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Amending FIRREA: An Alternative Proposal

Andrew W. Schilling*

The U.S. House of Representatives recently passed the "Financial Institutions Consumer Protection Act of 2016," a bill that responds to the government's aggressive use of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") to target financial institutions, and responds in particular to the Department of Justice's controversial enforcement initiative known as "Operation Choke Point." The author of this article explains the proposed amendments to FIRREA, the potential impact of the changes, and suggests an alternative that would impose reasonable restrictions on FIRREA investigations.

Near the end of his tenure, Attorney General Eric Holder publicly raised the prospect of amending FIRREA—the Financial Institutions Reform, Recovery, and Enforcement Act of 1989—to increase the incentives for blowing the whistle on financial fraud.[1] FIRREA is the federal statute the Department of Justice ("DOJ") has been using to bring fraud lawsuits against banks in the aftermath of the financial crisis, raking in billions for the federal treasury. Critics have not been satisfied by the government's enforcement efforts to date, and perhaps in response, the Attorney General suggested that the relatively low whistleblower bounties available under FIRREA—they are capped at $1.6 million, regardless of the government's recovery—were partly to blame. His proposal, which would have brought FIRREA's whistleblower bounties in line with the more generous rewards available under the False Claims Act, apparently received no traction on Capitol Hill: No bill was introduced and FIRREA's whistleblower provisions remain unchanged.

Recently, however, Congress has shown renewed interest in amending FIRREA—but to limit its reach, not to further empower the government. Specifically, on February 4, 2016, the House passed H.R. 766, the "Financial Institutions Consumer Protection Act of 2016," a bill that responds to the government's aggressive use of FIRREA to target financial institutions, and responds in particular to the DOJ's controversial enforcement initiative known as "Operation Choke Point." In that operation, the government reportedly

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[1] *See* http://www.justice.gov/opa/speech/attorney-general-holder-remarks-financial-fraud-prosecutions-nyu-school-law.

issued at least 50 FIRREA subpoenas to banks as part of an enforcement initiative designed to hold the banks accountable for allegedly facilitating consumer fraud committed by the merchant clients of the banks' payment processor customers. The idea was to use FIRREA to target the banks for allegedly facilitating fraud committed principally by their "customer's customers."[2] The Justice Department considered it more efficient to apply pressure on banks to "choke off" the merchants' access to the payment system, rather than engage in the "whack-a-mole"[3] pursuit of each of these merchants themselves, who may simply move from bank to bank.

If you listen to the congressional debate on H.R. 766, it is hard to know how to gauge its potential impact on FIRREA enforcement. On the one hand, proponents have said that the bill would work only a "modest change" to FIRREA enforcement.[4] Opponents of the bill, in contrast, claimed that the bill was about "crippling the Department of Justice"[5] and "stripping the Justice Department of its investigatory powers and its subpoena powers."[6]

The truth lies, as it often does, between these two extremes.

THE PROPOSED AMENDMENTS TO FIRREA

Although the House bill has several features unrelated to FIRREA, Section 3 of the bill would amend the civil fraud provisions of FIRREA in two ways, one substantive and one procedural. Substantively, the bill is designed to cabin the reach of the statute, precluding the use of FIRREA to target banks for facilitating the fraud of their customers (or their customers' customers). Procedurally, it would impose new restrictions on the government's ability to issue FIRREA subpoenas.

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[2] *Available at* http://www.justice.gov/opa/speech/financial-fraud-enforcement-task-force-executive-director-michael-j-bresnick-exchequer ("banks should endeavor not only to know their customers, but also to know their customers' customers.") (Remarks of Financial Fraud Enforcement Task Force Executive Director Michael J. Bresnick).

[3] Memorandum from Maame Ewusi-Mensah Frimpong to Staff of the Office of the Attorney general, dated Nov. 21, 2013, at 1 (recognizing that traditional enforcement approach "often results in 'whack-a-mole' results: We shut down a fraudulent scheme and other pops up, often involving the same perpetrators"), included with Appendix to the U.S. House of Representatives Committee on Oversight and Government Reform Staff Report dated May 29, 2014, *available at* https://oversight.house.gov/wp-content/uploads/2014/05/Appendix-1-of-2.pdf.

[4] 114 Cong. Rec. H571 (remarks of Rep. Luetkemeyer).

[5] 114 Cong. Rec. H580 (remarks of Rep. Waters).

[6] *Id.* at H576.

Limits on the Scope of FIRREA

First, the bill would limit the kind of cases that DOJ could pursue under FIRREA. In its current form, FIRREA authorizes the Justice Department to bring a suit for civil penalties against anyone who violates certain criminal statutes (such as mail and wire fraud) "affecting a federally insured financial institution."[7] In several cases, the Justice Department has argued that it may use this provision to sue banks for engaging in fraud even when the only federally insured financial institution "affected" was the bank itself. So far, three federal judges have upheld the government's interpretation of FIRREA's reach.[8]

Operation Choke Point, the main target of H.R. 766, relies in part on this "self-affecting" theory of FIRREA. According to internal DOJ memoranda (released as a result of a congressional investigation), DOJ officials explained that they were relying on a "broad reading of the phrase 'affects a financial institution.' "[9] In DOJ's view, banks that facilitate fraud by the merchant clients of their payment processor customers incur a risk of harm to their own reputations. That, in the government's view, was enough of an "affect" on a federally insured financial institution to warrant the use of FIRREA to sue the banks, even though the only insured financial institution whose reputation was at risk was the bank itself.

H.R. 766 targets this expansive approach. Specifically, Section 3 (a) the bill would strike the phrase "affecting a federally insured financial institution" from FIRREA and, in its place, require that, for FIRREA to apply, the fraud must be committed "against a federally insured financial institution" or "by a federally insured financial institution against an unaffiliated third party." As supporters of the bill explained, this language would preserve the government's ability to target, for example, "fraud committed by bank insiders against the bank," and fraud committed by the bank itself against third parties. As Representative Neugebauer observed, "where a bank defrauds a purchaser of a mortgage-backed security, as was alleged by the big bank settlements, FIRREA's civil tools

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[7] 12 U.S.C. § 1833a(c)(2).

[8] *See U.S. v. Bank of New York Mellon*, 941 F. Supp. 2d 438 (S.D.N.Y. 2013); *U.S. v. Countrywide Fin. Corp.*, 961 F. Supp. 2d 598 (S.D.N.Y. 2013); *U.S. v. Wells Fargo Bank, N.A.*, 972 F. Supp. 2d 593 (S.D.N.Y. 2013).

[9] Memorandum from Michael S. Blume to Stuart F. Delery, dated Sept. 9, 2013, at 12, included within Appendix to the U.S. House of Representatives Committee on Oversight and Government Reform Staff Report dated May 29, 2014, *available at* https://oversight.house.gov/wp-content/uploads/2014/05/Appendix-1-of-2.pdf.

remain available to the Department of Justice."[10] At the same time, supporters acknowledged that the bill would "prohibit the use of FIRREA tools where fraud is committed by the bank's account holder, but not by the bank itself."[11]

Limits on the Use of FIRREA Subpoenas

Second, the bill would make three changes to the procedures governing the issuance of subpoenas under FIRREA. As it now stands, Section 951 of FIRREA authorizes the Attorney General to issue subpoenas for documents and testimony "which the Attorney General deems relevant or material to the inquiry."[12] This relevance standard generally accords with the standard applicable to the issuance of an administrative subpoena by any federal agency, as courts have long required only that the information sought by the agency be "reasonably relevant" to an investigation.[13] FIRREA's subpoena provisions also incorporate by reference the "procedures and limitations" found in certain sections of the civil RICO statute, which allow the government to enforce the subpoena and for subpoena recipients to challenge the subpoena. Finally, as it reads today, FIRREA does not require that the Attorney General personally sign FIRREA subpoenas. In practice, that authority has been delated to lower-level officials at the Justice Department, as well as to all 93 United States Attorneys.[14]

Section 3 of H.R. 766 would work at least three changes to the government's FIRREA subpoena authority. First, it would heighten the standard for issuing a subpoena. Specifically, the bill would preclude issuance of a subpoena absent "specific and articulable facts showing that there are reasonable grounds to believe that the information or testimony sought is relevant and material for conducting an investigation." It is not clear that the new standard would really deter government lawyers from seeking or issuing a subpoena in most matters. In Choke Point itself, government attorneys articulated the factual basis for seeking issuance of their subpoenas in a series of memoranda to high-level supervisors.[15] The new standard would, however, provide a stronger basis for a subpoena recipient to challenge that subpoena in court, and a more stringent standard for the government to meet in response to such a challenge.

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[10] 114 Cong Rec. H577 (remarks of Rep. Neugebauer).

[11] *Id.*

[12] 12 U.S.C. § 1833a(g)(1).

[13] *U.S. v. Clayton Holdings, LLC*, 13-mc-116 (D. Conn. Nov. 11, 2013) (enforcing FIRREA subpoena); *see, e.g., In re Gimbel*, 77 F.3d 593, 601 (2d Cir. 1996).

[14] United States Attorney's Bulletin, Civil Remedies for Mortgage Fraud (May 2010) at 25.

[15] *See, e.g.*, Memorandum from Michael S. Blume to Stuart F. Delery, dated Feb. 8, 2013 (requesting issuance of FIRREA subpoenas).

Second, the bill would preclude the issuance of a FIRREA subpoena unless it was signed "personally" by the Attorney General or the Deputy Attorney General. As a result, the bill would remove subpoena authority from all U.S. Attorney's Offices as well as other senior officials at Justice who currently have that authority. In Choke Point, the subpoenas issued to banks were personally authorized by Assistant Attorney General Stuart F. Delery, who was then the highest-ranking official in the Civil Division of the Justice Department, and who later became the Associate Attorney General, the third-highest ranking official at Justice. But even he would rank too low in the hierarchy to issue subpoenas under the proposed bill.

Third, the bill would provide a new method for the government to seek documents or testimony: It could apply for a court order authorizing such pre-suit discovery. In an earlier version of the legislation, this route was the exclusive means for the government to seek testimony and documents during the investigative stage; the right to issue subpoenas would have been abolished completely. H.R. 766 does not go that far. The provision authorizing the government to seek a court order would provide an alternative method for lower-level government attorneys to seek documents and testimony, as there is no requirement that the Attorney General or her Deputy "personally" apply to the court for such an order. There is surprisingly little detail in the bill about what such a court proceeding would look like and how it would work in practice.

THE POTENTIAL IMPACT OF THESE CHANGES

Contrary to the claims of the bill's proponents, the proposed changes to Section 951 of FIRREA would work much more than a "modest change" in FIRREA enforcement. At the same time, they would not scuttle fraud prosecutions of banks to the extent claimed by opponents, either. In fact, the impact of the bill on its main target—Operation Choke Point—appears to be minimal.

On substance, eliminating the "self-affecting" theory is not likely to substantially curtail the number of cases that the government brings against banks under FIRREA. While that theory provided an important hook in a handful of cases, proponents of the law are correct that the substantive amendments would leave DOJ free to sue banks for engaging in fraud and to sue individuals for defrauding banks. Indeed, even today, not every FIRREA case requires the government to establish an "affect" on a federally insured financial institution; for a number of predicate offenses under FIRREA, that

element is not even required.[16] Also, while the "self-affecting" theory has been important to several of the government's cases, the loss of that theory would not have been fatal in all of these matters. In *United States v. Bank of New York Mellon*, for example, in which the government invoked (and the court sustained) the "self-affecting" theory of FIRREA, the government's complaint alleged harm not only to the defendant bank itself but also to federally insured financial institutions that were the victims of the alleged fraud.[17]

Perhaps most significant, given the impetus for the law, the amendment would probably not even preclude the government from bringing civil fraud actions under Choke Point. Proponents of the bill maintain that it would preclude suits against banks for the crimes of their customers. And that is a fair characterization of the government's approach in these cases. But the cases the government has filed to date under Choke Point actually go further, and accuse the banks *themselves* of committing crimes. In *United States v. Plaza Bank*, a case stemming from this initiative, the government's complaint alleged that the bank itself "violated the wire fraud statute . . . by participating in a scheme or artifice to defraud."[18] And while the complaint alleges that the bank "was affected by its own unlawful conduct," it also alleges that the bank's actions "affected dozens of federally-insured financial institutions whose customers were defrauded as result of Plaza's actions."[19] In addition, these Choke Point cases have relied not only on FIRREA, but also on the fraud injunction statute, 18 U.S.C. § 1345(b). That statute, which authorizes a court to enjoin fraud "affecting a federally insured financial institution," would remain unaffected by the House bill. As a result, the House bill would not actually prevent the government from bringing civil fraud suits against banks as part of Choke Point.

The proposed restrictions on DOJ's subpoena authority, on the other hand, would be game-changing. As a practical matter, the issuance of FIRREA subpoenas would grind to a near halt if the Attorney General herself, or the Deputy Attorney General herself, were required to sign every subpoena. FIRREA subpoenas are common today precisely because the authority to issue them is broadly shared within DOJ. But imagine the bureaucracy that would need to be navigated, and the delay that would ensue, if an Assistant U.S. Attorney in Kansas needed to seek permission from Loretta Lynch herself every time documents or testimony were needed for an investigation. Notably, prior

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[16] 12 U.S.C. § 1833a.

[17] *See Bank of N.Y. Mellon*, 941 F. Supp. 2d at 451 n. 78.

[18] Complaint, *U.S. v. Plaza Bank*, 15-cv-394 (C.D. Cal.) (filed Mar. 12, 2015) ¶ 102.

[19] *Id.* at ¶ 11.

to 2010, only the Attorney General himself could issue Civil Investigative Demands under the False Claims Act. As a result, such CIDs were rarely sought. But DOJ issued ten times as many CIDs in the first year after that authority was delegated than in the previous two years combined.[20] Because delegating subpoena authority to lower levels of the Department of Justice resulted in a dramatic increase in the number of subpoenas issued, withdrawing such a delegation can be expected to have an immediate and significant impact in the opposite direction.

The proposed alternative route of pursuing a court order would probably not solve this problem, as it too would likely be rarely used in practice. Although line-level prosecutors could by-pass the layers of internal government bureaucracy by going to a local judge, the government is generally loath to articulate publicly the nature of its investigations at such an early stage, and there is no provision in the bill to protect the confidentiality of such an application. At the same time, this provision would pose real problems for the targets of the investigation, because they would suffer an immediate reputational hit upon the disclosure that they are under investigation by federal prosecutors. With the threat of reputational harm hanging over them, targets may well readily cave in to requests by the government that they produce the information "voluntarily," a dynamic that is certainly susceptible to abuse, as prosecutors would have little incentive to narrowly tailor their subpoenas.

AN ALTERNATIVE PROPOSAL

The prospects of H.R. 766 becoming law are dim, at least in the near term. On February 2, 2016, the White House issued a statement threatening to veto H.R. 766, in part because the bill would make FIRREA enforcement actions "more burdensome, time-consuming, and rare."[21] Given the hurdles the bill would erect to the issuance of FIRREA subpoenas, that statement is probably true. Indeed, some in Congress sympathetic to the goal of shutting down Operation Choke Point have expressed reluctance to restricting the government's ability to investigate financial fraud.[22]

But there is a simpler change to FIRREA that would impose reasonable

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[20] *See* http://www.justice.gov/opa/speech/acting-assistant-attorney-general-stuart-f-delery-speaks-american-bar-association-s-ninth (Remarks of AAG Stuart F. Delery) ("In the last fiscal year, the Department authorized the issuance of 888 CIDs—more than 10 times the number of CIDs issued during the two years before re-delegation combined.").

[21] https://www.whitehouse.gov/sites/default/files/omb/legislative/sap/114/saphr766h_20160202.pdf.

[22] 114 Cong. Rec. H570.

restrictions on FIRREA investigations, and in a way that would probably win bi-partisan support. Specifically, Congress could simply require that the Justice Department apply the same rules applicable to False Claims Act investigations to FIRREA investigations.

Although both statutes authorize civil fraud investigations and lawsuits by the Justice Department, the False Claims Act imposes more restrictions on the government, and grants more rights to those under investigation, than FIRREA does. For example, the False Claims Act expressly provides that a person subpoenaed to give testimony has the right

(a) to have counsel or any other representative present;

(b) to be informed of the primary areas of inquiry;

(c) to consult with an attorney before answering any question;

(d) to object on the record to any question;

(e) to a reasonable opportunity to review the transcript and make changes;

(f) to obtain a copy of the transcript of the testimony; and

(g) to obtain witness fees for appearing.[23]

Section 951 of FIRREA affords the witness none of these basic rights. Also, when the authority to issue CIDs under the False Claims Act was delegated to local U.S. Attorneys in 2010, they were required to track the number of CIDs they issued and report those numbers to DOJ.[24] This reporting provision, while not stringent, at least allows for the collection of data on the use of CID authority by U.S. Attorneys, and would provide at least some basis for assessing whether, in practice, that authority is leading to overuse. In contrast, there is no requirement that anyone track the number of FIRREA subpoenas issued, and there is no meaningful way to measure how they are used.

It seems incongruous that the federal government may proceed under two different enforcement regimes when pursuing similar civil fraud investigations. Indeed, because some conduct may violate both FIRREA and the False Claims Act, having two different enforcement regimes, with two sets of rules, means that civil prosecutors are free to choose whether to proceed under FIRREA rather than under the False Claims Act. In other words, prosecutors have the discretion in some matters to decide the rules that apply to their own investigations, and the rights of the witnesses in those matters. There is no

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[23] 31 U.S.C. § 3733.

[24] 75 Fed. Reg. 14070, 14072 (Mar. 24, 2010).

obvious reason for having the target's rights subject to the whim of the government.

CONCLUSION

Former Attorney General Holder had a point, at least in one respect: When considering how best to amend FIRREA, it often makes sense to look to the False Claims Act. An amendment to FIRREA that incorporates the protections of the False Claims Act by reference—similar to the incorporation by reference of the "procedures and limitations" of Civil RICO—presumably would be non-controversial, and yet would establish at least some familiar ground rules for FIRREA investigations. It may not put an end to "Operation Choke Point," but neither will a bill that is perceived as unduly tying the hands of law enforcement and, as a result, is unlikely become law.