# FRAUD ENFORCEMENT AND RECOVERY ACT TOUGHENS FINANCIAL FRAUD LAWS AND PROMISES MORE RIGOROUS ENFORCEMENT

May 21, 2009

To Our Clients and Friends:

On May 20, 2009, President Obama signed into law the Fraud Enforcement and Recovery Act of 2009 ("FERA"). The purpose of this bipartisan law is to revise and strengthen the government's ability to investigate and prosecute corporate and mortgage fraud by (1) modernizing several federal fraud and money laundering statutes, and (2) increasing funding for the U.S. Securities and Exchange Commission ("SEC"), U.S. Department of Justice ("DOJ"), U.S. Postal Inspection Service, Inspector General for the Department of Housing and Urban Development, and U.S. Secret Service. Additionally, FERA creates a bipartisan commission of experts mandated to study the causes of the economic crisis and to refer potential wrongdoers to law enforcement personnel.

## REVISING AND MODERNIZING FRAUD STATUTES

The greatest effect that FERA will have on the corporate landscape is the revision and modernization of several fraud and money laundering statutes to strengthen the federal government's ability to prosecute securities and mortgage fraud. Among the changes are the following:

- FERA amends the criminal securities fraud statute (18 U.S.C. § 1348) to include commodities fraud. Previously, the securities fraud statute did not cover fraud relating to options or futures, including derivatives involving mortgage-backed securities and similar financial products.

- FERA expands the definition of "financial institution" in the U.S. criminal code to encompass "mortgage lending businesses," including "an organization … which finances or refinances any debt secured by an interest in real estate, including private mortgage companies and any subsidiaries." This definition also includes individual mortgage brokers. The change brings mortgage lenders and brokers under the umbrella of federal fraud and criminal laws, including, among others, the bank fraud statute (18 U.S.C. § 1344), which prohibits defrauding "financial institutions." The change also would have the effect of increasing the penalty for mortgage fraud and the availability of civil forfeiture.

- FERA changes the federal money laundering statute (18 U.S.C. §§ 1956, 1957) to countermand a recent Supreme Court decision, *United States v. Santos*,[1] which limited the scope of the money laundering statute to the "profits" of crimes, rather than the gross receipts from such activities. The decision effectively meant that unprofitable money laundering schemes were not prosecutable under the law. FERA makes clear that Congress intends the statute to cover all the proceeds of illegal activity, including gross receipts, not just profits.

- FERA amends the Federal Claims Act ("FCA"), a civil enforcement tool used to recover fraudulently-obtained federal funds, to restore Congress's original intent after several court decisions over the past few years have limited the FCA's scope. For example, in *Allison Engine Co. v. United States ex rel. Sanders*,[2] the Supreme Court held the FCA required the government to prove that a defendant intended specifically to defraud the federal government. Consequently, subcontractors could claim that they only intended to defraud the general contractor, not the federal government, and be found not liable under the FCA. FERA closes this loophole and makes several other changes, including attaching liability to knowingly making false requests or demands for money to the federal government, whether or not the federal government holds title to the funds.

## INCREASED FUNDING FOR FRAUD LAW ENFORCEMENT

Congress has given sharp teeth to these changes by increasing the funding of several government agencies and regulators. FERA authorizes appropriations of $165 million a year to the U.S. Attorney General for fiscal years 2010 and 2011 to be allocated between the Federal Bureau of Investigation, U.S. Attorney's Offices, and the Criminal, Civil, and Tax Divisions of the DOJ. Moreover, FERA increases the SEC's budget by $40 million over two years, which would enable the SEC to hire an additional 60 enforcement staff. FERA stipulates that the appropriations may only be used for fighting securities, mortgage, and other financial institution frauds, and frauds against federal assistance and relief programs, such as the Troubled Asset Relief Program.

## FINANCIAL CRISIS INQUIRY COMMISSION

Lastly, FERA creates a bipartisan commission of experts, called the Financial Crisis Inquiry Commission (the "Commission"), which will consist of ten members, appointed by Democratic and Republican leaders in the House and Senate. The Commission is mandated

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[1] *128 S. Ct. 2020 (2008).*

[2] *128 S. Ct. 2123 (2008).*

to examine "the causes of the current financial and economic crisis in the United States" and the causes of the collapse of each major financial institution that failed . . . or was likely to have failed if not for the receipt of exceptional Government assistance." The Commission has the authority to hold hearings, issue subpoenas, and refer individuals who may have violated the laws of the United States to the U.S. Attorney General.

**EFFECTS OF FERA**

The substantive changes to federal anti-fraud laws in FERA will apply to future conduct, but are not likely to apply retroactively to the past events that brought about the current financial crisis. Going forward, FERA certainly will focus a brighter spotlight on potential financial fraud in the United States and around the globe. In particular, the markets for derivatives involving mortgage-backed securities and similar financial products, as well as the activities of private mortgage brokers, will be brought more clearly and more forcefully under the umbrella of federal fraud enforcement. Moreover, after federal agencies have hired new prosecutors and other regulatory personnel, it seems likely those personnel will focus not only on the enforcement of FERA's new provisions, but also on the enforcement of pre-existing anti-fraud laws, such as the federal wire and mail fraud statutes, to attempt to prosecute those they deem responsible for the current financial crisis. Finally, as frequently happens after the passage of tougher anti-fraud laws, those who potentially could be affected by these changes should review their corporate compliance programs to gain added assurance that they are operating effectively to mitigate the risks associated with more aggressive enforcement activity.

Please feel free to contact us with any questions.

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