

## **The FERA's Focus on Financial Institutions**

By: *Thomas J. Kenny, Gilbert W. Boyce and Edward G. Warin*<sup>1</sup>

Attempting to thwart predatory lending and securities and commodities fraud, on May 20, 2009, President Obama signed the Fraud Enforcement and Recovery Act of 2009 (the "FERA") into law.<sup>2</sup> To finance the Administration's dramatic crackdown on various financial frauds, the FERA appropriates \$536 million in new funds to investigate and prosecute mortgage, securities and commodities fraud (including derivatives) and establishes a powerful new "Financial Crisis Inquiry Commission" (the "Commission") to examine how illegal activity and other events contributed to the current economic crisis. The FERA amends the federal criminal code to include a "mortgage lending business" under the definition of a "financial institution" and expands the prohibition against making false statements in mortgage applications to employees and agents of mortgage lenders. The FERA also expands existing securities fraud provisions to include fraud involving options and futures in commodities and modifies existing prohibitions against major fraud against the United States to include fraud involving economic relief and Troubled Asset Relief Program ("TARP") funds.

### **"Financial Institution" Definition Expanded**

Section 2 of the FERA redefines "financial institution" under 18 U.S.C. § 20 to include mortgage lending businesses. The FERA amends 18 U.S.C. § 27 to define a "mortgage lending business" as "an organization which finances or refinances any debt secured by an interest in real estate, including private mortgage companies and any subsidiaries of such organizations, and whose activities affect interstate or foreign commerce." This change will be significant because fraud affecting financial institutions is generally punished more severely than other fraud offenses.<sup>3</sup> Furthermore, bank fraud may be committed only by "obtain[ing] any of the moneys, funds, credits, assets, securities, or other property owned by, or under the control of, a *financial institution* by means of [fraud]" under 18 U.S.C. § 1344.<sup>4</sup> Under the FERA's new definition of a financial institution, those who fraudulently obtain the funds or property of a mortgage lending company are subject to more severe criminal sanctions, including a maximum fine of \$1,000,000 or maximum imprisonment of 30 years or both.

### **False Statements**

18 U.S.C. § 1014 prohibits knowingly making false statements on credit applications. The FERA amends Section 1014 to include a prohibition of false statements in connection with mortgage applications by mortgage brokers and agents of mortgage lending businesses. Employees and agents of mortgage lending businesses should review existing compliance procedures to avoid violations of Section 1014, as amended, given the severe penalties and renewed prosecutorial focus on such crimes.

## **Commodities Fraud**

The FERA broadens the scope of the securities fraud statute, 18 U.S.C. § 1348, to include options and futures in commodities. Previously, the securities fraud statute did not reach fraud involving commodities, which include “derivatives” that the Obama Administration has cited as partially responsible for the collapse of U.S. financial markets.<sup>5</sup> Fraud involving previously unregulated financial products, such as credit default swaps, now fall within the umbrella of Section 1348. This change is significant because fraud involving securities is more severely punished than many other types of fraud. After the passage of the FERA, commodities fraud may be punished by an unspecified fine or 25 years imprisonment or both.

## **TARP**

The FERA amends the major fraud against the United States statute, 18 U.S.C. § 1031, to include economic relief and TARP funds. Under the FERA, the fraudulent procurement of “any grant, contract, subcontract, subsidy, loan, guarantee, insurance, or other form of Federal assistance, including through the [TARP], an economic stimulus, recovery or rescue plan provided by the Government, or the Government’s purchase of any troubled asset,” is punishable by up to 10 years imprisonment and up to a \$5,000,000 fine.

## **Investigation and Prosecution**

Section 3 of the FERA authorizes more than half a billion dollars in new funding for federal investigations and prosecutions of financial fraud “involving Federal assistance programs and financial institutions.” Section 3 specifically appropriates \$536 million to various offices over the next two years, \$350 million of which is allocated to the Attorney General “for the purposes of investigations and prosecutions and civil and administrative proceedings involving Federal assistance programs and financial institutions.” In addition to these appropriations, Congress authorized a Financial Crisis Inquiry Commission to examine the causes of the current economic crisis. The Commission, with wide-ranging new powers, including authority to issue subpoenas and hold investigative hearings, will specifically examine fraud in the financial sector, including, in part, “fraud and abuse towards consumers in the mortgage sector,” “lending practices and securitization,” “derivatives and unregulated financial products and practices, including credit default swaps,” among others.

## **Practical Steps**

Because the FERA brings mortgage lending companies under the prohibitions applicable to “financial institutions” in the federal criminal code, these companies will benefit from reviewing and updating their compliance programs. Mortgage lenders should inform their employees and agents of the significant penalties for knowingly making false statements on credit applications and take steps to assure compliance with these provisions. Financial entities should also analyze how to address these new provisions criminalizing commodities fraud, which the Obama Administration has targeted for prosecution given their perceived role in the current economic crisis. Financial institutions generally should monitor these and other new laws to ensure appropriate modifications to their compliance processes and policies are made to avoid the Administration’s new prosecutorial initiatives and enhanced enforcement tools.

*For more information regarding the FERA or how your organization should proactively address the government's heightened prosecutorial focus on financial fraud, please feel free to contact the authors below. Each of the authors has deep experience in all manner of governmental and private litigation, including the topics addressed in this paper.*

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<sup>2</sup> Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21, 123 Stat. 1617. In a prior client alert, we outlined the FERA's amendments to the False Claims Act (the "FCA").

<sup>3</sup> *See, e.g.*, 18 U.S.C.A. § 1341 (2008) (imposing an additional 10 years to the maximum penalty for mail fraud if said fraud "affects a financial institution").

<sup>4</sup> Emphasis added.

<sup>5</sup> *See* Press Release, The White House Office of the Press Secretary, Reforms for American Homeowners and Consumers (May 20, 2009), available at [http://www.whitehouse.gov/the\\_press\\_office/Reforms-for-American-Homeowners-and-Consumers-President-Obama-Signs-the-Helping-Families-Save-their-Homes-Act-and-the-Fraud-Enforcement-and-Recovery-Act/](http://www.whitehouse.gov/the_press_office/Reforms-for-American-Homeowners-and-Consumers-President-Obama-Signs-the-Helping-Families-Save-their-Homes-Act-and-the-Fraud-Enforcement-and-Recovery-Act/).

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