rather, it reaches those frauds only when the conduct ''affect[s] a federally insured financial institution.'' While FIRREA does not define the phrase ''affecting a federally insured financial institution,'' and there has been no reported case law under FIRREA explaining the statute's reach, financial institutions are not without guidance.

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Several other federal criminal statutes use essentially the same phrase (without the requirement that the institution be ''federally insured'') in the context of financial fraud. For example, the penalties for mail and wire fraud are enhanced, and the statute of limitations ex-

[3] 18 U.S.C. § 20(10).

[4] *See, e.g.*, Press Release, U.S. Sec. and Exch. Comm'n, President Obama Establishes Interagency Financial Fraud Enforcement Task Force (Nov. 17, 2009), *available at* http://www.sec.gov/news/press/2009/2009-249.htm.

[5] 12 U.S.C. § 1833a(b)(1) & (2).

[6] 12 U.S.C. § 1833a(b)(3).

[7] 12 U.S.C. § 1833a(g).

[8] Redelegation of Authority of Assistant Attorney General, Civil Division, to Branch Directors, Heads of Offices and United States Attorneys in Civil Division Cases, 75 Fed. Reg. 14,070 (Mar. 24, 2010) (to be codified at 28 C.F.R. pt. 0).

[9] 12 U.S.C. § 1833a(g).

[10] 18 U.S.C. § 3322(a).

[11] *See, e.g United States v. Bolden*, 325 F.3d 471, 488 (4th Cir. 2003) (''A mail or wire fraud scheme often encompasses a range of activities that occur prior to, and culminate in, mail and wire submissions.''); *United States v. Akers*, 215 F.3d 1089, 1102 (10th Cir. 2000) (noting that ''courts have construed very broadly'' the mail and wire fraud statutes); *United States v. Bonnett*, 877 F.2d 1450, 1454 (10th Cir. 1989) (noting the mail and wire fraud statutes have been ''construed by the courts to reach a wide range of fraudulent activity'').

tended from five years to ten, when the offense ''affects a financial institution.''[12] Also, federal law defines a ''continuing financial crimes enterprise'' to include a series of mail or wire frauds ''affecting a financial institution.''[13] Similarly, a previous version of the Sentencing Guidelines provided for stiffer sentences for certain offenses that ''affected a financial institution.''[14] Thus, ''[w]hether a fraud does or does not 'affect a financial institution' is a recurring consideration in federal criminal jurisprudence,'' and cases interpreting that phrase in one context are generally found applicable in another.[15]

Several principles emerge from decisions interpreting this phrase in these related contexts. First, the Government need not establish that the fraud caused any actual loss to a financial institution to establish that the fraud ''affected'' that institution. Rather, a mere ''increased risk of loss'' is sufficient. As one court put it: ''[j]ust as society punishes someone who recklessly fires a gun, whether or not he hits anyone, protection for financial institutions is much more effective if there's a cost to putting those institutions at risk, whether or not there is actual harm.''[16] As another court observed, the dictionary defines ''affect'' broadly to mean ''simply to 'make a material impression on; to act upon, influence, move, touch, or have an effect on.' ''[17]

Second, a financial institution need not have been the victim or object of the fraud to be ''affected'' by it.[18] Thus, a fraud perpetrated against a wholly owned subsidiary of a financial institution may ''affect'' the parent financial institution.[19] The defendant in *Bouyea*, for example, was charged with wire fraud for using an interstate facsimile transmission to fraudulently obtain money and property from an equipment leasing and financing corporation in a manner affecting a financial institution of which the defrauded corporation was a wholly owned subsidiary. The court there held that, even though the defrauded corporation was not itself a financial institution, the fraud ''affected'' a financial institution because a jury could have concluded that the parent was affected by the fraud on its subsidiary in the form of a reduction of the subsidiary's assets.[20]

Third, and relatedly, it has been held that a financial institution may be affected by a fraud even where the financial institution itself was a direct participant in the fraud.[21] Thus, FIRREA arguably could be used against a financial institution for engaging in fraud, even when no other financial institution was ''affected'' by the fraud.

Although the courts thus have construed the term ''affects'' broadly in these other contexts, there are limits. Courts have recognized that there comes a point ''where the 'influence' a defendant's [] fraud has on a financial institution becomes so attenuated, so remote, so indirect that . . . it does not in any meaningful sense 'affect' the institution.''[22] For example, the mere use of a financial institution in a scheme to defraud is probably not enough to demonstrate that the financial institution was ''affected'' by the fraud.[23] Similarly, a fraud may be found too remote to affect the institution ''if the fraud was directed against a customer of the depository institution which was then prejudiced in its dealings with the institution.''[24] Accordingly, ''where a bank incurs only routine transaction costs[,] which it would have incurred had the transaction been completely legitimate[,] the transaction does not affect a financial institution. . . . Routine costs for transactions which, from the bank's point of view, are completely normal do not satisfy this standard.''[25] Accordingly, while a financial institution need not actually lose money as a result of a fraud to be ''affected'' by it (since a mere ''risk of loss'' to the institution is enough), incurring actual costs will not necessarily ''affect'' the institution for FIRREA purposes, as routine transaction costs have been found insufficient.

III. Conclusion

The pursuit of financial fraud remains a top priority of the DOJ. And given the broad reach of this powerful statute, it is not surprising that the Government is returning to FIRREA to combat and prosecute financial fraud. As cases are litigated, the courts will define more clearly the reach and limits of the statute in response to the Government's expansive application of the law. Until then, financial institutions and their counsel would be well advised to get to know this law better.

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[12] 18 U.S.C. U.S.C. §§ 1341, 1343 & 3293; *see also* 18 U.S.C. § 982(a)(2)(A) (authorizing forfeiture for certain fraud offenses ''affecting a financial institution'').

[13] 18 U.S.C. § 225.

[14] U.S. Sentencing Guidelines Manual § 2F1.1(b)(7)(B) (1998).

[15] *United States v. Grass*, 274 F. Supp. 2d 648, 654 n.5 (M.D. Pa. 2003) (quoting *United States v. Esterman*, 135 F. Supp. 2d 917, 919 (N.D. Ill. 2001)).

[16] *United States v. Serpico*, 320 F.3d 691, 694-95 (7th Cir. 2003).

[17] *United States v. Mullins*, 613 F.3d 1273, 1278 (10th Cir. 2010) (''While Congress certainly could have extended the limitations period only when wire fraud 'causes a loss' to a financial institution, it chose instead to use the considerably broader term 'affects.' And that means simply to 'make a material impression on; to act upon, influence, move, touch, or have an effect on,' I Oxford English Dictionary 211 (2d ed.1989), or, perhaps more appositely to this case, 'to have a detrimental influence on,' Webster's Third New International Dictionary 35 (2002).'').

[18] *See United States v. Pelullo*, 964 F.2d 193, 215-16 (3d Cir. 1992) (Congress's extension of a statute to reach any act of fraud ''that affects a financial institution[,]'' rather than requiring that the financial institution be the ''object'' of the fraud, evinced its intent to reach ''a broader class of crimes'').

[19] *Id.*; *see also United States v. Bouyea*, 152 F.3d 192, 195 (2d Cir. 1998).

[20] *Bouyea*, 152 F.3d at 195.

[21] *Serpico*, 320 F.3d at 695 (''[T]he mere fact that participation in a scheme is in a bank's best interest does not necessarily mean that it is not exposed to additional risks and is not 'affected.' ''); *United States v. Ohle*, 678 F. Supp. 2d 215, 229 (S.D.N.Y. 2010) (''In using Bank A as a central player in the HOMER conspiracy, Ohle and his co-conspirator[s] knew they were exposing it to risk if their fraud was uncovered. The whole purpose of § 3293(2) is to protect financial institutions, a goal it tries to accomplish in large part by deterring would-be criminals from including financial institutions in their schemes.'') (quotation omitted).

[22] *Mullins*, 613 F.3d at 1278.

[23] *See United States v. Ubakanma*, 215 F.3d 421, 426 (4th Cir. 2000) (scheme's ''mere utilization of the financial institution in the transfer of funds'' not enough).

[24] *Pelullo*, 964 F.2d at 216.

[25] *Grass*, 274 F. Supp. 2d at 654-55.