

The Fraud Enforcement
and Recovery Act
“FERA”



Increased prosecution of fraud is one of the government's goals with the Fraud Enforcement and Recovery Act. With substantial funds authorized to accomplish this, a number of public companies and private businesses may find themselves the subject of investigations by the FBI and the Department of Justice. The new Financial Crisis Inquiry Commission will add to the scrutiny some organizations will face.

The financial crisis that began in the United States in 2008 had its roots in the collapse of the housing and mortgage markets. Incentives in the mortgage production machine may have led various participants in the mortgage cycle to act unwisely or worse. The subsequent tsunami of defaults and foreclosures contributed to a collapse in the value of mortgage-backed securities and in housing prices. The sharp recession that followed is familiar to everyone.

Fraud in the mortgage market has allegedly involved borrowers, lenders, mortgage brokers, appraisers, and other parties.

The number of criminal mortgage fraud investigations opened by the FBI has more than doubled over the past three years, but resource constraints have limited the capacity of investigators and prosecutors to bring to justice the people who perpetrated fraud to boost their personal income or company profits.

Three main elements of FERA

1. Expands the Department of Justice's authority to prosecute mortgage fraud, commodities fraud, and fraud involving TARP and Recovery Act funds
2. Authorizes nearly \$500 million in additional resources for government fraud investigations, prosecutions, and civil proceedings
3. Establishes the Financial Crisis Inquiry Commission to investigate the causes of the financial crisis

The Fraud Enforcement and Recovery Act (FERA), signed by the president in May 2009 is a three-pronged attack on mortgage fraud and related wrongdoing. But if FERA follows the example of the RICO (Racketeer Influenced Corrupt Organizations) statute, it may end up impacting a broader array of organizations than just mortgage market participants.

1. Strengthening legislation

- FERA amends the definition of a "financial institution" in the criminal code to include mortgage lending businesses that are private and other non-bank lenders.
- It broadens the mortgage applications statute to make it a crime for mortgage brokers and agents of mortgage lending businesses to make false statements in applications to non-federally-regulated lenders.
- FERA amends the federal securities statute to cover fraud schemes involving commodities and options.
- It modifies the False Claims Act, to make it apply more broadly than some courts had recently found. FERA eliminates the requirement that a false claim be presented to a federal official or that it directly involve federal funds. This is intended to clarify the applicability of the Act to subcontractors who do not deal directly with the federal government.
- FERA also amends the False Claims Act's reverse false claims provision so that knowingly retaining an overpayment is a violation of the Act.

- FERA amends the major fraud statute to cover fraud in funds provided under the Troubled Asset Relief Program (TARP) and other economic stimulus, recovery or rescue plans, including the Emergency Economic Stabilization Act.
- FERA amends anti-money laundering laws to define “proceeds” as meaning any property derived from unlawful activity, including the gross receipts (not the net profits) from such activity.

2. Increasing funding for fraud investigations, prosecutions, and civil proceedings

- FERA authorizes (but does not appropriate) almost \$500 million in funding during the fiscal years 2010 and 2011 for fraud investigations, prosecutions, and civil proceedings in the areas outlined above.
- The bill directs the largest portion of the funding to the FBI, with significant funds also going to the U.S. Attorney’s Offices, the Department of Justice, the U.S. Secret Service, Postal Inspection Service, the Department of Housing and Urban Development, and the Department of Homeland Security.

3. Establishing a Commission of Inquiry

- FERA creates the Financial Crisis Inquiry Commission (the “Commission”) to examine the domestic and global causes of the current financial and economic crisis in the United States and to examine the causes of the collapse of each major financial institution that failed, were acquired to prevent their failure, or would likely have failed absent government assistance.
- FERA instructs the Commission to examine the role of 22 specific factors covering a broad range of legal, regulatory, and business practices.
- The Commission may hold hearings, take testimony, receive evidence, administer oaths, and require (including by subpoena) testimony and production of evidence.
- The Commission shall report to Congress by December 15, 2010.

“...if we want to fully dig ourselves out of this crisis, we’re going to need to do more than just change policy. We need all of us to live up to our responsibilities.”

Signing statement of the President

Potential implications

The additional funding for government investigations into potential fraud is a clear warning of increased prosecutorial activity to come. According to co-sponsor, Senator Patrick Leahy, this bill could permit the hiring of more than 300 federal agents, more than 200 prosecutors, and another 200 forensic analysts and support staff. The number of fraud cases prosecuted is likely to rise significantly.

The broadening of statutes addressing fraud will facilitate prosecution not only of previously non-regulated mortgage lenders, but also anyone trading in options and futures. Today, that includes companies big and small in a wide range of industries. These new prosecution tools may in time be used beyond their initial targets, as happened with the RICO statute.

The outcomes of the new Commission are uncertain, but with subpoena power and the ability to focus on individual companies as well as industry segments in public hearings, the Commission could probe both broadly and deeply, with the potential to significantly impact industry practices, corporate and individual reputations, and future prosecutorial activity.

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