Two Potent Weapons in the Government's War on Residential Mortgage Fraud: The False Claims Act and the Financial Institutions Reform, Recovery, and Enforcement Act of 1989

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The False Claims Act (FCA) and the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) are the primary civil statutes being wielded by the government as it seeks to recover the billions of dollars in losses from residential mortgage fraud. So far, these statutes have been used in cases alleging reckless lending that caused large losses on loans insured by the Federal Housing Administration (FHA), the Veterans Administration (VA), and other federal agencies, as well as on loans sold by banks and other lenders to Fannie Mae and Freddie Mac.[1] It is important for whistleblowers and their attorneys to understand the differences between these two statutes and the opportunities and challenges each presents.

False Claims Act: 31 U.S.C. §§ 3729, *et seq.*

The False Claims Act was first enacted during the Civil War, and has been significantly amended most recently in 1986 and 2009. Under the FCA, a whistleblower (known as a "relator") files a complaint under seal in federal district court, and serves the complaint and a disclosure statement of material evidence on the United States (but not the defendant). The case remains under seal while the Department of Justice (DOJ) investigates the allegations and decides if it wishes to intervene in the case and take over the litigation, or if is going to decline the case. In general, DOJ intervenes in only 20-25% of cases. A relator who is first to file (and not otherwise barred from recovery) is entitled to a reward or share of any recovery; the range of the share is between 15%-25% of the recovery if the government intervenes and takes over the case, and 25%-30% if the government declines, but the whistleblower goes ahead and litigates the case. There is no cap on the amount of the share as there is under FIRREA discussed below.

The essence of an FCA case is that the defendant defrauded the government, but the facts must fit into certain categories of violations to make out an FCA case. The FCA was amended in 2009 by the Fraud Enforcement and Recovery Act of 2009 (FERA); many of the amendments make it easier to prove mortgage fraud, however, not all of these amendments are retroactive. This is a problem because much of the mortgage fraud happened prior to the May 20, 2009 effective date of FERA. The specific provisions of

[1] *See, e.g.*, http://bit.ly/ShUy7j, http://bit.ly/U8lxja, http://bit.ly/RCjj17 and http://1.usa.gov/10Ljx9Z.

the FCA, as amended by FERA, that are most likely to be relevant in a mortgage fraud case are where a person/bank/lender:

- "knowingly"[2] presents or causes to be presented any false or fraudulent "claim"[3] for payment or approval
- "knowingly" makes, uses, or causes to be used or made, a false record or statement "material"[4] to a false or fraudulent "claim"
- "knowingly" makes, uses or causes to be made or used a false record or statement "material" to an "obligation" [5] to pay or transmit money or property to the Government, or to knowingly conceal or knowingly and improperly avoid or decrease an "obligation" to pay or transmit money or property to the Government
- conspires to do any of the above

In mortgage fraud cases, one must consider whether one can show or allege with good faith that a false claim has been made to the government, e.g., to FHA or VA for mortgage insurance or in the sale of mortgages to Fannie or Freddie, or that a false statement material to such a claim has been made or used. This is driven by the facts underlying the particular transactions at issue, as well as by the nature of the entity affected. For example, there is a question whether Fannie Mae and Freddie Mac are encompassed within the FCA. See blog.

If successful in proving an FCA violation, the government is entitled to recover three times its losses, as well as a civil penalty of between $5,500-$11,000/false claim or

[2] The FCA, 31 U.S.C. § 3729(b)(1), provides that "(1) the terms 'knowing' and 'knowingly' – (A) mean that a person, with respect to information – (i) has actual knowledge of the information; (ii) acts in deliberate ignorance of the truth or falsity of the information; or (iii) acts in reckless disregard of the truth or falsity of the information; and (B) require no proof of specific intent to defraud."

[3] The Federal FCA, as amended by FERA, defines a "claim" to include any request or demand, whether under contract or otherwise, for money or property that is made to an officer, agent, or employee of the United States or to a contractor, grantee, or other recipient if the United States Government provides any portion of the money or property which is requested or demanded, or if the Government will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested. 31 U.S.C. § 3729(b)(2). The amendments to this section and to 31 U.S.C. § 3729(a)(1(A) are among the most important to mortgage fraud case.

[4]The FCA, as amended by FERA, 31 U.S.C. § 3729(b)(4), provides that "(4) the term 'material' means having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property."

[5] The Federal FCA, as amended by FERA, defines an "obligation" to pay as "an established duty, whether or not fixed, arising from an express or implied contractual, grantor-guarantee, or licensor-licensee relationship, from a fee-based or similar relationship, from statute or regulation, or from the retention of any overpayment."

violation. Proving the "losses" can be challenging in these kinds of cases. As noted above, the relator may be entitled to a share of any FCA recovery.

While the FCA civil complaint/lawsuit is initially filed under seal in a federal district court, and remains under seal while the government investigates, it presumably will be unsealed to the public at some point, either because the government has declined to intervene or because it has decided to intervene to litigate the case or to settle it. When this happens, the relator's identity most likely will become public.

<u>Financial Institutions Reform, Recovery, and Enforcement Act of 1989: 12 U.S.C. §§ 1833a</u>

FIRREA was enacted during the savings and loan crisis of the late 1980's, and was amended in 2009. It provides that a whistleblower may file a declaration with the United States Department of Justice (DOJ) describing one or more violations of FIRREA "affecting" a depository institution insured by the FDIC or any other agency or entity of the United States. The declaration is not filed in court and is kept confidential by DOJ for at least one year (and maybe longer). DOJ is charged with investigating, and if successful and eligible for an award, the whistleblower can receive 20%-30% of any recovery up to the first $1 million revered, 10%-20% of the next $4 million recovered, and 5%-10% of the next $5 million recovered. This would translate to a maximum award of between $850,000-$1.6 million on a $10 million recovery by the U.S. In contrast, in an FCA case, the share would be a minimum of 15% and a maximum of 30% on the $10 million recovery, *and* would not be limited to the first $10 million. However, in a FIRREA case, the Attorney General also has the discretion to award a whistleblower a portion of any criminal recovery under FIRREA, e.g., if a criminal conviction is obtained in addition to or instead of a civil penalty.

Using FIRREA eliminates some of the weaknesses or challenges of using the FCA, particularly for conduct that occurred prior to FERA or prior to September 2008 when Fannie Mae and Freddie Mac were placed into federal government receivership. FIRREA basically provides for civil penalties for any one of a number of criminal violations affecting banking, but the government only has to prove the violation by a preponderance of the evidence (the usual civil standard) and the government does not need to prove a loss or damage. Civil penalties are imposed for the violation regardless of loss.

Among the predicate criminal violations for which a FIRREA civil penalty can be assessed are: wire fraud; mail fraud; using a false statement or report or willfully overvaluing land, property or security to affect the FHA (and others); bank fraud (scheme or artifice to defraud a "financial institution"[6] or obtain money, assets, securities, etc. affecting a federally insured institution); corruption, bribery, gifts, or providing "anything

[6] In FERA, Congress amended the definition of "financial institution" in 18 U.S.C. §§ 20, 27, to include a mortgage lending business and private mortgage companies.

of value" (i.e. a kickback basically); using false, forged or counterfeit statements for the purpose of influencing the FDIC; presenting a false, fictitious or fraudulent claim to the U.S.; using false statements or concealing or covering up; and frauds or swindles, including with securities; or a conspiracy to violate any of the foregoing.

These predicates combined with a civil burden of proof provide tremendous range, flexibility, and leverage for the government. Unlike the FCA, however, if the government does not proceed with the FIRREA allegations filed with it by the whistleblower, the whistleblower cannot pursue it on his or her own. Only the United States has standing to bring a FIRREA action in court.

Conclusion

Whistleblowers and the United States DOJ have been using the FCA and FIRREA to garner significant recoveries in residential mortgage fraud cases, and more cases are pending or under investigation. While different in their terms, each statute is critical to the success of the United States in recovering the billions of dollars lost in mortgage fraud. It is important for whistleblowers and their counsel to understand the reach and limits of each law.