FIRREA Civil Money Penalties:
The Government’s Rediscovered Weapon Against Financial Fraud
by
Edwin L. Fountain, Lawrence K. Nesbitt, & Alex P. McBride*

In recent years, the U.S. Department of Justice (“DOJ”) has begun using the civil money penalty provision of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (“FIRREA”) to investigate and prosecute persons suspected of financial fraud. Although FIRREA was enacted over 20 years ago in the wake of the savings and loan crisis, its civil money penalty provision generally lay dormant until its recent resurrection by the DOJ as a tool to combat financial fraud, particularly residential mortgage fraud. As a result, there was until recently a scarcity of case law interpreting the civil penalty provision. Four recent decisions, however, address important issues of first impression regarding the scope of liability and calculation of civil penalties under FIRREA. Over the past six months, three New York federal district judges have ruled that a federally insured financial institution may incur FIRREA liability for engaging in fraudulent conduct “affecting” itself (as opposed to frauds by third parties that victimize the bank). See United States v. The Bank of New York Mellon, No. 11 Civ. 06969 (S.D.N.Y. Apr. 24, 2013); United States v. Bank of America Corp., et al., No. 12 Civ. 01422 (S.D.N.Y. Aug. 16, 2013); United States v. Wells Fargo Bank, NAB, No. 12 Civ. 7527 (S.D.N.Y. (Sept. 24, 2013). These cases followed on the heels of a March 6, 2013 ruling by a California federal district court that set forth an eight-factor analysis to be used in assessing civil money penalties under FIRREA. See United States v. Menendez, No. 11 Civ. 06313 (C.D. Cal.).

What Is the FIRREA Civil Penalty Provision?
Section 951 of FIRREA, codified at 12 U.S.C. § 1833a, authorizes the DOJ to bring a complaint seeking civil money penalties against persons who violate one or more of fourteen enumerated criminal statutes (or predicate offenses) that involve or affect financial institutions and government agencies. For nine of the predicate offenses, which deal specifically with banks or other financial institutions (such as bank fraud, 18 U.S.C. § 1344), the government does not have to prove any additional element beyond violation of the predicate offense itself. For the five others, which are more general offenses including false claims on the U.S. government (18 U.S.C. § 287), false statements within federal jurisdiction (18 U.S.C. § 1001), fraud on federal receivers and conservators (18 U.S.C. § 1032), and mail and wire fraud (18 U.S.C. §§ 1341, 1343), the government must additionally prove that the violation of the underlying criminal statute was one “affecting a federally insured financial institution” (such as an FDIC-insured bank or thrift). FIRREA does not define the term “affecting” and, until recently, there were no reported decisions interpreting that term.

The DOJ has recently begun to invoke FIRREA, often in conjunction with the civil False Claims Act (31 U.S.C. § 3729 et seq.), to seek multi-million or billion dollar penalties against some of the largest financial institutions in the United States, including Bank of America, Wells Fargo, and Citigroup. Earlier this year, the DOJ filed its largest-ever lawsuit under FIRREA against the world’s largest credit rating agency, Standard & Poor’s (“S&P”), seeking more than $5 billion in civil money penalties based on allegations that S&P engaged in a scheme to defraud investors who purchased residential mortgage-backed securities and collateralized debt obligations. On July 16, 2013, the United States District Court for the Central District of California denied S&P’s motion to dismiss that case in full.

What Are the Benefits of FIRREA From the DOJ’s Perspective?
FIRREA provides the DOJ with a number of key advantages in conducting investigations and

* Edwin Fountain is a partner in the Washington office of Jones Day. Larry Nesbitt and Alex McBride are associates in the firm’s Washington and New York offices, respectively.
bringing civil penalty suits against persons suspected of financial fraud.

- **Scope.** FIRREA is broader in scope than the False Claims Act, which is generally limited to circumstances in which the United States suffers a pecuniary loss as a result of a fraud. By comparison, FIRREA allows the DOJ to pursue civil money penalties for any frauds involving or affecting financial institutions. 12 U.S.C. § 1833a(c). FIRREA’s broad scope is principally derived from the inclusion of the mail fraud and wire fraud statutes (18 U.S.C. §§ 1341 and 1343) among FIRREA’s predicate offenses, provided that the fraud “affects” a federally insured financial institution. The mail fraud and wire fraud statutes encompass virtually any fraud where interstate mail, email, telephone, faxes or other electronic communications are used in furtherance of the fraud.

- **Burden of Proof.** Unlike in a criminal prosecution, where the government must prove the defendant’s guilt “beyond a reasonable doubt,” in a FIRREA civil case the DOJ must prove only that a defendant committed one of FIRREA’s predicate offenses by a “preponderance of the evidence.” 12 U.S.C. § 1833a(f). This lower standard of proof makes FIRREA a useful alternative or supplement to criminal prosecutions, because it allows the DOJ to seek substantial civil money penalties even when it lacks evidence to prove the defendant’s guilt beyond a reasonable doubt.

- **Investigative Powers.** FIRREA authorizes the DOJ to issue administrative subpoenas for the purpose of conducting a civil investigation in contemplation of a civil proceeding. 12 U.S.C. § 1833a(g). Under this broad subpoena power, the DOJ may engage in extensive pre-suit investigations, including deposing key witnesses and compelling the production of documents and records, without obtaining prior judicial authorization. For instance, FIRREA’s subpoena power enabled the DOJ to conduct a multi-year investigation of S&P prior to filing its lawsuit early this year. During the course of that investigation, the DOJ’s attorneys reportedly served hundreds of civil subpoenas, spent thousands of hours reviewing and analyzing millions of pages of documents, and contacted and interviewed over 150 witnesses, including dozens of former S&P analysts and executives.

- **Statute of Limitations.** FIRREA has a ten-year statute of limitations, which is far longer than the more typical period of three to five years applicable to civil lawsuits. 12 U.S.C. § 1833a(h). This extended time period provides the DOJ with additional time to conduct its pre-suit investigations and to bring suits in connection with violations that would ordinarily be time-barred.

- **Civil Money Penalties.** While FIRREA does not authorize the imposition of criminal sanctions (such as imprisonment), the civil money penalties available under FIRREA are potentially crippling. FIRREA authorizes penalties up to $1.1 million per violation. For continuing violations, the maximum penalty increases to $1.1 million per day or $5.5 million per violation, whichever is less. 12 U.S.C. § 1833a(b) (1) and (2) (as adjusted for inflation pursuant to 28 C.F.R. § 85.3(a)(6) and (a)(7)). Moreover, FIRREA allows the court to increase the penalty up to the amount of the pecuniary gain that any person derives from the violation, or the amount of pecuniary loss suffered by any person as a result of the violation. 12 U.S.C. §1833a(b)(3). The DOJ has invoked this special penalty rule to seek more than $5 billion in civil money penalties from S&P in the current litigation.

**When Does a Fraud “Affect” a Federally Insured Financial Institution?**

On April 24, 2013, Judge Lewis Kaplan of the U.S. District Court for the Southern District of New York issued the first judicial interpretation of the phrase “affecting a federally insured financial institution” as used in FIRREA. In *United States v. The Bank of New York Mellon*, No. 11 Civ. 06969 (S.D.N.Y. Apr. 24, 2013), the DOJ brought suit against The Bank of New York Mellon and one of its employees under FIRREA for alleged violations of the mail fraud and wire fraud statutes in connection with the defendants’ alleged scheme to defraud Bank of New York’s custodial clients by fraudulently misrepresenting that the bank provided “best execution” when pricing foreign exchange trades under its “standing instructions” program.

In support of its claims, the DOJ contended that the defendants’ alleged fraudulent scheme...
“affected” a federally insured financial institution—namely Bank of New York itself—as well as a number of other federally insured financial institutions which were the bank’s foreign exchange clients. Bank of New York moved to dismiss the complaint, contending that a federally insured financial institution may only be “affected” by a fraud if it was the victim of or an innocent bystander of the alleged fraud, but not if it was the perpetrator.

After considering the text, statutory structure, and legislative history and purpose of FIRREA, the court rejected the defendants’ narrow construction. The court held that Congress intended the statute to apply in circumstances in which a federally insured financial institution was “affected” by the fraud, not just a “victim” of a fraud. The court viewed the term “affecting” as a “singularly broad term” meaning something closer to “involving” than “victimizing.” The court stated that the word “affect” ordinarily means “to act upon” as in “to produce an effect … upon,” “to produce a material influence upon or alteration in,” or possibly “to have a detrimental influence on” and, in the court’s opinion, those definitions were broader than “to victimize.”

The court considered that the essential purpose of FIRREA’s civil money penalties was to deter fraud that put federally-insured deposits at risk, in order to protect depositors and ultimately U.S. federal taxpayers, and so it was entirely consistent with that purpose to hold an institution liable for fraudulent conduct that harmed itself. The court also noted that FIRREA’s penalty provision applied to “whoever” violated a predicate offense, and that the statute could not be read to exclude the affected financial institution itself from the meaning of the word “whoever.”

The court also concluded that a fraud may “affect” an institution within the meaning of FIRREA if it exposes that institution to a new or increased risk of loss, even without a showing of any actual loss. As such, the court held that the DOJ sufficiently alleged that Bank of New York was negatively affected by its own fraud, even though the bank may have profited from that fraud. The DOJ’s complaint alleged that Bank of New York had been named as a defendant in numerous private lawsuits as a result of its alleged fraud, which required it to incur litigation costs, exposed it to billions of dollars in potential liability, and damaged its business by harming its reputation and causing a loss of clients, forcing the bank to adopt a less profitable business model. Furthermore, the court held that these negative effects were of a different character than any profits Bank of New York gained from the alleged fraud, such that those profits did not offset the negative losses and risks that affected the bank. As the DOJ’s complaint had sufficiently alleged that the fraud had negatively affected Bank of New York, the court declined to determine whether a direct but positive effect alone would be sufficient to “affect” a financial institution for the purposes of FIRREA.

The court did state one limiting principle on FIRREA liability, holding that to “affect” an institution, the fraud must be the proximate cause of the alleged negative effects on the institution, and that the touchstone of proximate causation was reasonable foreseeability. The court recognized that at “some point” the effect of a defendant’s fraud on a financial institution may become “so attenuated, so remote, so indirect” that it does not in any meaningful sense “affect” the institution. In the case before it, however, the court held that it was reasonably foreseeable that the alleged scheme, if uncovered, would result in the kind of harms suffered by Bank of New York.

Judge Kaplan’s ruling was essentially endorsed in a similar case four months later by another federal judge sitting in the Southern District of New York. In United States v. Bank of America Corp., et al., No. 12 Civ. 01422 (S.D.N.Y. Aug. 16, 2013), the DOJ alleged that Bank of America, Countrywide Financial Corporation, and other affiliated companies violated the predicate mail and wire fraud criminal statutes by selling defective mortgage loans to Fannie Mae and Freddie Mac that—for purposes of FIRREA—“affected” Bank of America itself, a federally-insured financial institution. In ruling on the defendants’ motion to dismiss, Judge Jed S. Rakoff concluded that the parties’ briefing of legislative history and policy considerations was unnecessary in assessing whether the government’s theory was viable. Instead, the assessment required “nothing more than straightforward application of the plain words of the statute.” The court noted that the statute’s key term, “affect,” is a “simple English word” defined in Webster’s Dictionary as “to have an effect on.” The court held that the “[t]he fraud here in
question had a huge effect on [Bank of America] itself (not to mention its shareholders)” because Bank of America allegedly “has paid billions of dollars to settle repurchase claims by Fannie Mae and Freddie Mac made a result of the fraud here alleged.”

Judge Rakoff did note in dicta that the term “affect” may not be broad enough to cover the DOJ’s additional theory of liability, namely that Bank of America’s fraudulent sales of the loans to Freddie and Fannie “affected” federally-insured community banks that owned preferred shares issued by Freddie and Fannie that were wiped out after Freddie and Fannie were placed in conservatorship in 2008. The court noted that the statute lacks the usual modifiers “directly or indirectly” that Congress typically employs to reach derivative effects. Although the government alleged that the fraud “proximately caused” harm to the community banks, thereby satisfying even a narrower reading of “affecting,” the court did not rule on the question, finding that the FIRREA requirement was satisfied by the allegation of an effect on Bank of America itself.

Most recently, Judge Jesse Furman, also of the Southern District of New York, followed Bank of New York Mellon and Bank of America in holding that a bank is “affected” within the meaning of FIRREA even when it is the alleged perpetrator of the fraud. United States v. Wells Fargo Bank, NAB, No. 12 Civ. 7527 (S.D.N.Y. Sept. 24, 2013). In that case the government alleged that Wells Fargo defrauded the Federal Housing Administration (“FHA”) out of hundreds of millions of dollars by knowingly certifying thousands of mortgage loans for FHA insurance that failed to meet FHA eligibility requirements. Judge Furman rejected Wells Fargo’s attempt to distinguish Bank of America by arguing that (unlike the repurchase claim settlements made by Bank of America) Wells Fargo has yet to be “affected” by its alleged misconduct. The court ruled that Wells Fargo could be “affected” by the alleged fraud merely through its increased risk of loss. In any event, the court ruled that Wells Fargo could be “affected” yet to be “affected” by its alleged misconduct. The court noted that the statute lacks the usual modifiers “directly or indirectly” that Congress typically employs to reach derivative effects. Although the government alleged that the fraud “proximately caused” harm to the community banks, thereby satisfying even a narrower reading of “affecting,” the court did not rule on the question, finding that the FIRREA requirement was satisfied by the allegation of an effect on Bank of America itself.

Judge Furman also made a significant ruling in Wells Fargo with respect to the scope of one of FIRREA’s predicate offenses, 18 U.S.C. § 1005. The Judge held that one key provision of Section 1005, which imposes liability for fraud on those who engage in transactions with a financial institution with intent to defraud the U.S. government, is not limited to fraud committed by bank insiders but applies to non-insiders as well.

Arguably, the court’s broad reading of FIRREA in the Bank of New York Mellon, Bank of America, and Wells Fargo cases contradicts the view of at least one other federal district court that “[p]unitive statutes, such as FIRREA, are to be narrowly construed.” See United States v. Vanoosterhout, 898 F. Supp. 25, 30 (D.D.C. 1995). In any event, the initial rulings that the term “affecting” is a “singularly broad term” — such that a financial institution is “affected” by a mere increased risk of loss — will encourage the DOJ to continue invoking FIRREA as it aggressively investigates and prosecutes financial institutions and others for financial fraud.

How Are Civil Money Penalties Calculated Under FIRREA?

As discussed above, FIRREA establishes maximum penalty limits, but otherwise leaves the precise award within the discretion of the court. FIRREA does not set forth any factors that a court must consider in calculating civil money penalties and, until recently, there were no reported cases that discussed such factors. On March 6, 2013, the U.S. District Court for the Central District of California issued the first judicial decision setting forth factors relevant to assessing civil money penalties under FIRREA.

In United States v. Menendez, the DOJ brought a FIRREA suit against a licensed real estate broker who had allegedly committed bank fraud in violation of 18 U.S.C. § 1344(1) by submitting a false certification to the U.S. Department of Housing and Urban Development (“HUD”) in connection with a short sale of a residential property. After obtaining summary judgment on the issue of the defendant’s liability, the DOJ requested that the court impose a penalty in the amount of approximately $1.1 million, which was the amount of the loss allegedly suffered by HUD as a result of the defendant’s fraudulent scheme. (The damages claim included
27 other transactions, as to which the court struck the DOJ’s proof of damages for inadequate foundation.) The defendant argued that the amount sought by the DOJ was excessive, and requested that the court either deny the DOJ’s motion or impose a substantially reduced penalty.

In its ruling on the issue, the court noted the absence of any authority setting forth factors or criteria that the courts should consider in assessing a civil penalty under FIRREA. In the absence of such authority, the court looked to factors that courts have applied in other contexts involving civil penalties. The court set forth the following eight factors for determining the civil penalty amount under FIRREA:

1. the good or bad faith of the defendant and the degree of his/her scienter;
2. the injury to the public, and whether the defendant’s conduct created substantial loss or the risk of substantial loss to other persons;
3. the egregiousness of the violation;
4. the isolated or repeated nature of the violation;
5. the defendant’s financial condition and ability to pay;
6. the criminal fine that could be levied for this conduct;
7. the amount the defendant sought to profit through his fraud; and
8. the penalty range available under FIRREA.

Applying these factors, the court imposed a civil money penalty of $40,000, or the amount that the defendant had profited from his alleged fraud. In determining that the $1.1 million penalty sought by the DOJ was excessive, the court noted that the maximum criminal fine for bank fraud was $1 million. The court also found that the likely fine under the federal sentencing guidelines would be in the range of $20-30,000. The court also rejected the DOJ’s argument that a defendant’s finances are irrelevant to assessing a civil penalty under FIRREA, holding that a heavy penalty was not warranted due to the fact that defendant had limited assets and income, and had filed a petition for Chapter 7 bankruptcy.

Menendez establishes that the courts have flexibility in determining the actual civil penalty awarded under FIRREA. Under this framework, the courts are instructed to consider the particular facts of the case and the defendant’s unique circumstances, and not to rigidly adhere to the statutory maximums. The Menendez factors will likely be followed by other courts adjudicating FIRREA claims. In the meantime, the decision provides a general framework for defendants and their advisers to evaluate the likely range of financial penalties that a court may impose for FIRREA violations.