USE OF FIRREA TO IMPOSE LIABILITY IN THE WAKE OF THE GLOBAL FINANCIAL CRISIS: A NEW WEAPON IN THE ARSENAL TO PREVENT FINANCIAL FRAUD

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Much attention has been paid to identifying the causes of the global financial crisis (GFC) and developing public policy responses to prevent its reoccurrence. Attention has turned to identifying blameworthy actors. There is consensus that financial fraud played a role in exacerbating the crisis. In spite of this, there have been few prosecutions.[1] Only one Wall Street executive has been jailed[2] and few firms involved in the events leading up to the crisis have been sued or prosecuted.[3] Moreover, the statute of limitations for fraud, which is typically five years, has expired. This lack of accountability is troubling. Mayer, Cava and Baird argue that "[w]ithout changes to the existing system, the lack of accountability for antisocial acts of financial fraud may become a permanent feature of our economy."[4] But, all hope is not lost. Recently, the Department of Justice (DOJ) has discovered a little-used statute[5] enacted in the wake of the

1. *See* David Zaring, *Litigating the Financial Crisis*, 100 VA. L. REV. 1405, 1410-1411 (2014) (discussing the government practice of assessing corporate fines coupled with the use of deferred prosecution agreements rather than pursing criminal penalties). This lack of prosecution can be compared to the large number of prosecutions following the Savings & Loan Crisis of the 1980's. *See* Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?*, N.Y. REVIEW OF BOOKS Jan. 9, 2014, http://www.nybooks.com/articles/archives/2014/jan/09/financial-crisis-why-no-executive-prosecutions/, *archived at* http://perma.cc/NDH5-VFGM ("In striking contrast with these past prosecutions, not a single high-level executives has been successfully prosecuted in connection with the recent financial crisis, and given the fact that most of the relevant criminal prosecutions are governed by a five-year statute of limitations, it appears that none will be.").

2. *See* Jesse Eisinger, *Why Only One Top Banker Went to Jail for the Financial Crisis*, N.Y. TIMES MAGAZINE, April 30, 2014, http://www.nytimes.com/2014/05/04/magazine/only-one-top-banker-jail-financial-crisis.html?_r=0, *archived at* http://perma.cc/XN4X-ACQH (describing why only one Wall Street executive went to jail for his involvement in the financial crisis); *See also* Zaring, *supra* note 1, at 1413 (arguing that imposing civil liability largely on corporate actors is inconsistent with the prior practice of prosecuting individual executives for fraudulent wrongdoing). *See also* Zaring, *id*., at 1439 (identifying some potential defendants and concluding that "[n]one of these potential defendants have been singled out, even though the harsh expression of disapprobation presented by a criminal case might seem to be appropriate given the intense nature of the carnage.").

3. Zaring, *supra* note 1, at 1438 ("There has not been a single conviction of a bailed-out bank, or a single executive who ran one.").

4. Don Mayer, Anita Cava & Catharyn Baird, *Crime and Punishment (or the Lack Thereof) for Financial Fraud in the Subprime Mortgage Meltdown: Reasons and Remedies for Legal and Ethical Lapses*, 51 AM. BUS. L.J. 515, 519 (2014).

5. Not only have there been few lawsuits brought in its 25 year history, it has been the subject of little scholarly commentary. Most commentary has focused on the director and officer liability provisions. *See, e.g.*, Robert J. Basil, *Suspension and Removal of Bank Officials Under the Financial Institutions Reform Recovery and Enforcement Act of 1989 (FIRREA)*, 18 J. LEGIS. 1 (1991) (describing the suspension and removal provisions under FIRREA); John J. Bryne, Douglas W. Densmore & Jeffery M. Sharp, *Examining the Increase in Federal Regulatory Requirements and Penalties: Is Banking Facing Another*

Savings & Loan Crisis of the 1980s. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA)[6] imposes civil liability for violation of certain specified criminal statutes. FIRREA's statute of limitations is longer, its burden of proof is lower, and the penalties can be severe.[7] It was used to force the Bank of America and Standard & Poor settlements,[8] and could be used to impose liability on other bad actors for their actions leading up to the GFC. Moreover, its use has the potential to transform the financial fraud landscape. But, is that a good thing? Certainly enforcing anti-fraud provisions is desirable. However, at least one commentator has questioned FIRREA's resemblance to a criminal statute.[9] If FIRREA is in effect a criminal statute stripped of the procedural safeguards afforded by criminal law, this is problematic and raises questions of fundamental fairness.

This article will consider those broad questions. In order to accomplish that goal, we will, in Part I, briefly outline the events leading up to the GFC. This has been done elsewhere in more depth and it is not our intent to replicate previous work. In Part II, we will outline the basic provisions of FIRREA. In Part III, we will briefly consider the use of

Troubled Decade?, 24 CAP. U. L. REV. 1, 19 (1995) ("While traditionally shielded by corporate law from liability for losses so long as they exercise good faith business judgment and act disinterestedly, directors are now confronted with the threat of virtual strict liability. . ."); Peter A. Lowy, *The Director Liability Provision of the Financial Institutions Reform, Recovery and Enforcement Act: What Does it Do?*, 16 ANN. REV. BANKING L. 355 (1997) (discussing the director liability provision under FIRREA); Jon Shepherd, *The Liability of Officers and Directors under the Financial Institutions, Reform, Recovery and Enforcement Act of 1989*, 90 MICH. L. REV. 1119 (1992) (discussing civil liability for officers and directors under FIRREA); Melinda M. Ward, *FIRREA – Finally Resolved?*, 67 UMKC L. REV. 407, 408 (1998) (describing the context that led to the FIRREA legislation).

6. Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Pub. L. 101-73, 103 Stat. 183. (1989) [hereinafter *FIRREA*].

7. The statute of limitations under FIRREA is ten years. FIRREA, §1833a (h).

8. *See* Nate Raymond, *Bank of America Liable for Fraud in Countrywide Mortgage Case: Jury,* HUFFINGTON POST, Oct. 23, 2013, http://www.huffingtonpost.com/2013/10/23/bank-of-america-fannie-mae-freddie-mac_n_4151479.html, *archived at* http://perma.cc/XWG9-ELD6 (describing Bank of America's liability under FIRREA for actions that led to the financial crisis). *See infra* notes 76-116 and accompanying texts where these lawsuits are discussed.

9. *See, e.g.*, Bruce A. Green, *After the Fall: The Criminal Law Enforcement Response to the S & L Crisis*, 59 FORDHAM L. REV. 155, 179 (1991) (stating that a civil proceeding under FIRREA is "basically a criminal proceeding stripped of such constitutional protections as the presumption of innocence and the requirements of proof beyond a reasonable doubt."). *See also* John R. Rowlett, *The Chilling Effect of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 and the Bank Fraud Prosecution Act of 1990: Has Congress Gone too Far?*, 20 AM. J. CRIM. L. 239, 246 (1993) ("The provisions allowing civil penalties for criminal offenses are unfair because they allow the prosecution to circumvent the criminal standard of proof for these offenses.").

FIRREA in cases stemming from the GFC. Our intent is to demonstrate the far-reaching implications of FIRREA and to outline existing case law. Here, we will examine the cases brought by the DOJ against Bank of America, Wells Fargo, Bank of New York Mellon and Standard & Poor's.

This brings us to the inevitable question. FIRREA appears to be a viable and formidable weapon in the war on financial fraud. But is it good public policy? In Part IV, we will consider two directions of inquiry. First, liability is imposed in the case of financial fraud largely to promote investor confidence in the market. This is an important public policy objective and arguably achieved by FIRREA as an enforcement tool. Second, imposition of civil liability for violation of criminal statutes appears to blur the distinction between civil and criminal law. However, the public policy objectives promoted by civil law differ from those intended by criminal law. FIRREA allows for an action to be brought by a civil prosecutor, seeking civil damages, with a civil burden of proof for violation of criminal law. This section of the article will consider whether this is good public policy. In this section, we will reject the dichotomy between civil and criminal law and consider whether FIRREA is most like administrative law. Although we can learn a lot from a comparison with administrative law, it is also not a perfect fit. We will conclude that although some commentators have concerns about imposing liability based on criminal law without the protections typically afforded in criminal prosecutions (*e.g.*, the heightened burden of proof), we are not persuaded by those concerns. We believe that concerns about imposing civil liability for violation of criminal law without the safeguards afforded criminal defendants are based on the conventional but antiquated view of the distinction between civil and criminal law. Instead, we believe that a more appropriate analysis looks at whether the procedural safeguards afforded by FIRREA are fair. In Part V, we conclude that the procedural safeguards required can best be viewed on a spectrum based on the severity of the punishment. Therefore, largely because of the absence of the possibility of incarceration in a FIRREA case, we conclude that given the government's overwhelming objective to protect the financial markets and investors and to generate confidence in the market, FIRREA is good public policy.

I. THE GLOBAL FINANCIAL CRISIS

The GFC began as a housing boom.[10] In the years prior to the GFC, borrowing rates were at historically low levels and credit was easy to

10. *See* Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis,* 13 N.C. BANKING INST. 5, 46 (2009) (discussing the practice of relying on securities backed by subprime mortgages as a contributing factor to the GFC).

obtain. These low interest rates, especially those associated with the early years of adjustable rate mortgages,[11] fueled demand for housing and led homebuyers to purchase homes that were more expensive than they could afford. This set the stage for unprecedented appreciation in home prices.[12]

In order to understand why lenders would lend to purchasers who could not afford the houses and the loans, one must understand the securitization process. Through the securitization process, mortgage originators sold individual mortgages into a pool of mortgage-backed securities (MBSs).[13] These mortgages were then housed in special purpose vehicles (SPVs) that created and issued new debt securities with the mortgages serving as underlying collateral.[14] The securities were typically issued in three tranches, with the first tranche bearing the most credit risk and subsequently carrying the highest rate of return. The third tranche was supposedly the most insulated from the risk of default and, hence, carried the lowest return.[15] Credit rating agencies rated each tranche to allow investors to gauge the credit risk involved. Unfortunately, the ratings were

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11. These adjustable rate mortgages often started with a low interest rate that allowed borrowers to qualify for a larger loan than they might have if they had instead obtained a fixed rate loan. *See generally* John C. Coffee, *What Went Wrong? A Tragedy in Three Acts*, 6 U. ST. THOMAS L. J. 403, 406 (2009) (describing the increase in no-document loans from 2001 to 2006); Richard E. Mendales, *Collateralized Explosive Devices: Why Securities Regulation Failed to Prevent the CDO Meltdown, and How to Fix It,* 2009 U. ILL. L. REV. 1359, 1394 (2009) (describing how adjustable rate mortgages often started with a low interest rate that allowed borrowers to qualify for later resets at higher rates they could not afford).

12. Between 1997 and 2006, home prices actually rose by 124%! Moran, *supra* note 10, at 20.

13. *See generally* Kia Dennis, *The Ratings Game: Explaining Rating Agency Failures in the Build Up to the Financial Crisis*, 63 U. MIAMI L. REV. 1111, 1118-1122 (2009) (arguing that "rating agencies' underestimation of the risks of mortgage backed securities" was economically rational); Mendales, *supra* note 11, at 1364-68. The practice of securitization became so prevalent that over two-thirds of all mortgages were securitized in 2005. This contrasts with less than 20% of mortgages securitized in 1999. Nicole B. Neuman, *A 'Sarbanes-Oxley' for Credit Rating Agencies? A Comparison of the Roles Auditors' and Credit Rating Agencies' Conflicts of Interest Played in Recent Financial Crises*, 12 U. PA. J. BUS. L. 921, 924 (2010).

14. John T. Lynch, *Credit Derivatives: Industry Initiative Supplants Need for Direct Regulatory Intervention—A Model for the Future of U.S. Regulation?*, 55 BUFF. L. REV. 1371, 1386 (2008). *See also* Moran, *supra* note 10, at 34 (describing tranches in the mortgage pool); Frank Partnoy & David A. Skeel, *The Promise and Perils of Credit Derivatives*, 75 U. CIN. L. REV. 1019, 1022 (2007) (explaining collateralized debt obligations).

15. The task of deciding how much principal was allocated to each tranche was a complicated task accomplished by using models based on "quantitative finance." John Patrick Hunt, *Credit Rating Agencies and the 'Worldwide Credit Crisis': The Limits of Reputation, the Insufficiency of Reform, and a Proposal for Improvement,* 2009 COLUM. BUS. L. REV. 109, 118 (2009).

determined using statistical models that failed to accurately measure the likelihood of default for each tranche.[16] Securities comprising the riskiest tranches were created and re-bundled in a way that still allowed the upper 80% of the structure to be rated highly and disguised the fact that the underlying assets were often subprime loans.[17] Because of information asymmetry,[18] these securities were marketable only because of the CRA rating.[19]

As housing prices rose, there was increased pressure on mortgage originators to issue and securitize even more mortgages.[20] This pressure

16. *See* John Crawford, *Hitting the Sweet Spot by Accident: How Recent Lower Court Cases Help Realign Incentives in the Credit Rating Industry*, 42 CONN. L. REV. 13, 16(2009).

17. *See* Aaron Unterman, *Innovative Destruction – Structured Finance and Credit Market Reform in the Bubble Era*, 5 HASTINGS BUS. L. J. 53, 69 (2009) ("This magical transformation was achieved in spite of the fact that the underlying securities belonged largely to the lowest rated tranches of the original subprime securitizations."). *See also* Michel G. Crouhy, Robert A. Jarrow & Stuart M. Turnbull, *The Subprime Crisis of 07*, 7(Working Paper, 2008), http://ssrn.com/abstract= 1112467, ("[T]he rating agencies assigned AAA ratings to CDO's senior bond tranches that did not reflect the CDO bond's true credit risk."). CRAs viewed bundling MBSs as a "statistical problem" and did not think it was necessary to analyze the underlying mortgages. David Schmudde, *Responding to the Subprime Mess: The New Regulatory Landscape,* 14 FORDHAM J. CORP. & FIN. L. 709, 747 (2009).

18. *See infra* notes 120-123 and accompanying text (defining information asymmetry in the MBS context and explaining its effect).

19. *See* Coffee, *supra* note 11, at 409 ("In overview, investment banks bought unsound loans because they knew they could securitize them on a global basis if – and only if – they could obtain investment-grade ratings from major credit rating agencies. Without that rating, the debt was unmarketable."). *See also* Dennis, *supra* note 13, at 1122 ("Thus, the rating agencies became the de facto gatekeepers of the market."); David J. Matthews, *Ruined in a Conventional Way: Responses to Credit Ratings' Role in Credit Crises*, 29 NW. J. INT'L L. & BUS. 245, 250 (2009) ("With respect to structured finance issuances, however, the CRA rating takes on a gatekeeper role. . ."); Lawrence J. White, *Credit Rating Agencies and the Financial Crisis: Less Regulation of CRAs is a Better Response*, 25 J. INT'L BANKING L. & REG. 170 (2010) (emphasizing the importance to packagers of obtaining favorable ratings on the securities in order to sell the securities).

20. *See generally* Damon Silvers & Heather Slavkin, *The Legacy of Deregulation and the Financial Crisis—Linkages between Deregulation in Labor Markets, Housing Finance Markets, and the Broader Financial Markets*, 4 J. BUS. & TECH. L. 301, 302 (2009) (analyzing consumer debt as the cause of the financial crisis). Moreover, as the MBSs were themselves repackaged for more than their underlying value, there was increased pressure to both originate new mortgages and to create and sell additional derivatives. *See also* Claire A. Hill, *Why Did Rating Agencies Do Such a Bad Job Rating Subprime Securities?*, 71 U. PITT. L. REV. 585, 590 ("[W]ith someone to sell the loans to, lenders discovered a new enthusiasm for making them."); Frank Partnoy*, Overdependence on Credit Ratings was a Primary Cause of the Crisis* 2, 5 (U. San Diego, Research Paper No. 09-015, 2009), http://ssrn.com/abstract=1430653 ("These transactions, too, persisted over time, so much so that the appetite for second-level mortgage securitizations drove financial intermediaries both to originate new and increasingly risky mortgages, and to create synthetic exposure to

resulted in lax behavior on the part of mortgage originators.[21] Credit checks of applicants became superficial and often loans were extended without verifying income, employment, or assets.[22] Subprime lending became common[23] and mortgages were issued to borrowers who would have not previously qualified. The practice of requiring a 20% down payment towards the purchase of a house was virtually abandoned; interest-only and balloon payment mortgages became popular.[24]

Favorable ratings[25] by CRAs exposed the greater economy to these

mortgages, which then could be resecuritized through tranched special purpose entities, again at higher prices than the underlying mortgage-backed securities were trading in the market.").

21. Coffee, *supra* note 11, at 406. Coffee describes this as "a classic moral hazard problem. Because you do not bear the risks, you will expend little time or effort on precautions, such as screening borrowers." *Id*. *See also* Alyssa King, *The Protection of Deposits and Depositors: A Limited Interpretation of 12 U.S.C. § 1833A*, 63 CATH. U. L. REV. 759, 763 (2013-2014) ("This environment created a moral hazard problem in which the banks, encouraged by the government and regulators, took on risky bets").

22. The "no doc" loans often led to fraudulent loan applications and some of them were termed "liar loans." *See* Mendales, *supra* note 11, at 1394-1395 (discussing such loans). *See* Matthews, *supra* note 19, at 252 (describing how securitization both "spread risk" and "diluted responsibility."). Some argue this lead to an "explosion in mortgage fraud." *See, e.g.*, Andrew J. Ceresney, Gordon Eng & Sean R. Nuttall, *Regulatory Investigations and the Credit Crisis: The Search for Villains*, 46 AM. CRIM. L. REV. 225, 236-237 (2009) ("Given its prevalence and scope, many commentators have speculated that such fraud was at least partly to blame for the collapse of the mortgage market, and in turn for triggering the credit crisis."). Moreover, the numbers of such loans grew. *See* Deryn Darcy, *Credit Rating Agencies and the Credit Crisis: How the "Issuer Pays" Conflict Contributed and What Regulators Might Do About It*, 2009 COLUM. BUS. L. REV. 605, 614-615 (2009) ("In 2001, 28.5% of subprime borrowers could not verify information about employment, income, or other credit-related data. This figure increased to nearly 51% in 2006."). In addition, subprime mortgages without documentation of the borrower's income, assets or employment grew to 44% of the subprime market by 2005. Silvers & Slavkin, *supra* note 20, at 329.

23. Subprime loans are loans made to people where the potential for default is higher than other mortgages. Matthews, *supra* note 19, at 246 ("The term connotes lending to borrowers whose employment history, savings, credit history, or other characteristics create a higher expectation in the lender of loan default as compared to prime borrowers."). Subprime lending grew substantially during this period. *See* Crouhy, Jarrow & Turnbull, *supra* note 17, at 4 ("By 2006, subprime mortgages represented 13% of all outstanding mortgage loans with origination of subprime mortgages representing 20% of new residential mortgages compared to the historical average of approximately 8%."); Darcy, *supra* note 22, at 614 ("[S]ubprime mortgages accounted for 20%, or more than $600 billion, of all mortgages originated in 2005."); Silvers & Slavkin, *supra* note 20, at 328 ("In 2001, subprime lending represented 7.2% of mortgage originations but exploded over the next five years until they reached 20% of mortgage originations in 2006.").

24. *E.g.*, interest-only loans increased from 0% of housing loans in 2001 to 23% in 2006. Coffee, *supra* note 11, at 407.

25. The justification for these higher than merited ratings was a belief that any risk was lessened by the broad diversity of loans contained in each pool, especially geographic

toxic securities because institutional investors, like pension funds and banks, added them to their portfolios. The money that was received by the MBS issuers from securitizing mortgages was funneled back to mortgage lenders and mortgage brokers who then issued increasingly risky mortgages. The credit quality of the mortgages was of no concern to the mortgage companies because the mortgages and the credit risks were transferred to the SPV. The origination fees received for issuing additional mortgages provided a powerful incentive which encouraged mortgage originators to issue even more mortgages.[26]

It is clear that mortgages were granted that should not have been. It is clear that the securities that were created by bundling these mortgages were rated much higher than they should have been and that in some cases they were actually worthless. Moreover, it is clear that many of the parties involved were engaged in intentionally fraudulent activities. In fact, the Financial Crisis Inquiry Commission concluded that many of the subprime lenders were guilty of fraudulent lending practices and that some Wall Street actors packaged and sold these loans in ways that were fraudulent.[27]

Such financial fraud can be prosecuted as mail/wire fraud[28] or

diversity. Moran, *supra* note 10, at 47. Moran equates this to a game of Russian roulette where the likelihood of a disastrous outcome appeared to be so low that it was ignored by CRA models. *Id*. In other words, CRAs believed that it was highly unlikely that all the mortgages in the pool would default in unison because any downturn in housing would be geographically localized. *Id*. Moreover, it was assumed that housing prices would continue to rise; hence, even if a borrower defaulted, there was little risk because the values of the underlying collateral would continue to cover any isolated losses. Coffee, *supra* note 11, at 407.

26. *See* King, *supra* note 21, at 763 ("The deregulation of financial institutions encouraged the mortgage industry to issue risky mortgages under the securitization system because they were paid based on the volume of the loans processed"). *See also* Brooke A. Murphy, *Credit Rating Immunity? How the Hands-Off Approach Toward Credit Rating Agencies led to the Subprime Credit Crisis and the Need for Greater Accountability*, 62 OKLA. L. REV. 735, 740 (2010) ("The originator, therefore, has no incentive to maintain prudent lending standards, since its profits derive solely from transactional fees, and not from the eventual repayment of the mortgage.").

27. THE FIN. CRISIS INQUIRY COMM'N, FINAL REP. ON THE CAUSES OF THE FIN. AND ECONOMIC CRISIS IN THE U. S. (Comm'n Print Jan. 2011) at xxii (Accessed at http://fcic.law.stanford.edu/report). *See also* King, *supra* note 21, at 765 ("Along every step of the process, fraud occurred and incentives encouraged risky lending, haphazard compositions of the securities, and the inaccurate ratings of the securities to reflect the associated risk").

28. 18 U.S.C. §§ 1341, 1343 (2012). Under mail/ wire fraud, one faces liability if he engaged in 1) an intentional scheme to defraud; 2) through the use of interstate mails or wires. In order to prove a scheme to defraud, the government must demonstrate a misrepresentation of a material fact or a willful omission. *See* Carpenter v. United States, 108 S. Ct. 316, 321 (1987) (holding that an employee may be criminally liable under the mail and wire fraud statutes when he intentionally leaks confidential business information). *See also* Mayer, Cava & Baird, *supra* note 4, at 524 (stating that under the mail and wire

securities fraud.[29] Why then have so few of these actors been prosecuted? Putting aside questions of political will,[30] it appears that one main obstacle to imposing criminal liability upon both individual and corporate wrongdoers has been the mens rea requirement. Because of the severity of criminal sanctions, criminal liability is not imposed lightly. Among other safeguards, in order to attach criminal liability, the defendant must have committed the act intentionally – the so-called mens rea requirement.[31] Meeting the mens rea requirement is typically more difficult than meeting the scienter requirement or specific intent requirement necessary to prove fraud.[32] A second obstacle relates to the fact that it is often difficult to meet the burden of proof required to criminally prosecute financial fraud cases.

One way around these obstacles to criminal prosecution is by use of FIRREA. Enacted in the aftermath of the Savings and Loan Crisis of the 1980s, FIRREA provides *civil* liability for violation of certain specified *criminal* statutes. As such, it offers a vehicle to "punish past fraud and deter future fraud" in cases where imposing criminal liability is blocked by either the mens rea requirement or the burden of proof obstacle.[33] In Part II, we will outline the basic provisions of FIRREA.

II. FIRREA

FIRREA was enacted in the wake of the Savings & Loan (S & L) crisis. As the true proportions of the crisis became apparent, there were calls for action.[34] Congress perceived that fraud committed by both

fraud statutes, anyone using the respective means covered by each statute to commit fraud can be held criminally liable and punished).

29. 15 U.S.C. § 78j(b) (2012); 18 U.S.C. § 1348 (2012); 17 C.F.R. § 240.10b-5 (2013).

30. Mayer, Cava & Baird, *supra* note 4, at 518.

31. Barry J. Pollack, *Time to Stop Living Vicariously: A Better Approach to Corporate Criminal Liability*, 46 AM. CRIM. L. REV. 1393, 1394 (2009).

32. *See* Nan S. Ellis & Steven B. Dow, *Attaching Criminal Liability to Credit Rating Agencies: Use of the Corporate Ethos Theory of Criminal Liability*, 17 U. PA. J. BUS. L. 167 (2014) (considering the difficulty of meeting the mens rea requirement in the case of corporate crime). *See also* Mayer, Cava & Baird, *supra* note 4, at 525-527 (discussing how fraudulent intent can be inferred from the conduct of the parties).

33. Leon Weidman, *Civil Remedies for Mortgage Fraud*, U. S. ATT'YS'. BULL. (U. S. Dep't of Just. Exec. Off. for U.S. Att'ys., Wash., D.C.), May 2010, at 23.

34. It is not unusual for statutes to be enacted in the wake of crisis. *See, e.g.*, *Prosecuting Fraud in the Thrift Indus.: Hearings Before the Subcomm. on Criminal Justice of the Comm. on the Judiciary H. of Reps.*, 101st Cong. 2 (1989) (statement of Charles E. Schumer, Chairman, Subcomm. on Criminal Justice of the Comm. on the Judiciary H. of Reps.) (noting before a hearing that "[i]n the last 2 years, the Bank Board, the regulatory agency that oversees the thrift industry, referred 11,000 cases to the Justice Department for criminal prosecution. The flourish of referrals came after years of relative inaction on the Bank Board's part which appeared to favor pursuing civil suits to the exclusion of making

outsiders and insiders (*e.g.*, officers and directors of those institutions) against financial institutions was a major factor leading up to the crisis.[35] In fact, it was estimated that fraud accounted for between 10-100% of savings and loan failures.[36] There were several statutes already on the books that could have been used to prosecute wrongdoers.[37] For example, the National Banking Act of 1863[38] made embezzlement and misapplication of bank funds criminal[39] and the bank fraud statute of 1984 extended many of the prohibitions to bank insiders.[40] There were, however,

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criminal referrals. Yet the Department of Justice obtained conviction in fewer than 200 of these 11,000 cases. That means that in less than 2 percent of the criminal cases referred to the Department of Justice has real punishment been exacted. It should be remembered that the fraud, the enormous losses and the failed and ailing institutions actually account for only a small portion of the entire thrift industry. That's why it's more important than ever that we ferret out these few bad apples that threaten to drag down an entire industry. We should also recognize that the very tangible benefits we receive from vigorous prosecution, $10 billion, would go a long way towards housing the homeless or feeding the poor, educating the public, caring for the sick. . . . What faith can the public have in the system if it permits this type of activity to go on with impunity? . . . [W]hy have there been so few successful criminal prosecutions for bank fraud? . . . [D]oes the administration's proposal for remedying the thrift crisis get to the heart of the system's failings in processing these cases?"). *See also* Elisa S. Kao, *Moral Hazard During the Savings and Loan Crisis and the Financial Crisis of 2008-09: Implications for Reform and the Regulation of Systemic Risk Through Disincentive Structures to Maintain Firm Size and Interconnectedness*, 67 N.Y.U. ANN. SURV. AM. L. 817, 860 (2012) (opining that a "good crisis should never go to waste."). The Savings & Loan Crisis was no exception. *See also* LAWRENCE J. WHITE, THE S & L DEBACLE: PUBLIC POLICY LESSONS FOR BANK AND THRIFT REGULATION 180-181 (1991) (describing FIRREAs as "an Act of anger" on the part of Congress); Carol Ann Sennello, *FIRREA's Damage Provisions: Inequitable, Unnecessary, and Costly to Boot*, 45 DUKE L. J. 183, 183 (1995) (characterizing Congress as being in a "bad mood" when it enacted FIRREA).

35. H.R. REP. NO. 100-1088, at 1, 8 (1988). *See generally* Green, *supra* note 9, at 155-156 (stating that federal officials stressed that criminal misconduct by insiders played a large part in the thrift crisis); John J. McDonald, Jr., *Similarities Between the Savings & Loan Crisis and Today's Current Financial Crisis: What the Past Can Tell us about the Future*, 76 DEF. COUNS. J. 470, 473-74 (2009).

36. Brian T. Fitzpatrick, *Congressional Re-Election Through Symbolic Politics: The Enhanced Banking Crime Penalties*, 32 AM. CRIM. L. REV. 1, 11-12 (1994) (describing early estimates of loses due to insider fraud at 25-100% and bipartisan estimates of between 10% and 15% percent); *See* Kao, *supra* note 34, at 833 (discussing estimates of the degree to which criminal activity by insiders contributed to the Savings & Loan crisis). *See also* Green, *supra* note 9, at 162-168 (outlining this underlying belief and questioning the degree to which criminal conduct was realistically an important contributing factor).

37. *See, e.g.*, Rowlett, *supra* note 9, at 241-242 (1993) (listing alternative available criminal statutes).

38. National Banking Act, ch. 58, 12 Stat. 665, 675, (1863).

39. 18 U.S.C. § 656. *See* Green, *supra* note 9, at 157-160 (discussing the misappropriation provision and its applicability to maladministration by bank insiders).

40. 18 U.S.C. §1344 (1988).

relatively few successful prosecutions in the financial services industry[41] and sentences imposed in those cases were typically light.[42] A new statute was seen as the answer.

FIRREA was designed in part to provide a mechanism for the government to recover some of the bailout costs associated with the S & L crisis[43] and more broadly to control "outright fraud and insider abuse."[44] Thus, the statute represented Congressional intent to punish[45] wrongdoers who engaged in fraud as well as to deter future fraudulent activity.[46] To accomplish this goal, FIRREA provides the federal government with a significant amount of flexibility. First, it authorizes the DOJ to seek civil penalties[47] for those who violate one of fourteen specified criminal laws

41. *Contra* Zaring, *supra* note 1, at 1441 (comparing the criminal prosecution during the savings and loan crisis to the GFC and noting that "by 1992 there had been 1100 criminal prosecutions of individuals involved in major S&L fraud, with 839 convictions, and, in total, 5490 criminal investigations opened by the FBI.").

42. Green, *supra* note 9, at 161 ("The sentences meted out to defendants who committed banking crimes, however, were generally lenient . . . .").

43. King, *supra* note 21, at 766; *See* Lowy, *supra* note 5, at 356 (outlining the basic provisions of FIRREA and breaking them into five categories: 1) those that set aside money for resolutions; 2) those that provide for new agency enforcement powers; 3) those that dissolve the FSLIC and the FHLBB; 4) those that attempt to assure that a similar problem will not occur again; and 5) those that attempt to recoup losses); *See also* Ward, *supra* note 5, at 408 (estimating that the costs to taxpayers exceeded $1 trillion).

44. H.R. REP. NO. 101-54(1), at 294 (1989). One of the general purposes of the statute is "[t]o strengthen the civil sanctions and criminal penalties for defrauding or otherwise damaging depository institutions and their depositors." FIRREA § 101(10).

45. It has been described as a "punitive piece of legislation." Sennello, *supra* note 34, at 183. Bryne, Densmore and Sharp opine that "[f]ocusing on several dishonest individuals, Congress apparently extrapolated that the banking and thrift industries had been populated by the dishonest." Bryne, Densmore & Sharp, *supra* note 5, at 1. *See also* Green, *supra* note 9, at 168 (arguing that retribution was one of the primary goals of FIRREA "'to get a pound of flesh from those who committed fraud'") (quoting 136 Cong. Rec. s9488 (daily ed. July 11, 1990, statement of Sen. Domenici).

46. United States v. Bank of New York Mellon, 941 F. Supp. 2d 438, 546 (S.D.N.Y. Apr. 24, 2013) (FIRREA is "consistent not only with seeking to prevent fraud perpetrated against the financial institutions, but also with deterring or punishing fraud . . . ."). *See* United States v. Serpico, 320 F.3d 691, 694 (7th Cir. 2003) (recognizing deterrence as a major goal of the enhanced civil/criminal provisions). *See also* Robert Almon, Matt Greve, & Nick Wamsley, *Financial Institutions Fraud*, 50 AM. CRIM. L. REV. 1023, 1042 (2013) ("FIRREA was passed with the intention to 'both clean up the savings and loan mess and prevent future disasters.'") (quoting John Leubsdorf, *Symposium on James Atleson's Values and Assumptions in American Labor Law, A Twenty-Fifth Anniversary Retrospective Article: Legal Ethics Falls Apart*, 57 BUFF. L. REV. 959, 974 (2009)); Lowy, *supra* note 5, at 379 ("The language of FIRREA as it was signed into law makes clear that FIRREA's purpose is to strengthen the False enforcement powers and to deter unacceptable activities that arguably caused or contributed to the savings and loan crisis.").

47. *See infra* notes 156-157 and accompanying text (arguing that these civil penalties can be imperfectly analogized to administrative penalties imposed by administrative

involving financial institutions.[48] Second, because the fines are civil in nature, prosecutors merely have to show by a "preponderance of the evidence" that the elements of the underlying crime were met.[49] This lower burden of proof greatly enhances the prospects for successful enforcement of federal fraud statutes. Third, it creates a mechanism to gather information using administrative subpoena power rather than having to commence litigation to trigger the discovery process.[50] Fourth, it harmonizes civil forfeiture provisions with the general racketeering statute, allowing regulators the ability to seize assets before they can be placed out of the government's reach.[51]

Fifth, it extends the statute of limitations to ten years to provide regulators with sufficient time to uncover and take action against fraud.[52] Lastly, it allows for payment of a reward to individuals to provide crucial information to prosecutors[53] and a whistleblower provision to protect bank employees from retaliation.[54] Some of these provisions merit further attention.

A. *Civil Penalties*

FIRREA, as a so-called "hybrid" statute,[55] provides *civil* penalties and

agencies).

48. 12 U.S.C. § 1833a(c)(1)-(3); FIRREA § 951.

49. 12 U.S.C. § 1833a(h); 12 U.S.C. § 1833a(f).

50. 12 U.S.C. § 1833a(g).

51. *See, e.g.*, Michael Malloy, *Nothing to Fear but FIRREA Itself: Revising and Reshaping the Enforcement Process of Federal Bank Regulation*, 50 OHIO ST. L. J. 1117 (1989) (examining FIERRA's enforcement methods). *See also* Marc S. Nurik & Susan R. Healy, *New Federal Banking Legislation: No More Mr. Nice Guy*, 65 FLA. B.J. 53 (1991) (providing a general overview of the statute).

52. 12 U.S.C. § 1833a(h). The typical statute of limitations for civil fraud suits is between three and five years. Jennifer Ecklund, *The Evolving Definition of Mortgage Fraud: Analyzing the Changes in Interpretation Through Court Cases and Legislation since the Subprime Mortgage Crisis,* ASPATORE, 2014 WL 3725824 (2014).

53. FIRREA, § 933(b). *See* Bryne, Densmore & Sharp, *supra* note 5, at 16 (describing bankers as "hunted prey" because of this provision).

54. FIRREA § 932. *See* Rowlett, *supra* note 9, at 250-251 (arguing that the "bounty hunter provisions" coupled with the whistleblower provisions provide a financial incentive for biased or perjured testimony). Attorney General Holder has called for reform increasing the amount of the rewards to 30% of the sanctions imposed. *See* Stephanie Russell-Kraft, *$1.38B S&P Settlement Cements FIRREA As DOJ Darling*, Law 360 (accessed at http://www.law360.com/articles/618042/1-38b-s-p-settlement-cements-firrea-as-doj-darling, *archived at* http://perma.cc/9CP7-3MZL).

55. United States ex rel. Edward O'Donnell v. Countrywide Home Loans, Inc., 33 F. Supp. 3d 494, 498 (S.D.N.Y 2014). In this regard, FIRREA is similar to racketeering legislation. It is no coincidence that the statute specifically states that the procedures applicable to civil investigation demands under FIRREA are the same as those used in

civil forfeiture in response to *criminal* activity. Under Section 951, civil liability is attached if the defendant violates one of a specified number of criminal statutes.[56] The predicate offenses are broken into two categories: a) those that apply without any additional limitations;[57] and b) those that apply only if the violation is one "affecting a federally insured financial institution."[58] As such, these offenses relate to fraudulent activity involving financial institutions, or conspiracy to engage in a scheme to defraud a financial institution. For our purposes the most important predicate

investigations under the Racketeering Influenced and Corrupt Organizations Act. 18 U.S.C. §§1961-1968 (2013) [hereinafter, "RICO"]. Not only are FIRREA and RICO structured similarly, they share a number of predicate offenses, including bank fraud, wire fraud and mail fraud. Congress patterned aspects of FIRREA after the RICO statute in order to facilitate civil actions, safeguard federally insured assets, and penalize misconduct in the financial services industry.

56. H.R. 1278 identified eight predicate offenses in the federal criminal code that could be used as the basis for assessing civil penalties involving fraud in the financial services industry. H.R. 1278 allows for the imposition of civil penalties for violating the following sections of Title 18: § 215 (bank bribery); § 656 (misapplication and embezzling related to banks); § 657 (misapplication and embezzling related to federally insured financial institutions); § 1005 (placing of false statements by an insider in the books of a bank); § 1006 (placing of false statements by an insider in the books of an S&L); § 1007 (making a false statement to the FDIC to induce the FDIC to enter into certain transactions); § 1014 (making a false statement to a federally insured institution in order to obtain credit); § 1344 (bank fraud). REP. ON THE FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT OF 1989, H.R. Rep. No 101-54, pt.5 at 5 (1989) [hereinafter, "Judiciary Committee Report"]. In addition, the legislation allowed for penalties to be imposed for mail fraud (18 U.S.C. § 1341), wire fraud (18 U.S.C. § 1343) and conspiracies related to wire and mail fraud. Judiciary Committee Report at 5. Six additional predicate offenses were later added by the House Judiciary Committee, bringing the total to fourteen. 12 U.S.C. § 1833a(c)(1)-(3) (1966). The six additional offenses were: 18 U.S.C. §287 (false, fictitious, or fraudulent claims); 18 U.S.C. §1001 (false statements); 18 U.S.C. §1032 (concealment of assets from a conservator, receiver, or liquidating agent); and 15 U.S.C. §645(a) (false statements regarding the overvaluation of securities). *See* 101 Cong. Rec. H17198 (daily ed. Aug. 1, 1989) (record of amendment to FIRREA). *See also*, Judiciary Committee Report at 9 (explaining the amendments relating to civil penalties).

57. 12 U.S.C. § 1833a(c)(1), (3) (1966). There are nine offenses listed here. These include financial institution bribery, theft or embezzlement from a financial institution, false entries in financial institution records, false statements to influence the FDIC and false statements to influence regulators or financial institutions on an application.

58. 12. U.S.C. § 1833a(c)(2) (1966). There are five offenses here. These include false claims to the United States, false statements within federal jurisdiction, concealing assets or impeding the FDIC and mail/wire fraud. The statute does not define what is meant by "affecting" a financial institution, but there is reason to believe that this requirement will be interpreted broadly. *See* King, *supra* note 21 at 768 (outlining the case law considering this question); Andrew W. Schilling, *Understanding FIRREA's Reach: When Does Fraud "Affect" a Financial Institution?*, 99 BNA BANKING REP. 186 (2012) (accessed at http://www.buckleysandler.com/uploads/36/doc/understanding-firreas-reach.pdf, *archived at* http://perma.cc/E8F6-TMT9). Moreover, *see infra* notes 81-82, 94, 101 and accompanying text (discussing the "self-affecting doctrine").

offenses are: 1) mail and wire fraud; 2) making false statements; and 3) financial institution fraud. These fall into the second category. As such, they are actionable only when their violation affects a federally insured financial institution.

FIRREA provides for civil penalties as an alternative to the criminal penalties specified in the federal criminal code.[59] As a general proposition, the maximum fine is set at $1.1 million per violation.[60] For continuing violations, the penalty may not exceed the lesser of $1.1 million each day or $5.5 million in total.[61] However, these caps can be disregarded if any person derives any financial gain from violating any of the predicate offenses, or if a victim suffers a loss from the activities of a violator, which exceeds the $1.1 million/$5.5 million caps.[62] The statute also provides that, for the purposes of calculating the civil fine, losses include those suffered by the various Federal depository insurance programs.[63] In such a case, the maximum fine levied may be equal to – but no greater than – the amount of gain by the perpetrator(s) or loss by the victim(s).[64] In addition, the statute makes clear that the amount of the fine can be tailored in a way that not only provides adequate deterrence but also avoids harm to innocent parties,

59. Early drafts of the legislation called for these civil penalties to be levied in addition (and not as an alternative) to criminal penalties set forth in the federal criminal code. However, there were concerns that the civil penalties might be characterized by the courts as criminal in nature, and thus, vulnerable to constitutional challenge under the Double Jeopardy Clause. This was at least in part a response to the Supreme Court case of *U.S. v. Halper*, 490 U.S. 435 (1989) which upheld double jeopardy challenges. Judiciary Committee Report, *supra* note 56, at 6. *See generally* Matthew Hofer, Madison Lichliter & Bridgette Makia, *Financial Institutions Fraud*, 51 AM. CRIM. L. REV. 1209, 1237-1238 (2014) (discussing double-jeopardy questions raised by FIRREA). Thus, the civil penalty section was significantly altered in the final bill. Judiciary Committee Report, *supra* note 56, at 7 ("The Committee on the Judiciary amended the civil penalty provisions in a number of ways to address [the double jeopardy] concerns. The fundamental purpose of these changes is to modify this penalty provision to make it a civil penalty in fact and law as well as in name."). The court in *Hudson v. United States*, 522 U.S. 93, 105 (1997), discussed the degree to which FIRREA's civil sanctions might invoke double-jeopardy and found that where the civil sanctions are intended to serve a deterrent function the fact that they also serve a punitive function will not convert civil sanctions into criminal punishment.

60. 12 U.S.C. § 1833a(b)(1) (1966). It should be noted that the fines authorized in FIRREA are subject to adjustment pursuant to the Federal Civil Monetary Penalties Inflation Adjustment Act of 1990, Pub. L. 101-410. As such, the thresholds set in the original FIRREA statutory language have been increased to$1.1 million. *See,* 28 C.F.R. § 85.3(a)(6).

61. 12 U.S.C. § 1833a(b)(2) (1966), as adjusted, per 28 C.F.R. § 85.3(a)(7).

[62] 12 U.S.C. § 1833a(b)(3)(A) (1966) , as adjusted, per 28 C.F.R. § 85.3(a)(6) and (a)(7).

63. 12 U.S.C. § 1833a(3)(B) (1966).

64. 12 U.S.C. § 1833a(b)(3)(A) (1966).

like taxpayers and depositors.[65] By tying the maximum fines to economic gains by the perpetrator(s) and/or losses by the victim(s), Congress attempted to insulate FIRREA's civil penalty provisions from Constitutional challenge.[66]

B. *Standard of Proof*

Because FIRREA imposes civil liability, the federal government must prove its case by the traditional civil standard of "preponderance of the evidence."[67] In other words, the government must prove only that it is more likely than not that the defendants violated one of the fourteen predicate offenses relating to defrauding a financial institution. This is a significantly easier burden than the "beyond a reasonable doubt" burden imposed in criminal cases.[68] Williams *et al*. termed meeting this burden a "walk in the park" compared to the more rigorous burden of proof in criminal cases.[69]

65. Bank of New York, *supra* note 46, at 463. *See, e.g.*, United States v. Menendez, No.11-06313, 2013 WL 828926, at *5-6 (C.D. Cal. Mar. 6, 2013) (setting forth the relevant factors applicable to setting the penalty including "(1) the good or bad faith of the defendant and the degree of his scienter; (2) the injury to the public, and whether the defendant's conduct created a 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; and (5) the defendant's financial condition and ability to pay").

66. Early drafts set civil penalties at a maximum of $1 million per incident or $5 million maximum. Judiciary Committee Report, *supra* note 56, at 5. It was feared, however, that the capped fine might be viewed as more punitive than remedial. Relying on dicta from the Supreme Court in *Halper*, the Judiciary Committee felt that in order for the penalty to be properly considered civil in nature, there must be a rational relationship between the penalty amount and the government loss. Thus, they rejected the proposed penalty of a maximum fine of $1 million regardless of the government's pecuniary loss. *See*, Judiciary Committee Report, *supra* note 56 at 6 (explaining the amendment tying the penalty to loss to the government). *See also*, 12 U.S.C. § 1833a(b)(1)-(3)(1966) (outlining the applicable civil fines for FIRREA violations).

67. 12 U.S.C. § 1833a(f) (1966).

68. Judiciary Committee Report, *supra* note 56, at 7. This was a change from earlier drafts of the statute. As the Banking Committee considered H.R. 1278, an amendment was offered to set the burden of proof for civil penalties using a "clear and convincing" standard. Lower than the "reasonable doubt" standard required for criminal charges and penalties, the "clear and convincing" standard was considered, in part, to reinforce Congressional intent to establish the civil nature of the penalties. Judiciary Committee Report, *supra* note 56, at 8. However, the Judiciary Committee lowered the burden of proof even more. When the bill was taken up by the Judiciary Committee, the civil fine provision was redefined to withstand judicial scrutiny. Confident that the civil fine provision would not run afoul of the Constitution's Double-Jeopardy Clause, the Judiciary Committee then lowered the burden of proof to the traditional civil standard of "preponderance of the evidence." *Id*. at 7-8.

69. Jay Williams, Valarie Hays & Mir Ali, *FIRREA: An Old Acronym is Turning into*

C. *Administrative Subpoenas and Other Fact-Finding Tools*

FIRREA provides prosecutors and regulators with enhanced powers to obtain information from potential defendants and other parties. Under the statute, they are authorized to subpoena documents, summon witnesses, and seek testimony under oath, so long as the government is acting in anticipation of bringing civil charges under FIRREA.[70] In doing so, Congress obviated the need for prosecutors to actually commence litigation and begin the discovery process to obtain evidence. As long as the government intends to seek redress under FIRREA, prosecutors may use administrative powers to compel production of documents and obtain testimony. No court order is required in this context.[71] Moreover, the civil attorneys in the DOJ are allowed to freely receive any information obtained as part of the criminal investigations by the DOJ, including grand jury information.[72]

D. *Civil Forfeiture*

FIRREA provides regulators with the additional tool of civil forfeiture to deal with fraud in the financial services industry: civil forfeiture. By allowing the DOJ to seize assets connected to bank fraud, prosecutors and regulators are empowered to safeguard a financial institution's assets before they can be transferred offshore or otherwise put beyond the government's reach.[73] While a number of statutes authorize asset

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the Government's New Hammer on Banks and Other Financial Institutions, 129 BANKING L.J. 579, 580 (2012) ("FIRREA is a comparative walk in the park for government attorneys compared to the rigorous burden of proof required in criminal cases and the criminal discovery rules, which are focused largely on protecting a criminal defendant's rights").

70. 12 U.S.C. § 1833a(g)(1) (A)-(C) (1966).

71. *See* Jeffrey Manns, *Downgrading Rating Agency Reform*, 81 GEO. WASH. L. REV. 749, 782 (2013) (characterizing this as an "extraordinary grant of pre-suit civil discovery.").

72. *See* Green, *supra* note 9, at 179 ("The result is that civil attorneys for the government and criminal prosecutors may work in tandem in developing evidence."); Manns, *supra* note 71, at n. 181 ("Additionally, FIRREA allows criminal grand jury material to be passed on for use in DOJ civil suits without a court order. This means that the DOJ can potentially use any material developed in the pursuit of a failed criminal investigation to have a second bite at the apple in a civil proceeding").

73. FIRREA, § 963. The House Judiciary Committee amended the Banking Committee's version of H.R. 1278 to allow the use of civil forfeiture for banking related offenses. Judiciary Committee Report, *supra* note 56, at 9. In addition, Congress amended the RICO statute, 18 U.S.C. § 981 (2012) *et seq*., to include the following as predicate offenses: 18 U.S.C. § 215 (receipt of gifts or commissions for procuring loans); 18 U.S.C. § 656 (theft or embezzlement by a bank officer); 18 U.S.C. § 657 (Embezzlement, Abstraction, Purloining or Willful Misapplication); 18 U.S.C. § 1005 (placing of false statements by an insider in the books of a bank); 18 U.S.C. § 1006 (placing of false

forfeitures, this provision was modeled after the RICO provisions allowing for forfeitures of any property obtained in violation of the statute.[74]

III. FIRREA'S RECENT USE

Although FIRREA was enacted in 1989, it was virtually ignored as a vehicle to address financial fraud until the GFC.[75] This section will outline its use in four illustrative cases from the GFC: *United States v. Bank of New York Mellon*, *United States v. Bank of America*, *United States v. Wells Fargo* and *United States v. McGraw-Hill Companies*. These cases provide guidance as to the developing FIRREA case law as well as offering evidence of its far-reaching application and of its power as a tool to combat financial fraud.

statements by an insider in the books of an S&L); 18 U.S.C. § 1007 (making a false statement to the FDIC to induce the FDIC to enter into certain transactions); 18 U.S.C. § 1014 (making a false statement to a federally insured institution in order to obtain credit); and 18 U.S.C. § 1344 (bank fraud). *Id*. *See also* 18 U.S.C. § 981(a)(1)(C) (2012) (listing offenses that the violation of will subject property to forfeiture).

74. For a discussion of civil forfeiture in general and RICO specifically, *see* Lisa H. Nicholson, *The Culture of Under-Enforcement: Buried Treasure, Sarbanes-Oxley and the Corporate Pirate*, 5 DEPAUL BUS. & COM. L.J. 321, 350 (2007) (discussing RICO forfeiture provisions). Before the government can obtain civil forfeiture under RICO, the defendant must first be convicted of a RICO violation. *Id*. *See also id*. where Nicholson argues that asset forfeiture is a better deterrent in the case of white collar crime, especially fraud, than either incarceration or fines. In FIRREA cases, on the other hand, the guilt or innocence of the property owner is irrelevant; it is enough that the property was involved in a violation to which forfeiture attaches. In contrast, criminal forfeiture proceedings are in personam proceedings, and confiscation is only possible upon the conviction of the owner of the property and only to the extent of defendant's interest in the property. *See* Bennis v. Michigan, 516 U.S. 442, 453 (1996) (holding that forfeiture provision was not a violation of Due Process); United States v. One "Piper" Aztec "F" DeLuxe Model, 250 PA 23 Aircraft, 321 F.3d 355, 360 (3d Cir. 2003) (upholding lower court's judgement of forfeiture); United States v. Funds in the Amount of Thirty Thousand Six Hundred Seventy Dollars (Calhoun), 403 F.3d 448, 469 (7th Cir. 2005) (finding that civil forfeiture was permissible); United States v. Contorinis, 692 F.3d at 146 (vacating and remanding forfeiture order); United States v. Liquidators of European Federal Credit Bank, 630 F.3d 1139, 1150 (9th Cir. 2011) ("The government may pursue civil forfeiture even after a failed criminal prosecution.").

75. Previously, FIRREA had been used primarily against officers and directors of failed financial institutions. Robert Anello, *New Justice Department's FIRREA Cases Against Banks: Holding the Victim Responsible*, FORBES: THE INSIDER (May 16, 2013, 11:41 AM), http://www.forbes.com/sites/insider/2013/05/16/new-justice-departments-firrea-cases-against-banks-holding-the-victim-responsible, *archived at* http://perma.cc/98E6-HTH4. Therefore, most of the commentary on the statute concerned the director and officer liability provisions.

A. *United States v. Bank of New York Mellon (BNYM)*[76]

This case was one of the first cases to use FIRREA stemming from the GFC. As noted above,[77] FIRREA provides for *civil* liability for violating certain specified *criminal* statutes where the actions of the defendants affect a federally insured financial institution. In this case, prosecutors brought a claim under FIRREA against the BNYM, alleging that the bank violated mail and wire fraud statutes in three ways. First, BNYM represented that it provided "best execution" when pricing foreign exchange trades under its "standing instructions" program.[78] Under the standing instructions service, BNYM automatically provided currency exchange services as the need arose, and the client was not aware of the actual exchange rate until after the transaction was completed. Second, the complaint alleges that BNYM represented that it engaged in netting to benefit clients. Netting allows a bank to aggregate exchanges and can result in significant cost savings to the client. Third, the complaint alleges that BNYM asserted that all standard instruction clients would receive the same pricing. Contrary to the representations, the pricing adopted by BNYM was not consistent with industry understanding of best execution. Instead of providing its clients with the best prices it could obtain in the market, BNYM collected all standing trade requests throughout the day and held them. Each afternoon, the bank determined an aggregate level needed to accommodate all client requests and executed the needed transactions on its own behalf in the spot market. Later, it determined a price for each transaction. BNYM was able to profit from this method of exchange.[79] With respect to netting, it appears that some trading desks netted the trades and others did not. Third, the Bank allegedly did not provide the same pricing to all clients. The complaint alleges that BNYM profited enormously from these practices. For example, standing instructions trades generated 69% of the foreign exchange trading profits in spite of the fact that they accounted for only 12% of the foreign exchange trading volume.[80]

In the BNYM case, the court considered the novel question of whether

76. Bank of New York Mellon, 941 F. Supp. 2d 438 (2013).

77. *See* cases cited and statutes cited *supra* notes 55-58 and accompanying text (outlining "predicate offenses" that can serve as the basis for civil penalties under FIRREA).

78. Bank of New York Mellon, 941 F. Supp. 2d at 442, 444-447. For the facts referenced to in this section, *see id.* at 444-448 (discussing BNYM's allegedly improper actions).

79. *Id.* at 447 ("For example, BNYM might sell euros to a client at the highest price at which the euro traded that day, while buying euros from another client at the lowest price at which the euro had traded.").

80. *Id.* at 448. For discussion of these allegations, *see id.* at 447-458 (referencing the allegations against BNYM).

the affected institution required by statute could in fact *be* the defendant. In other words, does the behavior that complies with the predicate offense have to be committed by a third party? The complaint in the BNYM case alleges that the bank practices which constituted mail and wire fraud affected BNYM in several ways. First, these practices provided large profits to the bank. Second, the practices exposed the bank to the potential for liability and legal fees. Third, when clients learned of these practices, many withdrew their business. Relying on these assertions and a plain reading of the statute and its legislative history, Judge Kaplan rejected the defendant's motion to dismiss, holding:

> "[i]n passing FIRREA, Congress sought to deter fraudulent conduct that might put federally insured deposits at risk. Where, as alleged here, a federally insured financial institution has engaged in fraudulent activity and harmed itself in the process, it is entirely consistent with the text and purposes of the statute to hold the institution liable for its conduct."[81]

This decision is interesting in that the bank is essentially both the defendant and victim of the wrongdoing. The court expressly rejected the argument that "affecting" meant "victimizing."[82] Arguably, this interpretation of FIRREA creates civil liability for essentially any financial crime committed by a financial institution.

A second issue discussed by the BNYM court concerned how significant the effect on the institution had to be. The court acknowledged that the effects had to be direct enough to trigger statutory liability. But, the court found the effects alleged in the complaint to be sufficient, stating:

> "[T]he alleged negative effects are slightly removed from the underlying alleged scheme insofar as they manifested only when that scheme was revealed, not as it was ongoing. No matter. The touchstone of proximate causation is reasonable foreseeability, and it certainly was reasonably foreseeable that this alleged scheme, if uncovered, would result in these kinds of harms to the Bank." [83]

The last issue considered by the court had to do with the scienter requirement. The court opined that there were two components needed to

81. *Id*. at 443. *See also id*. at 457 (The court "declines to conclude that an institution cannot be affected by a fraud solely because it participates in it."). *See* King, *supra* note 21, at 777-779 (briefly discussing this issue).

82. *Id*. at 451 ("If Congress had wanted to limit civil penalties to cases in which the financial institution was the victim, it obviously could have done so; instead, it chose a singularly broad term.").

83. *Id*. at 460. *See also id*. at 459 (discussing that the effect had to be "substantially direct" in order to trigger liability).

meet the scienter requirement for mail/ wire fraud: 1) intent to deceive; and 2) contemplation of harm to the victim. The court then concluded that intent to deceive can be inferred from the conduct of the parties. The complaint alleged that bank employees knew that their practices were inconsistent with industry norms and took active steps to conceal the actual method in which their trades were priced.[84] The court found these allegations to be sufficient.[85]

B. *United States v. Countrywide Financial Corporation/Bank of America*[86]

The second case to apply FIRREA to the GFC was *United States v. Countrywide Financial Corporation*. In this case, prosecutors alleged that defendant banks violated mail and wire fraud statutes by originating loans in violation of Freddie Mac and Fannie Mae guidelines and then selling those loans to Freddie Mac and Fannie Mae while representing that they had adhered to those guidelines. Specifically, as default rates were rising in 2007, Countrywide adopted a streamlined loan origination model. As part of this model, Countrywide eliminated checks on loan quality and compensated employees based solely on the volume of loans originated. This allegedly led to an increase in the amount of fraud and serious loan defects.[87] Because of escalating default rates, Fannie Mae and Freddie Mac began tightening their requirements and refused to purchase risky loans. This was communicated to lenders, including Countrywide. Well aware of Freddie Mac and Fannie Mae's actions, Countrywide represented to Freddie Mac and Fannie Mae that it had tightened the underlying guidelines.[88] Moreover, Countrywide was aware of the fact that many aspects of the Hustle model violated Fannie/Freddie guidelines.[89] In fact, Countrywide's internal reports revealed material defect rates of 57% in the

84. *Id*. at 443. For further discussion of the scienter issue, *see id*. at 463-464 (discussing the court's reasoning behind its decision on the scienter issue).

85. *Id*. at 470 (The complaint "alleges a pattern of misrepresentations by Bank employees who, the [complaint] plausibly alleges, knew that their representations were false. These give rise to a strong inference that these Bank employees intended to deceive customers into believing that they were receiving best execution as the [complaint] alleges that term is understood").

86. Countrywide Home Loans, Inc., 33 F. Supp. 3d at 494 (2014).

87. *Id*. at 497. *See also* Complaint-in-Intervention, infra note 88, at ¶ 3-5 (discussing the emphasis on quantity instead of quality of loans). This loan origination model was called "the Hustle." *Id*. at ¶ 2-4.

88. Complaint-in-Intervention of the United States of America at ¶ 51, U.S. ex rel. O'Donnell v. Countrywide Home Loans, Inc. 33 F. Supp. 3d 494 (S.D.N.Y. July 30, 2014) (No. 12 Civ. 1422).

89. *Id*. at ¶ 66.

Hustle loan pool overall.[90] Thus, Countrywide's internal reports revealed that more than half of the loans that were "cleared to close" were ineligible for sale to any investor, even though those loans were to be sold to Freddie Mac and Fannie Mae.[91] In addition, Countrywide concealed both its bonus structure from Fannie/Freddie and the fact that its quality control team was incentivized to rebut quality control findings.[92]

The complaint alleged that the fraud affected Fannie Mae and Freddie Mac investors; however, neither Freddie Mac nor Fannie Mae are federally insured financial institutions.[93] Therefore, the question again became whether the defendant banks can themselves be the affected financial institutions (what has now become termed the "self-affecting" theory). Again, the court held that the FIRREA requirement had been met. Relying on the plain meaning of the statute, the court found that "the fraud here in question. . . had a huge effect on BofA defendants"[94] and therefore the requisite affect was met.

Thus far, this case is the only FIRREA case to have gone to a jury. On October 23, 2013 a jury returned a verdict in favor of the government; Judge Rakoff subsequently imposed damages in the amount of $1.2 billion.[95]

90. *Id*. at ¶ 70.

91. Countrywide Home Loans, Inc. 33 F. Supp. 3d at 499.

92. In addition, it is alleged that Countrywide offered employees an incentive for rebutting earlier findings that loans were defective. Complaint-in-Intervention of the United States of America at ¶¶ 90, 107, *Countrywide Home Loans*, 33 F. Supp. 3d 494 (No. 12 Civ. 1422) ("Another former Fannie Mae executive commented that it was misleading for Countrywide to be representing, on the one hand, that it was tightening its underwriting controls, while simultaneously engaging in a game of 'catch me if you can' on the quality control side").

93. Complaint-in-Intervention of the United States at ¶¶ 131—133. Recall that mail and wire fraud violations are only actionable if they impact a federally insured financial institution. 12 U.S.C. § 1833a(c)(2). *See, e.g.*, King, *supra* note 21, at 784-785 (discussing this requirement).

94. United States v. Countrywide Fin. Corp., 996 F. Supp. 2d 247, 249 (S.D.N.Y. 2014). *See also* Countrywide Home Loans, Inc. 33 F. Supp. 3d at 494.

95. *Id*. at 497. Judge Rakoff relied in large part on the guidelines set forth by the Menendez court. *See* Menendez, No. CV 11-06313 MMM, 2013 WL 828926, at *5-6 (C.D. Cal. Mar. 6, 2013) (setting forth the relevant criteria). After reviewing the facts of the case relevant to those criteria, Judge Rakoff described Countrywide's actions as "the vehicle for a brazen fraud by the defendants, driven by a hunger for profits and oblivious to the harms thereby visited, not just on the immediate victims but also on the financial system as a whole." Countrywide Home Loans, Inc. 33 F. Supp. 3d, at 503.

C. *United States v. Wells Fargo Bank*[96]

In another illustrative case, FIRREA claims were brought against Wells Fargo Bank. Wells Fargo Bank was a participant in the Department of Housing and Urban Development (HUD)'s Direct Endorsement Lender Program. As a participant in that program, Wells Fargo agreed to comply with HUD regulations related to granting mortgages. After granting a mortgage, the lender in this program must make certain certifications regarding compliance with HUD regulations. For example, the lender must certify "the integrity of the data" used to determine the quality of the loan, must perform due diligence on the loans granted, and must implement a quality control system to review loans.[97] These mortgages are then automatically granted HUD mortgage insurance. The government alleged that Wells Fargo engaged in reckless lending practices and falsely certified to HUD that their loans were eligible for Federal Housing Administration insurance.[98] Specifically, the complaint alleged that Wells Fargo used inadequately trained employees, paid a bonus based on the number of loans written, pressured loan officers to close loans, required a short turnaround time and employed lax underwriting standards and controls.[99] Moreover, the complaint alleged that Wells Fargo's own Quality Assurance department noted a high violation rate and notified senior management of the riskiness of the loans being granted, but the Bank did nothing in response to these results. Lastly, knowing that approximately half of their mortgages were granted in violation of HUD regulations, the Bank submitted claims for 97% of them.[100]

By now the self-affecting theory had become well settled. Judge Furman denied the defendant's motion to dismiss saying that the argument "merits little discussion."[101] Here, the court found that the defendant bank's actions had created an increased risk of loss to the bank.

96. United States v. Wells Fargo Bank, N.A., 972 F. Supp. 2d 593(S.D.N.Y. 2013).
97. *Id.* at 600.
98. *Id.* at 602.
99. *Id.*
100. *Id.* at 603.
101. *Id.* at 630. Judge Furman cited the Bank of New York Mellon and the Countrywide cases in addition to relying on the plain meaning of the statute ("The question considered by courts in these cases was whether a financial institution, through its own misconduct, can affect itself within the meaning of FIRREA. Courts have repeatedly held that it can."). *Id.* Arguably, this makes sense since the primary purpose of FIRREA is punitive rather than compensatory. Despite the fact that civil liability is imposed under FIRREA, the fines serve a punitive function. Therefore, the defendant can be punished for misconduct even when compensatory damages would be nonsensical (*e.g.*, if the fine was paid to the "affected" party, the defendant would be compensating itself).

D. *United States v. McGraw-Hill Companies*

The most recent case to be brought by the DOJ is *United States v. McGraw-Hill Cos., Inc*. In this case, the DOJ alleged that Standard & Poor (S&P) engaged in mail and wire fraud in their rating of MBSs in the time leading up to the GFC. The complaint alleged that S&P made several significant misrepresentations. S&P represented that their ratings were objective, independent and uninfluenced by any conflicts of interest. In fact, they represented that they had internal controls and policies in place to address conflicts of interest in ratings. At the same time, they failed to disclose that they were receiving fees from the issuer of the Collateralized Debt Obligations (CDOs) and MBSs. The complaint alleged that S&P knew that the ratings inaccurately rated the riskiness of the tranches and failed to modify the ratings out of a desire for increased revenue and market share.[102] The complaint outlined how S&P refused to downgrade their ratings or to revise the models used to set these ratings even as employees within the company expressed fears that their ratings were inaccurate. Moreover, the complaint outlined how the affected financial institutions relied on these ratings in their investment decisions.

S&P raised a number of issues in a motion to dismiss. They argued that any representations that their ratings were independent and objective were "generalized aspirational language and 'puffery,'"[103] that the complaint failed to specify fraud with sufficient particularity and that the complaint failed to allege that S&P acted with specific intent to defraud the investors of the MBSs. In denying the defendants' motion to dismiss,[104] Judge David O. Carter rejected the "puffery" argument. He held that the representations by the CRA were not "'general, subjective claim[s]' about the avoidance of conflicts of interest," but instead were "specific assertions of current and ongoing policies."[105] Moreover, the court found that it is not necessary for a FIRREA claim that the money flow directly from the party deceived to the defendant. In other words, S&P argued that even if they

102. Complaint for Civil Money Penalties & Demand for Jury Trial at 2, United States v. McGraw-Hill Cos., Inc., CV 13-00779 (C.D. Cal. Feb. 4, 2013) [hereinafter McGraw Hill Complaint]. For further discussion of the facts in this case, *see id*. at 107 (discussing S&P's alleged mail and wire fraud in the time preceding the GFC).

103. Order Denying Defendants' Motion to Dismiss at 7, United States v. McGraw Hill Cos., Inc., No. 2:13-cv-00779-DOC-JCG (C.D. Cal. July 8, 2013) [hereinafter Order Denying]. *See* United States' Opposition to Defendants' Motion to Dismiss Complaint Pursuant to Federal Rules of Procedure 9(b) and 12(b)(6) at 1, No. 2:13-cv-00779-DOC-JCG (C.D. Cal. May 20, 2013) (opposing this argument, the DOJ equates this to "an infomercial hawker's claim that his knife will outlast any other.").

104. Order Denying, *supra* note 103.

105. *Id*. at 9-10.

benefitted from fraud that they were paid by the issuers of the securities, not by the parties deceived (the investors). In rejecting this argument, the court relied on assertions in the complaint that S&P was engaged in a "scheme to defraud investors," they knew this scheme would defraud investors and that S&P would obtain money from the investors as the costs of issuing ratings were passed through to the investors.[106]

The government sought damages in the amount of $5 billion. On February 3, 2015, a settlement was reached between the parties in which S&P agreed to pay $1.375 billion.[107] While admitting that business concerns affected rating decisions[108] and that S&P executives purposely delayed adopting new models that might have lowered ratings,[109] S&P did not admit fault.[110] As part of the settlement, S&P was banned by the SEC from rating certain types of new MBS transactions until 2016.[111]

E. *Lessons Learned*

What can we learn from these four lawsuits? We see the power of FIRREA. Although it has been rarely used since the S&L Crisis, it is presently a formidable weapon.[112] Courts have by and large rejected the

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106. *Id.* at 17.

107. Press Release, Dep't of Justice, Justice Department and State Partners Secure $1.375 Billion Settlement with S&P for Defrauding Investors in the Lead Up to the Financial Crisis (Feb. 3, 2015) http://www.justice.gov/opa/pr/justice-department-and-state-partners-secure-1375-billion-settlement-sp-defrauding-investors, *archived at* http://perma.cc/Z7SB-MH8H.

108. Kaja Whitehouse, *Critics Blast Justice Department's S&P Settlement,* USA TODAY (Feb. 3, 2015), http://www.usatoday.com/story/money/business/2015/02/03/sp-settlement-14b-wrongdoing-change/22808017/, *archived at* http://perma.cc/UNZ6-62YR.

109. Addison Morris, *DOJ announces $1.375 billion settlement with S&P*, JURIST (Feb. 3, 2015), http://jurist.org/paperchase/2015/02/doj-announces-1375-billion-settlement-with-sp.php. *See* Department of Justice Press Release, *supra* note 107 (indicating that S&P acknowledged that: 1) they promised investors that its ratings were independent and objective; 2) decisions about testing and timing of updates to the ratings models were based, at least in part, on concerns about ongoing business relationships with issuers; 3) people in S&P knew that many of the underlying loans were delinquent and that losses were likely; and 4) S&P representatives continued to issue positive ratings without adjustments).

110. Samantha Sharf, *S&P To Pay $1.5 Billion In Settlements With DOJ, States, CalPERS* (FORBES, Feb. 3, 2015), http://www.forbes.com/sites/samanthasharf/2015/02/03/sp-to-pay-1-5-billion-in-settlements-with-doj-states-calpers/, *archived at* http://perma.cc/EY2P-NLYL *See, e.g.*, Edvard Pettersson, *S&P Faces Squeeze After $1.3 Billion Countrywide Fine*, BLOOMBERG NEWS (Sept. 9, 2014) (explaining that there had been speculation that S&P would settle after the Countrywide fine was announced).

111. Whitehouse, *supra* note 108.

112. *See* Russell-Kraft, *supra* note 54 (featuring Acting Associate Attorney General Stuart Delery discussing the S&P settlement by stating, "In this case, the department once

arguments by financial institution defendants that FIRREA does not apply to them because they are both the defendant and the victim of fraud and instead adopted the self-affecting theory. This theory allows the DOJ to bring FIRREA claims against financial institution defendants when their actions injured the profitability of the defendant. Moreover, in the S&P lawsuit we see that the DOJ does not need to prove any direct communication between the affected financial institution and the defendant. In the S&P case, it was enough for the DOJ to assert that financial institutions relied on the ratings issued by the defendant. Some see this as a "significant expansion of FIRREA's reach."[113]

The DOJ has demonstrated that FIRREA is an effective weapon. On the heels of the Countrywide verdict, DOJ has settled case after case. In the summer of 2015, they reached a $16.65 billion settlement with Bank of America, $5 billion of which was to settle FIRREA claims; they reached a $4 billion settlement with Citigroup and a $2 billion settlement with JP Morgan Chase and Co.[114] It is possible that the potential for huge liability will induce other defendants to enter into settlements.[115] Moreover, as an example of the far-reaching potential of FIRREA, there is speculation that the DOJ is considering initiating FIRREA suits against lenders involved in granting and securitizing subprime automobile loans.[116]

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again has demonstrated that FIRREA is a powerful weapon for combating financial fraud and a vital mechanism for holding accountable those who violate the law.").

113. Latham & Watkins Litigation Department, *The DOJ's Case Against Standard & Poor's and the Continued Rise of FIRREA as a Tool for Government Enforcement*, LATHAM AND WATKINS CLIENT ALERT (Apr. 15, 2013), http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CCAQFjAA&url=http%3A%2F%2Fwww.lw.com%2FthoughtLeadership%2FDOJ-vs-SP&ei=PxtVVLu1K4OmyATy-YJw&usg=AFQjCNEhEqz5VrfIUFPVTVo3wPfiul3aNw&sig2=XA-KfCm0BofZCFbXBQ8dIw, *archived at* https://perma.cc/N5TC-G8LR?type=source.

114. Russell-Kraft, *supra* note 54.

115. *See, e.g.*, Patricia S. Abril & Ann Morales Olazabal, *The Locus of Corporate Scienter*, 2006 COLUM. BUS. L. REV. 81, 113 (2006) (hypothesizing that the complications of determining whether individuals or corporations act with the scienter requirement may encourage settlement); Peter J. Henning, *Corporate Criminal Liability and the Potential for Rehabilitation*, 46 AM. CRIM. L. REV. 1417, 1418-1419 (2009) (emphasizing that the difficulties that arise when applying criminal liabilities to corporations may lead to settlement); Andrew Weissmann, *A New Approach to Corporate Criminal Liability*, 44 AM. CRIM. L. REV. 1319, (2007) (noting that one of the dangers of imposing criminal liability in the instance of corporate crime is thought to be the over-inclusiveness that comes from the stigma of criminal liability). In other words, some commentators argue that corporations enter into settlements in the case of criminal liability even when they are not in fact guilty. Arguably, this concern of over-inclusiveness might apply to FIRREA liability.

116. Financial Services Report, Morrison Foerster, (Spring 2015), http://www.mofo.com/~/media/Files/Newsletter/2015/03/150309FinancialServicesReport.pdf, *archived at* http://perma.cc/YPZ4-P58L.

IV. FIRREA: SOUND PUBLIC POLICY?

A. *The Public Policy of Financial Regulation*

The availability of credit is essential to the smooth functioning of financial markets, and investor confidence is essential to the availability of credit.[117] If investors do not have confidence that the risks of their investments are relatively transparent and free from fraud, they will not invest in the market.[118] The issuers, however, often know more about their business operations and future prospects, and as such, are in a position to take advantage of investors by not disclosing relevant information.[119] This creates a situation of asymmetric information,[120] which can hinder the investment choices that consumers make. This in turn creates the lemons problem.[121] In his now classic example, Professor Akerlof illustrates how information asymmetry creates an adverse selection problem.[122] This

117. One of the purposes of FIRREA was to restore confidence in the regulatory system. *See, e.g.*, Michael M. Neltner, *Government Scapegoating, Duty to Disclose, and the S & L Crisis: Can Lawyers and Accountants Avoid Liability in the Savings and Loan Wilderness*, 62 U. CIN. L. REV. 655, 662 (1993) (arguing that President Bush became aware of the need to restore confidence in the regulatory system in the wake of the 1988 presidential election).

118. Capital markets function when funds flow from investors to issuers in an efficient manner. This results in optimal allocation of resources in the economy. Fraud interferes with efficient allocation. For more details on the idea of efficient allocation, *see, e.g.*, ANTHONY SANTOMERO & DAVID BABBEL, FINANCIAL MARKETS, INSTRUMENTS & INSTITUTIONS 39-52 (2001) (describing the role interest rates play in allocation of resources). For example, it was estimated that the loss of consumer confidence in the integrity of capital markets following Enron led to a loss of over $8 trillion in U.S. equity markets from 2001 to 2002. Lisa H. Nicholson, *The Culture of Under-Enforcement: Buried Treasure, Sarbanes-Oxley and the Corporate Pirate*, 5 DEPAUL BUS. & COM. L.J. 321, 323 (2007).

119. Paul M. Healy & Krishna G. Palepu, *Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature*, 31 J. OF ACCOUNTING & ECON. 405, 407 (2001).

120. *See* Stephanie Rousseau, *Enhancing the Accountability of Credit Rating Agencies: The Case for a Disclosure-Based Approach*, 51 MCGILL L. J. 617, 622 (2006) ("Inevitably, information asymmetry exists in the debt market because issuers have superior information regarding their creditworthiness than do investors."); White, *supra* note 19, at 4 ("The critical problem is one of asymmetric information: the borrower usually knows more about the prospects for repayment than does the lender.").

121. *See generally* George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. OF ECON. 488 (1970) (explaining how the presence of information asymmetry can lead to the degradation of goods offered within a market).

122. Assume that a consumer is interested in buying lemons but he cannot tell a bad lemon from a good lemon. Therefore, he is willing to pay an average price for the lemon. This rewards sellers of bad lemons (the adverse selection) and promotes the sale of more bad lemons than good lemons. Assuming that consumers are rational, they anticipate this

applies to capital markets and creates a situation where if investors cannot judge the value of an investment, they assume that they are being offered a "lemon" and are unwilling to pay a high price for that investment. In other words, if investors lack sufficient information to judge the value of a security, they will assume it is a risky or low-value investment and either fail to purchase that security or price it accordingly. If that happens, there is potential for a breakdown in capital flows which will impede economic growth.[123]

Financial regulation is designed to address the lemons problem with overall aims of protecting investors and encouraging investment in financial markets.[124] It does this by requiring disclosure and by banning fraud.[125] The disclosure requirements are far-reaching; they are intended to

adverse selection and lower the price at which they are willing to buy lemons. This, in turn, promotes the sale of more bad lemons. *Id*. *See also* Yossi Spiegel, *Topic 4: Asymmetric Information Models of Capital Structure* 1 (unpublished lesson overview) (www.tau.ac.il/~spiegel/teaching/corpfin/Topic4.pdf, *archived at* http://perma.cc/2SM9-GWQT) (applying Akerlof's lemons theory to corporate finance).

123. Healy & Palepu, *supra* note 119, at 408 (discussing how the lemons problem can lead to a breakdown in capital markets). Rousseau explains that one result of this information asymmetry is that it can lead to "an adverse selection problem in that the debt of issuers with good credit quality will be undervalued, thereby undermining the viability of the market." Rousseau, *supra* note 120, at 623.

124. *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, SECURITIES EXCH. COMM'N (http://sec.gov/about/whatwedo.shtml) [hereinafter Investor's Advocate] ("The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation") [hereinafter Investor's Advocate]. *See generally* Troy A. Paredes, *On the Decision to Regulate Hedge Funds: The SEC's Regulatory Philosophy, Style, and Mission*, 2006 U. ILL. L. REV. 975, 990 (2006) ("[T]he SEC is charged with ensuring that investors are sufficiently confident in the integrity of securities markets so that they do not withdraw from the market.").

125. Thomas Lee Hazan, *Disparate Regulatory Schemes for Parallel Activities: Securities Regulation, Derivatives Regulation, Gambling and Insurance*, 24 ANN. REV. BANKING & FIN. L. 375, 383 ("Disclosure rather than a merit approach remains the regulatory philosophy of the federal securities laws today."). The theory is that if risks are made transparent that investors would properly price all risks. *See* Steven L. Schwarcz, *The Alchemy of Asset Securitization,* 1 STAN. J.L. BUS. & FIN. 133, 218 (1994) (discussing this theory). *See also* Investor's Advocate, *supra* note 124 ("The laws and rules that govern the securities industry in the United States derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it. To achieve this, the SEC requires public companies to disclose meaningful financial and other information to the public. This provides a common pool of knowledge for all investors to use to judge for themselves whether to buy, sell, or hold a particular security. Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions. . . . Here the SEC is concerned primarily with promoting disclosure of important market-related information, maintaining fair dealing, and protecting against fraud."). Finance scholars recognize that disclosure is essential to a proper functioning

address the quality of the securities offered and indirectly regulate the management of the issuer companies.[126] Disclosure encourages firms to make credible commitments to investors, which then results in allocation of capital to investors who will make the best use of it.[127] Moreover, it provides an opportunity for investors to distinguish themselves from their competitors by offering sufficient information about the quality of the investment.[128] The overarching goal of financial and banking regulation is to make capital available in the long run.[129] Therefore, we want banks and other lending institutions to be cautious in their lending practices (to protect investment in those institutions) and we want issuers of securities to be transparent and free from fraud.[130]

How does FIRREA work to achieve these overriding objectives? By allowing *civil* action for violation of specified *criminal* statutes involving crimes affecting financial institutions, FIRREA promotes the anti-fraud aims of financial regulation. Perhaps more importantly, the recent use of FIRREA against wrongdoers whose behavior contributed to the GFC has to some degree worked to restore investor confidence in the market. When investors perceive that massive financial fraud has gone unpunished they assume that such fraud will continue and are reluctant to invest. By enforcing anti-fraud statutes, investors and public confidence is restored.

As a hybrid statute, FIRREA blurs the line between civil and criminal law. While liability is imposed only when the government can prove that the defendant violated one of the listed *criminal* statutes, the penalties

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capital market. *See* Joseph A. Franco, *Why Antifraud Prohibitions are not Enough: The Significance of Opportunism, Candor and Signaling in the Economic Case for Mandatory Securities Disclosure*, 2002 COLUM. BUS. L. REV. 223, 231 (2002) (dividing disclosure requirements into antifraud prohibitions and mandatory disclosure requirements).

126. *See* James Fanto, *Paternalistic Regulation of Public Company Management: Lessons from Bank Regulation*, 58 FLA. L. REV. 859, 886 (2006) ("Historically the SEC's regulation of management through the federal securities laws was indirect because it was based on disclosure.").

127. Jonathan Macey, *The Regulator Effect in Financial Regulation*, 98 CORNELL L. REV. 591, 592 (2013).

128. *Id.*

129. *See, e.g.*, Kao, *supra* note 34(recognizing the need for liquidity and the need to prevent the type of liquidity crises that would result from bank runs).

130. Some have argued, however, that too much regulation might actually restrict the availability of credit. Thus, when FIRREA was enacted, some argued that it would make lenders too cautious in their lending practices and limit the availability of credit. The resulting "credit crunch" would be contrary to the public policy meant to be supported. *See, e.g.*, Rowlett, *supra* note 9, at 253 ("There is no doubt that FIRREA . . . [has] made lenders more cautious in their lending. This takes for form of curtailing credit and exercising more diligence in documentation."). Rowlett was concerned primarily with unintended consequences of limiting lending by banks. Most of this article has, instead, focused on the application of FIRREA to financial institutions not as lenders but as issuers of securities.

imposed are said to be *civil* in nature. While the public policy objectives served by imposition of civil liability differ from those of criminal law, there is significant overlap; this overlap is illustrated by FIRREA. Thus, the questions become: what are the public policy objectives of civil and criminal law, does FIRREA fulfill those objectives, and how will it serve the overarching objectives of financial regulation?

B. *FIRREA: The Nature of a FIRREA Case and the Issue of Procedural Safeguards.*

1. Legal Categories

FIRREA offers one way of achieving the broader policy objectives of financial and banking regulation. A complete policy assessment of FIRREA requires, however, that we move beyond the area of financial services industry regulation and consider more basic principles of substantive law. In this section we first analyze the noteworthy features of FIRREA using the conventional divisions of civil law, criminal law, and administrative law. A cursory review of FIRREA reveals that while it exhibits some features of each it does not neatly fit into any one of these conventional categories. In this section, we will consider the hybrid nature of the statute by examining who initiates the action, the type of sanctions imposed as well as some procedural features of the statute. As part of this analysis, we will consider the broad public policy objectives of criminal, civil, and administrative law and conclude that this type of analysis is actually unproductive. That leads us to consider the much more important issue of procedural safeguards available to a defendant in a FIRREA case.

i. *FIRREA as Civil Law*

Under FIRREA, liability is imposed only where the government can prove that the defendant violated one of the listed federal criminal statutes, but the sanctions imposed appear to be more *civil* than *criminal* in nature. Incarceration, the hallmark of a criminal statute,[131] is conspicuously absent. The sum of money that a defendant has to pay under FIRREA for violating one or more of the predicate statutes has some characteristics of a criminal fine, some characteristics of an administrative fine, and some (perhaps the fewest) characteristics of money damages in a civil case.

131. *See* 1 WAYNE R. LAFAVE, SUBSTANTIVE CRIMINAL LAW 21 (2d ed. 2003) ("[C]riminal punishment, with emphasis on imprisonment, is on the whole more drastic than the sanctions, with emphasis upon paying money, imposed by the civil law . . . ."). *See also id*. at 54 (discussing administrative fines).

One of the hallmarks of civil liability is its compensatory nature; the money damage judgments imposed on defendants primarily serve to compensate injured plaintiffs.[132] This is one of the key characteristics that sets civil liability apart from criminal liability.[133] FIRREA does not appear to serve this compensatory goal because it assesses a sum of money that is paid to the government rather than providing for compensatory damages to be paid to the injured parties.[134] In other words, the fines imposed do not operate to compensate innocent investors who suffered losses because of financial fraud. The non-compensatory nature of the financial penalties is a characteristic of a criminal statute: the fines are paid to the government, not to the victim of the criminal act. At the same time, however, the sum of money a defendant would have to pay to the government under FIRREA is intended, at least in part, to help compensate the federal government for the substantial expenses it incurred in enforcing criminal statutes and regulations governing the financial services industry. In both the savings and loan crisis and the GFC, the government incurred substantial losses in bailing out the financial sector. Recall that the maximum fine imposed under FIRREA is at least tangentially tied to the amount of the government's loss.[135] A FIRREA recovery, although not expressly tied to the amounts of the bailouts, does provide a way to at least partly compensate the government, if not the investors injured, for these losses.[136]

Another noteworthy feature of FIRREA is the standard of proof required in an action under the statute: preponderance of evidence. This standard of proof, which is nearly universal in civil cases[137] and is typical in

132. *Id.* at 22.

133. As an example of the overlap between civil and criminal policy, it should be noted that punitive damages in a civil case are designed to punish (specifically to deter) defendants in a case of particularly egregious behavior. Such cases must be proven by a preponderance of the evidence. Punitive damages are an accepted part of tort law and serve a legitimate purpose.

134. One important feature of criminal law is that any financial penalties imposed are paid as fines to the government, not to the injured party as compensation. Restitution to the victim of the crime is, however, becoming more common in the array of sanctions available to the judge in a criminal case. Professor LaFave writes: "In spite of the theory that criminal law is not concerned with compensating the victim of crime, in practice restitution of property obtained by theft is sometimes, with or without statutory authority, made a condition of probation . . . ." LaFave, *supra* note 131, at 22, n.5.

135. *See supra* note 65 and accompanying text (indicating that for the purposes of calculating the civil fine, losses include those suffered by the various Federal depository insurance programs).

136. *See* Lowy, *supra* note 5, at 379 (discussing an effort in the 1980s by federal regulators to "recoup a portion of the billions of federal dollars lost in the bankruptcy of federally-insured banks and thrifts . . . .").

137. LaFave, *supra* note 131, at 25.

administrative law cases,[138] is justified in civil cases because the absence of punitive sanctions and the emphasis on compensation minimize the concern over a possible erroneous outcome.

This analysis has demonstrated that while FIRREA has some of the key characteristics of a civil statute, most notably its standard of proof, it fails to serve the overriding public policy goal of compensating the victims. Hence, the non-compensatory nature of the statute's remedial provision and the fact that the financial penalty is paid to the government require that we consider whether or not FIRREA better fits within the category of criminal law.

ii. *FIRREA as Criminal Law*

Traditionally, civil law existed as an alternative to criminal law. As we have demonstrated, FIRREA does not fit neatly into the category of civil liability. The question thus becomes: to what extent is FIRREA more appropriately viewed as a criminal statute and does it better meet the public policy objectives of criminal law? One of the hallmarks of modern criminal law is that prosecutions to enforce the criminal code are brought by the government, typically by a prosecutor acting on behalf of the public.[139] This is the case with a FIRREA action which may only be initiated by the federal government, not by private parties. This is a traditional characteristic of both criminal law and modern administrative law and distinguishes the statute from a typical civil action that is brought by a private party plaintiff.

Another hallmark of criminal law is the fact that criminal law is intended to *punish* wrongdoers.[140] This punishment serves a variety of public policy purposes such as deterrence, rehabilitation, and retribution.[141]

138. 2 RICHARD J. PIERCE JR., ADMINISTRATIVE LAW TREATISE 971(5th ed. 2010).

139. LaFave, *supra* note 131, at 22. While private prosecutions were once typical in Anglo-American law, by the middle of the nineteenth century public prosecution became the norm. *See generally* Roger A. Fairfax, *Delegation of the Criminal Prosecution Function to Private Actors*, 43 U.C. DAVIS L. REV. 411 (2009) (discussing the public prosecution norm); Allen Steinberg, *From Private Prosecutor to Plea Bargaining: Criminal Prosecution, the District Attorney, and American Legal History*, 30 CRIME & DELINQUENCY 568 (1984) (describing the authoritative role of the public prosecutor in the American criminal justice system).

140. LaFave, *supra* note 131, at 18 (Criminal law aims to "prevent harm to society." "This it accomplishes by punishing those who have done harm, and by threatening with punishment those who would do harm, to others.").

141. LaFave, *supra* note 131, at 36-47; Ashley S. Kircher, *Corporate Criminal Liability versus Corporate Securities Fraud Liability: Analyzing the Divergence in Standards of Culpability,* 46 AM. CRIM. L. REV. 157, 170 (2009) ("The goals of imposing corporate criminal liability are retribution, rehabilitation, and deterrence."). Some argue that

As such, the fines and other sanctions (such as incarceration) are imposed to punish defendants who are found guilty of engaging in criminal behavior.[142] FIRREA serves this punitive function. Judge Rakoff in the Countrywide/Bank of America case noted that "a FIRREA action is not primarily intended to serve compensatory functions but rather to serve quasi-civil punitive and deterrent functions."[143] There is no threat of imprisonment; the fine serves as the entirety of the punishment.[144] The absence of this threat is not determinative because there are many fine-only criminal statutes.[145] Incarceration is a sanction that is found only in criminal law, but it is not a necessary condition of a criminal statute. Insofar as criminal statutes are applied to corporate defendants, incarceration as a punishment is impossible. This is not to suggest that the absence of incarceration as a sanction is unimportant. As we will discuss in Part 2 of this section, the absence of incarceration as a sanction is very significant with respect to the issue of procedural safeguards.[146]

Another hallmark of a criminal law is its location in the jurisdiction's codes. Criminal law is placed in the criminal code, which in federal law is

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rehabilitation is one of the justifications for punishing, so is deterrence. By contrast, some reject these justifications and argue that punishment should bring about retribution (for engaging in morally wrong behavior). *See* Regina A. Robson, *Crime and Punishment: Rehabilitating Retribution as a Justification for Organizational Criminal Liability*, 47 AM. BUS. L.J. 109 (2010) (discussing the merits of retribution and deterrence as goals of organizational criminal liability).

142. Kircher, *supra* note 141, at 170 ("The goals of imposing corporate criminal liability are retribution, rehabilitation, and deterrence."); Robson, *supra* note 141. For a discussion of the difference between damages awarded in civil suits and fines imposed in the criminal context, *see* Dan M. Kahan, *Social Meaning and the Economic Analysis of Crime*, 27 J. LEGAL STUD. 609, 619 (1998) ("Just as fines fail to express condemnation relative to imprisonment of natural persons, so civil damages fail to express it relative to criminal liability for corporations. Indeed, like fines, civil damages seem to connote that society is 'pricing' corporate crime.").

143. Countrywide Opinion and Order, *supra* note 86, at 5. *See also id*. at 11 (noting the punitive and deterrent nature of FIRREA's civil penalty provisions).

144. This is not unusual in the case of corporate crime. Retribution is an important public policy goal furthered by imposition of criminal penalties upon corporations. *See* Kircher, *supra* note 141, at 170 ("the fine is meant to be proportional to the harm committed by the corporate offender in an effort to satisfy the public's demand for justice."). *See generally* Lawrence Friedman, *In Defense of Corporate Criminal Liability*, 23 HARV. J. L. & PUB. POL'Y 833 (2000) (discussing the purpose of corporate criminal liability); Robson, *supra* note 141 (discussing criminal law as the ultimate deterrent to corporate crime). In the case of corporate crime, however, retribution is achieved largely through assessment of a fine on the corporation.

145. These are mainly minor misdemeanors. *See, e.g.*, Atwater v. City of Lago Vista, 532 U.S. 318 (2001) (equating a fine-only offense with a misdemeanor).

146. *See infra* notes 166-174 and accompanying text (discussing the importance of the lack of incarceration as an important element of a consideration of the procedural safeguards required).

found in Title 18 of the United States Code. FIRREA appears in Title 12, which weighs heavily against classifying it as a criminal statute. This is not merely playing with labels. Other than the threat of incarceration and placement in the criminal code, there are no other unambiguous characteristics of criminal law.

Criminal law also serves an important deterrent function. As a justification for imposition of criminal penalties, deterrence is traditionally broken down into specific and general deterrence.[147] Specific deterrence is intended to deter this particular defendant from committing criminal acts in the future; general deterrence is intended to deter other similarly situated individuals from engaging in similar misconduct.[148] FIRREA is intended to serve a deterrent effect. Its legislative history makes it clear that one of the "primary purposes of [FIRREA was to] . . . enhance the regulatory enforcement powers of the depository institution regulatory agencies to protect against fraud . . . ."[149]

In order to establish liability under FIRREA the government must prove that the defendant violated one of the specified federal criminal statutes, *i.e*. predicate offenses. The use in FIRREA of existing criminal statutes to establish standards of behavior is, in fact, part of the established practice of attaching civil liability to conduct that falls below standards established in criminal statutes.[150] The use in civil cases of standards of behavior established in criminal statutes is not surprising because despite their differences, both criminal law and civil law aim "to shape people's conduct along lines that are beneficial to society . . . ."[151] Once a legislature identifies conduct as deserving moral condemnation and labels it criminal (by placing the statute in the criminal code, e.g. Title 18 of the United States Code), the subsequent step of imposing civil liability for engaging in that same behavior (with proof by a preponderance of evidence) is

147. LaFave, *supra* note 131, at 37-40.

148. *Id*. at 37-38; Marcia Narine, *Whistleblowers and Rogues: An Urgent Call for an Affirmative Defense to Corporate Criminal Liability*, 62 CATH. U.L. REV. 41, 54 (2012); Weissmann, *supra* note 115, at 1325.

149. H.R. Rep. 101-54(I), at 307-08 (1989). *See also* Judge Kaplan's comments *supra* note 81 and accompanying text (holding a federally insured financial institution civilly liable under FIRREA). *See generally* John Leubsdorf, *Symposium on James Atleson's Values and Assumptions in American Labor Law, A Twenty-Fifth Anniversary Retrospective Article: Legal Ethics Falls Apart*, 57 BUFF. L. REV. 959, 974 (2009) (stating that FIRREA was passed "both to help clean up the savings and loan mess and to prevent future disasters").

150. For example, many jurisdictions hold that violation of a criminal statute is negligence per se ("or at least evidence of negligence") in an action brought by someone who is among those intended to be protected by that statute. LaFave, *supra* note 131, at 25-26.

151. LaFave, *supra* note 131, at 21.

relatively unproblematic. In the case of FIRREA, instead of the courts using a statute to establish a standard of behavior with which to impose common law liability (*e.g*., for fraud), Congress is using its own criminal statutes (in U.S.C. Title 18) to establish a standard of behavior to impose statutory civil liability (under U.S.C. Title 12). For this reason, FIRREA's use of existing criminal statutes in no way compels us to classify it as a criminal law.

In a FIRREA case, the government can prevail by proving its case by a preponderance of the evidence. This standard of proof makes considering FIRREA as a criminal statute problematic. This is because one of the most significant features of a criminal prosecution is the requirement that the government prove its case against the defendant beyond a reasonable doubt. The place this traditional safeguard has in a criminal prosecution was recognized by the end of the eighteenth century and was confirmed more than four decades ago by the Supreme Court in *In re Winship*.[152] The conventional justification for this high standard of proof is that the severe penalties that might be imposed on a defendant who is convicted of a crime, namely incarceration and possibly the death penalty, civil disabilities such as denial of the right to vote, along with the stigma that attaches to a criminal conviction, mandate that extreme measures be taken to avoid an erroneous conviction.[153] In other words, the highest standard of proof provides a high level of confidence to society (on whose behalf the prosecution is undertaken) that the array of severe penalties is imposed on a defendant only when there is a very high level of confidence of that defendant's guilt. The absence of a requirement in FIRREA of proof beyond a reasonable doubt highlights the critical question in this analysis: does the significantly lower standard of proof (preponderance of evidence) signify that the statute does not fall into the conventional category of criminal law, or does it suggest that FIRREA is a defective criminal statute because it lacks an important procedural safeguard? It has already been

152. In In re Winship, 397 U.S. 358, 361 (1970), the Court stated that "[t]he requirement that guilt of a criminal charge be established by proof beyond a reasonable doubt dates at least from our early years as a Nation." The Court also noted that "[i]t is now accepted in common law jurisdictions as the measure of persuasion by which the prosecution must convince the trier of all the essential elements of guilt." *Id*. at 361 (quoting C. MCCORMICK, EVIDENCE § 321, at 681-2 (1954)).
The proof beyond a reasonable doubt standard is seen as "a prime instrument for reducing the risk of convictions resting on factual error. The standard provides concrete substance for the presumption of innocence . . . ." *Id*. at 363. Although the Court did not limit its holding to criminal cases in which the defendant was convicted and incarcerated, *id*. at 364, it is abundantly clear that the majority of the court was primarily concerned about a mistaken conviction resulting in imprisonment and the stigmatization that accompanies a criminal conviction. *Id*. at 363-64.

153. *Id*.

suggested that while FIRREA embodies some features of a criminal statute, it also embodies some features of civil law. Moreover, because it lacks the threat of incarceration and stigma associated with criminal law, it cannot comfortably be classified as a criminal law. The presence of the lowest standard of proof is an important additional reason. At the same time, this lower standard of proof does raise the important issue of procedural safeguards.[154]

This brief examination of FIRREA within the conventional categories of criminal law and civil law reveals that while its purpose fits within the "broad aim of the criminal law," namely, preventing harm to the public,[155] and it exhibits some of the hallmarks of a criminal law, it does not fit neatly into that category. At the same time, we also see that while it exhibits some of the hallmarks of a civil liability statute, it does not fit neatly into that category either. However, civil law and criminal law do not exhaust the major categories of modern American law. Over the last century administrative law has become an increasingly important area of law, in some ways surpassing the importance of the more traditional areas. It is to this category that we now turn in our analysis of FIRREA.

iii. *FIRREA as Administrative Law*

A conventional analysis of FIRREA should not be limited to the traditional categories of civil law and criminal law. American administrative law was established over a century ago and it occupies a dominant position in American law.[156] The history and the public policies underlying administrative law make it appropriate to include it in the analysis of FIRREA. In fact, FIRREA comports with many features of administrative law. Given the circumstances that led up to its enactment,

154. *See infra* notes 165-175 and accompanying text (comparing the burden of proof used in criminal law with the burden used in administrative law).

155. WAYNE R. LAFAVE, CRIMINAL LAW HORNBOOK SERIES 10 (2000).

156. For background on the history of American administrative law, *see generally* LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 120-29, 329-49, 559-63 (3d. Ed. 2005) [hereinafter Friedman, History] (providing background information on the history of American administrative law); LAWRENCE M. FRIEDMAN, AMERICAN LAW IN THE 20TH CENTURY 59-67 (2002) [hereinafter Friedman, American Law] (describing the emergence of state and local regulations in response to numerous public health and safety problems); RICHARD J. PIERCE, JR., SIDNEY A. SHAPIRO & PAUL R. VERKUIL, ADMINISTRATIVE LAW AND PROCESS 8-32 (6th Ed. 2014) (outlining the various justifications for administrative law and the changing interpretations of the role of government regulations); BERNARD SCHWARTZ, ADMINISTRATIVE LAW 28-35 (3d. Ed. 1991) (summarizing the major changes in administrative law in the United States during the twentieth century). Federal agencies adjudicate far more disputes each year than do federal courts. PIERCE, *supra* note 138, at 909.

this is not surprising. FIRREA is a potent tool provided to federal bank and financial services regulators to prevent harm to the public through the imposition of the sanctions permitted by the statute. Seen from this perspective, FIRREA is neither extraordinary nor at odds with the underlying policy objectives of administrative law. Administrative actions are brought by the government, as is the case with an action under FIRREA, which is brought by the DOJ, an executive agency. Administrative fines are imposed on those found to be in violation of relevant standards of behavior. The fine is not compensatory in nature and must be paid to the government, not to an individual who was injured as the result of the defendant's actions. This is largely descriptive of the sanctions imposed under FIRREA. Finally and perhaps most importantly, the standard of proof in FIRREA is preponderance of evidence, which is the default standard in administrative law.[157] A standard of proof that is less than beyond a reasonable doubt is one of the key features that distinguishes administrative law from criminal law.

Finding that FIRREA loosely fits within the model of administrative law raises the question of whether is promotes the policy goals of administrative law. The rise of the administrative state, starting mainly in the nineteenth century, was in response to the perception that conventional criminal law and civil law processes were inadequate to effectively deal with an array of social and economic problems that arose during that period.[158] Shifting the problem of worker injuries away from tort litigation in civil courts is just one example.[159] Conventional legal processes, both civil and criminal, were judged to be inadequate to effectively deal with these problems. In enacting FIRREA, Congress expressed the policy that existing civil law and criminal law processes were inadequate to deal with the significant wrongful behavior that had been occurring and was feared to continue to occur in the banking and financial services industries. There is no doubt that Congress has the authority to shift to administrative-like

157. *See infra* note 171 and accompanying text (explaining that the Supreme Court generally requires only a preponderance of the evidence as the standard of proof in administrative proceedings, absent a statutory mandate dictating otherwise). *See also* Judiciary Committee Report, *supra* note 68 (discussing the fact that Congress considered imposing a higher burden of proof of clear and convincing evidence).

158. This story is told in Pierce's administrative law treatise, among many other sources. *See, e.g.*, PIERCE, SHAPIRO & VERKUIL, *supra* note 156, at 6-20 (explaining the objectives of administrative law with reference to specific problems addressed by government regulations).

159. *See generally* FRIEDMAN, HISTORY, *supra* note 156, at 516-18 (summarizing the introduction of the workers' compensation system); FRIEDMAN, AMERICAN LAW, *supra* note 156, at 62, 353-55, 361-64, 539-40 (providing further background information on transition towards the workers' compensation system).

measures such as those contained in FIRREA to address these problems and doing so does not raise issues of fundamental fairness.

It is tempting to view FIRREA through the lens of administrative law. Several key features of FIRREA are routinely found in that area of law. However, administrative law ultimately does not provide a perfect framework within which to analyze FIRREA. The main reason for this conclusion is that the standards of behavior which are the subject of a FIRREA enforcement action are not embodied in agency regulations. They are embodied in federal criminal statutes. As a result, the enormous body of case law and scholarly commentary that deals with whether agency rules, which are the subject of enforcement actions, go beyond the scope of the agency's authority is irrelevant. The vulnerably of some agency rules to the claim that they are *ultra vires* is completely avoided in FIRREA because these standards of conduct are embodied in federal criminal statutes and as such cannot be challenged under the array of theories that agency rules can be challenged.

Thus far this section has been organized around an effort to ascertain whether FIRREA fits into one of the conventional categories into which law is routinely divided. This effort was based on the assumption that the statute has to fit within one of these categories, and if it does not, then the statute is flawed and its enforcement problematic. Recall that some commentators have argued that FIRREA is flawed because it is essentially a criminal statute stripped of the procedural safeguards associated with criminal law. It is submitted, however, that the assumption that FIRREA must fit within a conventional category is itself flawed. The apparent failure of FIRREA to fit within an existing legal category is not significant because there is no inherent need for it to fit within one of these categories. As lawyers and legal scholars, we are so used to thinking about law along these lines that we come to believe (at an early point in law school) that these categories are necessary, that they are inherent in the nature of law. The fact of the matter is that these categories are conventional. Writing about the distinction between public and private law that exists within the civil law tradition, John Henry Merryman and Rogelio Perez-Perdomo state that "[t]he conventional way of dividing the law becomes part of the law itself, affecting the way that law is formulated and applied."[160] The public law-private law distinction "seems to most civil lawyers to be fundamental, necessary, and, on the whole, evident."[161] These authors suggest that lawyers within the common law tradition "tend to think of the division of

160. JOHN MERRYMAN & ROGELIO PEREZ-PERDOMO, THE CIVIL LAW TRADITION: AN INTRODUCTION TO THE LEGAL SYSTEMS OF EUROPE AND LATIN AMERICA 91 (3d Ed. 2007).

161. *See* MERRYMAN & PEREZ-PERDOMO, *supra* note 160, at 92 ("They *know* that public law and private law are essentially different.").

law as conventional . . . ,"[162] but this gives common law lawyers far more credit than they deserve. Common law lawyers, like civil lawyers, have created their own sets of intellectual straitjackets. Common law lawyers tend to think of the civil law–criminal law distinction as "fundamental, necessary, and, on the whole, evident." This results in calling into question a statute like FIRREA because it does not easily fit into one of these categories.

The assumption on which the conventional analysis is based, *i.e.* that a law must fall within the established categories of civil law, criminal law, or administrative law is very similar to the assumption that resulted in a decades-long struggle over the origin and development of administrative law. The belief that established categories of traditional substantive law and the procedures that were linked to them could not effectively deal with the array of significant problems facing federal, state, and local governments and the corresponding effort to fashion a modern administrative regime to remedy these problems, were met by an onslaught of criticism that doing so would upend the natural order of the legal world. The critics argued that established legal categories were the only ways in which legal reality could be perceived and that any other arrangement would have dire consequences.[163]

The fundamental question regarding FIRREA is not whether the statute falls within the categories of civil law, criminal law, or administrative law. The fundamental question in the analysis of FIRREA is whether or not Congress can or should authorize an executive agency of the federal government (the DOJ) to bring an action to enforce standards of behavior contained in existing criminal statutes and specify that if it can be proved by a preponderance of evidence that the defendant violated those standards, then financial penalties, which may be substantial, can be assessed against that defendant. The purpose of FIRREA is not to make any changes in the targeted conduct; FIRREA targets exactly the same conduct that is targeted in the predicate statutes.[164] Instead, the enactment

162. *Id.* at 91.

163. PIERCE, SHAPIRO & VERKUIL, *supra* note 156, at 8-23.

164. Approaching this matter from a very different perspective, Richard Epstein presents an interesting analysis on the relationship between tort and criminal law. He argues that the decision to utilize the civil law tort system or the criminal system is not a critical one. The critical, threshold decision is whether specific conduct should be prohibited. In his view, far too much conduct is prohibited. But, for him, once we decide that specific conduct should be prohibited, the question of whether to do so through the civil tort system or through the criminal justice system is not an important one. His preference is for using the tort system, but he readily acknowledges that there are a number of inefficiencies in the tort system that call for using the criminal justice system in certain situations. Richard A. Epstein, *Symposium: The Tort/Crime Distinction: A Generation Later*, 76 B.U. L. REV. 1

of FIRREA reflects Congress's judgment that the original sanctioning mechanism—the criminal justice system—was inadequate and needed to be supplemented with an alternative sanctioning mechanism. It happens that this alternative sanctioning mechanism shares a number of characteristics with civil law and administrative law. This bypasses the issue of how to categorize the statute and instead raises the important issue of procedural safeguards.

2. Procedural Safeguards

Recall that some critics of FIRREA contend that it resembles a criminal statute more than a civil statute.[165] The concern expressed is that FIRREA is in essence a criminal statute, imposing criminal sanctions but without the procedural safeguards afforded by criminal law. The fundamental fairness of FIRREA is thus called into question. Instead of thinking about civil law, criminal law, and administrative law as distinct categories, a more useful way to approach a critical issue in FIRREA is to look at these together on a continuum. What we notice with respect to sanctions (and the related consequences of error) is that as the quality and the quantity of the sanctions become more severe, there is an increase in the number of safeguards that should be in place. This is true along the entire continuum. For example, when the consequence of an error is requiring someone to pay compensatory damages, the quality and quantity of safeguards are relatively minimal. But, when the consequence of an error is incarcerating someone in prison or, perhaps, imposing the death penalty, the quality and quantity of safeguards should be at their highest level. The same basic relationship is also true within a more narrow range along the continuum, such as what is conventionally labeled criminal law. For example, the constitutional right to a jury trial does not exist in every criminal case. It is not triggered unless the statute includes the possibility of incarceration for more than six months.[166] Similarly, the constitutional

(1996). With respect to FIRREA, Congress has already made the judgment that the specific conduct targeted in the predicate criminal statutes should be prohibited. And, as we have discussed in the previous section, there are important public policy reasons behind regulation of financial markets. For more information, *see supra* notes 117-30 and accompanying text (discussing the role of regulation in restoring investor confidence and stabilizing financial markets).

165. *See, e.g.*, Green, *supra* note 9 and accompanying text (stating that a civil proceeding under FIRREA is basically a criminal proceeding without constitutional provisions).

166. In *Duncan v. Louisiana*, 391 U.S. 145 (1968), the Court said that the right to a jury trial comes into play with serious crimes. The best way to tell if the legislature considers the crime to be serious is to look at the punishment that is attached to a conviction under the

right to counsel does not exist in every criminal case. In a misdemeanor case it comes into play only when the defendant is incarcerated (even for one day).[167] In a misdemeanor case in which the judge only fines the defendant and imposes no jail sentence, there is no right on the part of an indigent defendant to have a lawyer provided. The severity of sanctions explains all of these rules.

The severity of sanctions also explains the need in some cases for proof beyond a reasonable doubt. A conviction in a criminal case requires proof beyond a reasonable doubt.[168] The opinion in *In re Winship* emphasized the loss of liberty that imprisonment entails.[169] And, even though no incarceration is actually imposed on the defendant in some cases and the fine is not large, the stigma attached to a criminal conviction and the civil disabilities that may be imposed on the defendant call for the highest standard of proof.[170] By comparison, an administrative proceeding in which a fine is imposed by an administrative agency for violations of its regulations does not require such a high level of proof. In fact, preponderance of evidence is normally an adequate standard of proof.[171] A substantial administrative fine does not change this because the violation of administrative regulations does not carry the stigma of a criminal conviction and cannot result in incarceration as a punishment. Congress can require a higher standard of proof, but in the absence of such a decision by Congress, the courts do not insist on a higher level.[172]

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statute. Incarceration for over 6 months indicates that the crime is a serious one. Incarceration for not more than 6 months indicates that the crime is petty. So this is based on potential punishment, not actual punishment. The right to a jury trial comes into play with serious crimes only. *See also* Lewis v. United States, 518 U.S. 322 (1996) (holding that the defendant's offense was punished by a maximum of six months in jail and thus was a petty offense that did not warrant a jury trial).

167. *See* Scott v. Illinois, 440 U.S. 367 (1979) (holding that because the defendant was fined $50 and not ever actually incarcerated, he did not have a constitutional right to a lawyer).

168. *See* In re Winship, 397 U.S. 358 (1970) at 361(describing the requirement that guilt of a criminal charge be established by proof beyond a reasonable doubt).

169. *Id*. at 363-64.

170. *Id*.

171. Unless Congress requires a higher standard of proof in the relevant administrative statute, the Supreme Court does not require in administrative proceedings a standard higher than preponderance of evidence. *See* Woodby v. INS, 385 U.S. 276 (1966) (concluding that in a deportation proceeding, the burden of proof is clear, unequivocal, and convincing evidence); Steadman v. SEC, 450 U.S. 91 (1981) (adopting the traditional preponderance-of-the-evidence standard). For more information, see generally PIERCE, ADMIN. LAW VOL. II, *supra* note 138, at 971-73 (discussing the historical progression of the Court towards a preponderance of the evidence standard as the default standard in administrative proceedings).

172. *See supra* note 171 and accompanying text (describing how the Supreme Court has not required a higher standard of proof than preponderance of the evidence).

Is preponderance of evidence an adequate level of protection in a FIRREA case? The Supreme Court does not require proof beyond a reasonable doubt in cases where an administrative fine is imposed by an agency for violating its rules.[173] This is true regardless of how large the fine might be. Proof beyond a reasonable doubt is not required in a deportation hearing that might result in someone being removed from the United States.[174] In light of the horrendous consequences of a mistake in such a case, it is difficult to see why the highest level of proof should be required in a FIRREA case, which would entail, at most, a financial penalty.

The conclusion that proof beyond a reasonable doubt is not called for in a FIRREA case does not mean that procedural safeguards for a defendant are absent in a proceeding under that statute. On the contrary, the normal safeguards that are available in a civil case are available in a FIRREA proceeding. Moreover, the statute provides for the right to a jury trial. This is noteworthy because while the financial penalty that might be imposed on the defendant places FIRREA in position adjacent to administrative law on the continuum, the right to a jury trial provides the defendant with a level of safeguards that exceed those found in administrative proceedings.[175]

V. CONCLUSION

FIRREA is a new weapon in the government's arsenal to deter financial fraud. Its use in the cases stemming from the GFC and outlined above illustrate its power. In many ways that is good public policy. The fraudulent actions by bad actors leading up the GFC should not go unpunished. We want to deter future misconduct and to compensate innocent victims. Enforcing the anti-fraud provisions of financial regulation promotes investor and public confidence in financial markets and in doing so supports the smooth operation of those markets. The questions are whether the addition of FIRREA to the other, existing laws, both criminal and civil, is justified and whether its use is fair. As a hybrid statute it imposes civil liability for violating criminal statutes. It neglects the public policy goal of compensation, and instead focuses on punishment primarily for the purposes of deterrence.

Perhaps the key (but not unique) feature of the statute is that it

173. Steadman, *supra* note 171.

174. Vance v. Terrazas, 444 U.S. 252 (1980).

175. Jury trials and the rules of evidence that apply in judicial adjudications do not apply in agency adjudications. PIERCE, SHAPIRO & VERKUIL, *supra* note 156, at § 2.8; PIERCE, ADMIN. LAW VOL. II, *supra* note 138, at § 10.1 – 10.7.

imposes civil liability for the violation of standards of conduct that are contained in criminal statutes. Many commentators[176] argue that this arrangement— moving from criminal to civil law (or administrative law)— is fairly unproblematic. The more controversial step is to criminalize some type of behavior initially. This is based on a belief that criminal law should not be used lightly. Instead, it should only be used when the behavior brings the moral condemnation that is at the core of traditional criminal law.[177] Arguably, once we have decided that some action is a crime, attaching civil or administrative liability to it is not a big leap.[178]

Criminal sanctions can be severe and the consequences of an error in determining culpability require that significant protections be in place, both constitutional and statutory. Criminal liability is not imposed unless a strict burden of proof (i.e., beyond a reasonable doubt) has been met. Traditionally there is a mens rea hurdle that must be met; there is a presumption of innocence; typically there is a relatively short statute of limitations; and for non-petty offenses there is a right to a jury trial. Liability under FIRREA can be imposed without most of these protections. Under FIRREA, there is a lower burden of proof, no mens rea requirement, and a longer statute of limitations. In this article we have argued that this does not make FIRREA a flawed statute. The absence of incarceration among the sanctions that might be imposed on a defendant weighs heavily against classifying FIRREA as a criminal statute. More importantly, we have argued that the failure of FIRREA to fit neatly into criminal law or civil law is not problematic.

Although FIRREA does not fit perfectly into the administrative law model, the statute shares many characteristics of administrative law. Using that model allows us to consider how best to achieve the public policy goals of protecting investors and restoring confidence in capital markets. By shifting the focus away from the civil law—criminal law dichotomy, we turn instead to the broad public policy goals FIRREA intended to promote. FIRREA is part of an array of statutes designed to protect financial markets and investors. Without such protections, investors will lack confidence in

176. *See generally* LAFAVE, *supra* note 131, at 22, 25-26 (2003) (stating that criminal punishment is harsher than civil punishment); Epstein, *supra* note 164 (further discussing criminal punishment).

177. LaFave, *supra* note 131.

178. By contrast, going from civil to criminal liability is much more problematic. *Id.* at 26. Civil wrongs, either set out by statute or common law, do not necessarily carry with them the moral condemnation that is the hallmark of a criminal act. Imposing criminal penalties to the violation of standards of behavior that are contained in a civil statute or common law rule is something that should not be undertaken hastily. But this is not a concern with respect to FIRREA because it imposes civil liability for violating standards of conduct that are already contained in criminal statutes.

the market, which will lead to a decrease in capital. The GFC illustrates how severe the consequences of inadequate regulation of financial markets can be. Moreover, it is important that legal liability be imposed on the actors whose behavior contributed to the GFC. This is important for a variety of reasons,[179] one of which is public perception and investor confidence.

The use of administrative law to achieve these objectives is not novel. In fact, the Securities and Exchange Commission is an administrative agency charged with protecting financial markets. Its broad enforcement powers allow it to meet these objectives, including the ability to bring criminal, civil, or administrative actions.[180] Both civil law and criminal law have public policy objectives. It's important to keep in mind that these overlap. Both try "to shape people's conduct along lines what are beneficial to society." They accomplish this with somewhat different sanctions, although here there is an overlap as well.[181]

We see FIRREA as creating a quasi-administrative scheme to promote the important goals just mentioned. While there is no new administrative agency created to administer the policy set forth by the statute, Congress instead created a quasi-administrative remedy for a serious problem with the intent that it be administered by an existing executive agency (i.e. the DOJ). Surely it would have been within the powers of Congress to establish a new administrative agency to carry out provisions of FIRREA. Giving this responsibility to an existing agency in the executive branch should not raise any red flags.

If there is a need to place FIRREA within existing legal categories, it is best viewed as a quasi-administrative type of law. The enforcement

179. One reason to impose liability on actors whose behavior contributed to the GFC is, of course, to deter such action by others in the future. *See, e.g.*, Karl S. Okamoto, *After the Bailout: Regulating Systemic Moral Hazard*, 57 UCLA L. REV. 183, 232 (2009) ("A seemingly logical corollary of that effort is a call for stricter legal rules with greater legal sanctions to deter the next round of bad decisions."). Okamoto opines that imposing greater legal sanctions brings with it its own set of "unintended consequences." *Id.* He writes that "the prevailing response to this logic (beyond any issues of fairness and moral culpability) is the fear of unintended consequences. What becomes of the American economy when the cost of risk taking includes the potential for personal legal liability?" *Id.* We would assert that asking the corporate actor to consider the potential for legal liability when making decisions is the intended consequence and provides deterrence against bad behavior.

180. Investor's Advocate, *supra* note 124 ("The Division of Enforcement assists the Commission in executing its law enforcement function by recommending the commencement of investigations of securities law violations, by recommending that the Commission bring civil actions in federal court or as administrative proceedings before an administrative law judge, and by prosecuting these cases on behalf of the Commission.").

181. LaFave suggests that "[p]aying damages (especially "punitive damages") for torts or contract breaches is not much different from paying fines for criminal violations." LaFave, *supra* note 131.

actions are proved by a preponderance of the evidence, only the government brings the actions, and the financial penalties are paid to the government. Certainly, the situation in the financial services industry calls for such new measures to be put in place alongside existing measures. Congress found the existing legal processes, both civil and criminal, to be inadequate. This is a classic case calling for administrative-type solutions. One of the major issues in administrative law is control over agency actions. This statute adequately addresses any concern along these lines. It specifies exactly what behavior can lead to liability and is very specific as to how to calculate the fines.

At least one commentator[182] has argued for a narrow interpretation that would in effect limit the application of FIRREA to cases of fraudulent conduct on federally insured deposits or depositors. She argues that the effects must be "sufficiently direct, reasonably foreseeable, and not too attenuated."[183] We think this solicitude is unjustified. If there is a concern about imposing civil liability for what is in essence fraud, we might want to contrast the sanctions available under FIRREA with the severity of the criminal sanctions available under other, related statutes that deal with the same problem. In previous financial crises, people went to jail.[184] Some commentators argued against the imposition of corporate criminal liability for a host of reasons; perhaps the imposition of civil or quasi-administrative liability for the violation of criminal statutes is a more palatable alternative.

The DOJ can pursue a criminal case under a predicate offense if it thinks it can prove its case beyond a reasonable doubt. If it gets a conviction, that would entail the consequences of a criminal conviction, *e.g.*, the stigma and moral condemnation, along with criminal fines, etc. Using FIRREA instead means that the special negative consequences of a criminal conviction are absent. The sanctions can be severe, perhaps more so than under a criminal conviction, but this is not unheard of either.[185] Congress uses existing criminal laws as the standards of behavior in this non-criminal regulatory scheme. We see FIRREA as a formidable weapon in the arsenal to fight financial fraud, to protect investors, and to ensure confidence in the market and, as such, support its use.

182. King, *supra* note 21, at 781-87.
183. *Id.* at 786.
184. *See generally* Zaring, *supra* note 1 (noting that even huge civil penalties might be seen as less harsh of a punishment than jail time).
185. LaFave, *supra* note 131, at 12.