

8-1-2014

The Protection of Deposits and Depositors: A Limited Interpretation of 12 U.S.C. § 1833a

Alyssa King

Follow this and additional works at: <https://scholarship.law.edu/lawreview>



Part of the [Administrative Law Commons](#), and the [Banking and Finance Law Commons](#)

Recommended Citation

Alyssa King, *The Protection of Deposits and Depositors: A Limited Interpretation of 12 U.S.C. § 1833a*, 63 Cath. U. L. Rev. 759 (2014).

Available at: <https://scholarship.law.edu/lawreview/vol63/iss3/10>

This Comments is brought to you for free and open access by CUA Law Scholarship Repository. It has been accepted for inclusion in Catholic University Law Review by an authorized editor of CUA Law Scholarship Repository. For more information, please contact edinger@law.edu.

The Protection of Deposits and Depositors: A Limited Interpretation of 12 U.S.C. § 1833a

Cover Page Footnote

J.D. Candidate, May 2015, The Catholic University of America, Columbus School of Law; B.A., 2011, University of Virginia. The author would like to thank Professor Heidi Mandanis Schooner for her guidance, support, and invaluable insight. The author also wishes to thank her colleagues on the Catholic University Law Review for their exceptional work on this Comment. Finally, she thanks her family for their love and support throughout law school.

THE PROTECTION OF DEPOSITS AND DEPOSITORS: A LIMITED INTERPRETATION OF 12 U.S.C. § 1833A

Alyssa King⁺

The Financial Crisis of 2008, and resulting economic recession, imposed enormous costs on the American people—tens of millions of Americans lost their jobs; trillions of dollars in household wealth disappeared; retirement accounts and life savings vanished; and millions of families faced foreclosure.¹ As a result, the United States government promptly implemented a comprehensive response to the crisis utilizing drastic fiscal and monetary tools.²

⁺ J.D. Candidate, May 2015, The Catholic University of America, Columbus School of Law; B.A., 2011, University of Virginia. The author would like to thank Professor Heidi Mandanis Schooner for her guidance, support, and invaluable insight. The author also wishes to thank her colleagues on the *Catholic University Law Review* for their exceptional work on this Comment. Finally, she thanks her family for their love and support throughout law school.

1. THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES xv, available at <http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf> [hereinafter THE FINANCIAL CRISIS INQUIRY REPORT]; see also Bill Thomas, Keith Hennessey, & Douglas Holtz-Eakin, *What Caused the Financial Crisis*, WALL ST. J., Jan. 27, 2011, at A21 (summarizing the findings of the Financial Crisis Inquiry Commission and criticizing the potentially oversimplified explanation of the origins of the crisis).

2. See *The Recovery Act*, THE AMERICAN RECOVERY AND REINVESTMENT ACT, http://www.recovery.gov/arra/About/Pages/The_Act.aspx (last visited Feb. 7, 2014) (outlining the government's response to the Financial Crisis); see also *The Federal Reserve's Response to the Financial Crisis and Actions to Foster Maximum Employment and Price Stability*, FED. RES. (last updated Jan. 8, 2014), http://www.federalreserve.gov/monetarypolicy/bst_crisisresponse.htm (detailing the monetary tools that the Federal Reserve utilized); Ben S. Bernanke, Chairman, Fed. Reserve Bd. of Governors, *The Crisis and the Policy Response* (Jan. 13, 2009), <http://www.federalreserve.gov/newsevents/speech/bernanke20090113a.htm> [hereinafter Chairman Bernanke Speech] (discussing the crisis and the Federal Reserve's response).

In response to the financial crisis, Congress passed the American Recovery and Reinvestment Act of 2009, often referred to as the “stimulus package,” to encourage job creation and economic growth. See *The American Recovery and Reinvestment Act of 2009*, Pub. L. No. 111-5, 123 Stat. 115; *The Recovery Act*, *supra*. The Treasury Department, through the Troubled Asset Relief Program (TARP) that was “authorized by Congress through the Emergency Economic Stabilization Act of 2008,” purchased upwards of \$700 billion worth of distressed mortgage-backed securities to help stabilize the U.S. financial markets. *What Is TARP?*, U.S. DEP'T OF THE TREASURY, <http://www.treasury.gov/initiatives/financial-stability/about-tarp/Pages/what-is-tarp.aspx>; *Treasury Announces \$700 Billion Bailout Plan for Mortgage Debt*, ANDREWS FIN. CRISIS LITIG. REP., 2008 WL 4601773 (Sept. 25, 2008) (explaining that the bailout plan would help the economy recover “by removing distressed assets from the financial system” as a means to alleviate the credit shortage). See generally *Emergency Economic Stabilization Act of 2008*, Pub. L. No. 110-343, 122 Stat. 3765.

The Federal Reserve undertook measures to stabilize the economy, mend the credit market, and avert a panic by instituting a series of emergency lending programs and by purchasing

The response was an effort to “prevent[] the collapse of the financial system, [] restart[] economic growth, and [] restor[e] access to credit and capital.”³ The financial crisis not only affected the United States, but also created a world-wide recession.⁴ Governments across the world took drastic measures to stabilize the financial markets.⁵

In addition, the U.S. government turned to the justice system to hold those who were involved in fraudulent conduct associated with the crisis accountable for their actions.⁶ A recent example of such action is a lawsuit that the Department of Justice (DOJ) filed against Bank of America and several of its affiliates for their role in residential mortgage-backed securities (RMBS) fraud.⁷ In addition to alleging investor fraud, the complaint seeks civil penalties under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA),⁸ which is codified at 12 U.S.C. § 1833a.⁹ This action is representative of the government’s newest approach to combatting financial

mortgage-backed securities and government debt. Sewell Chan, *Bernanke, Pointing to 1930s, Credits Fed’s Actions for Avoiding a Worse Downturn*, N.Y. TIMES, Apr. 9, 2010, at B4.

Additionally, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act to reform the financial industry in hopes of avoiding future crises. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010). This act significantly changed the regulation of financial institutions. *Wall Street Reform: The Dodd-Frank Act*, WHITE HOUSE, <http://www.whitehouse.gov/economy/middle-class/dodd-frank-wall-street-reform> (last visited Jan. 28, 2014). The government placed the Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae), the Nation’s largest housing finance institutions, under conservatorship in order to stabilize the housing market and strengthen their weakened financial conditions. *Treasury Announces \$700 Billion Bailout Plan For Mortgage Debt*, supra; Mark Jickling, *Fannie Mae and Freddie Mac in Conservatorship*, CONG. RES. SERV. 2 (Sept. 15, 2008), <http://fpc.state.gov/documents/organization/110097.pdf>.

3. *Financial Crisis Response in Charts, Introduction*, U.S. DEPT. OF TREASURY 2 (April 13, 2012), http://www.treasury.gov/resource-center/data-chart-center/Documents/20120413_FinancialCrisisResponse.pdf.

4. Chairman Bernanke Speech, supra note 2.

5. See *EU Austerity Drive Country by Country*, BBC NEWS EUROPE (May 21, 2012), <http://www.bbc.co.uk/news/10162176>; see also *Financial Turmoil Timeline*, FED. RES. BANK OF N.Y., http://newyorkfed.org/research/global_economy/Crisis_Timeline.pdf (last visited Apr. 13, 2014) (showing the actions taken by the Federal Reserve system and other central banks).

6. See Exec. Order No. 13,519, 3 C.F.R. 271 (2009) (establishing the Financial Fraud Enforcement Task Force to deal with financial crimes that specifically relate to the financial crisis and recovery).

7. Complaint, United States v. Bank of Am. Corp., No. 13–CV–446 (W.D.N.C. Aug. 6, 2013), 2013 WL 4007594. The complaint alleges that Bank of America committed various acts of financial and investment fraud. *Id.*; see also Press Release, Dep’t of Justice, Dep’t of Justice Sues Bank of America for Defrauding Investors in Connection with Sale of Over \$850 Million of Residential Mortgage Backed Securities (Aug. 6, 2013), <http://www.stopfraud.gov/iso/opa/stopfraud/2013/13-ag-886.html> [hereinafter DOJ Press Release].

8. Pub. L. No. 101-73, 103 Stat. 183.

9. *Id.*

fraud.¹⁰ In other financial fraud cases, the government has sought civil penalties under FIRREA,¹¹ but now, the government intends to apply this provision to allegations of fraud associated with the creation, issuance, and sale of RMBSs.¹²

The FIRREA civil penalties provision is a tool that the government uses to exact civil monetary penalties from persons who allegedly commit certain enumerated crimes, including banking-related criminal offenses and frauds.¹³ Until recently, courts had yet to interpret the language of the civil penalties provision.¹⁴ In light of the government's recent reliance on this provision, it is important to understand FIRREA's scope and possible limitations through a proper interpretation of the statute.

This Comment will argue that while the courts have broadly interpreted FIRREA's civil penalties provision, there are numerous limiting considerations within the provision's text, structure, and legislative history that require a narrower interpretation focused on the effects of fraudulent conduct on federally insured deposits or depositors. In Part I, this Comment discusses the interplay between the origins and effects of the financial crisis, the structure and practices of the financial industry, particularly the use of RMBSs, and the effects of the crisis on the banking system. Part II traces the origins and development of FIRREA as an anti-fraud enforcement tool. Part III analyzes recent, post-financial crisis cases interpreting the FIRREA civil penalties provision. Part IV examines the text, structure, and legislative intent of the civil penalties provision to illustrate its necessary limitations. Part V suggests that the proper application of the statute to RMBS fraud cases is limited and must center on the effects of fraud on federally insured deposits and depositors. This Comment concludes that while the use of the FIRREA civil penalties provision may be an effective tool in combatting financial fraud, the government must be aware of the inherent limitations of the statute when utilizing the provision as part of its enforcement scheme. This Comment also serves as a guidepost for both the government and the banking industry regarding the proper scope and application of FIRREA's civil penalties provision.

10. See DOJ Press Release, *supra* note 7 (asserting that the Bank of America Complaint "marks the latest step forward in the Justice Department's ongoing efforts to hold accountable those who engage in fraudulent or irresponsible conduct").

11. See *United States v. Wells Fargo Bank, N.A.*, No. 12 Civ. 7527(JMF), 2013 WL 5312564, at *1 (S.D.N.Y. Sept. 24, 2013) (alleging misconduct in the origination and underwriting of government-insured home mortgage loans); *United States v. Countrywide Fin. Corp.*, No. 12 Civ. 1422(JSR), 2013 WL 4437232, at *1 (S.D.N.Y. Aug. 16, 2013) (alleged fraud in connection with the sale of mortgage loans to Fannie Mae and Freddie Mac); *United States v. Bank of N.Y. Mellon*, 941 F. Supp. 2d 438, 442 (S.D.N.Y. 2013) (alleging fraud associated with foreign exchange trade).

12. Complaint, *supra* note 7, at 1; DOJ Press Release, *supra* note 7.

13. 12 U.S.C. § 1833a (2012).

14. See *Bank of N.Y. Mellon*, 941 F. Supp. 2d at 443 (presenting an issue of first impression for the U.S. District Court for the Southern District of New York).

I. THE FINANCIAL CRISIS OF 2008

A. *Origins of the Crisis*

In 2008, the financial markets suffered the largest losses since the Great Depression.¹⁵ The collapse of the housing bubble¹⁶ sent a shock through the financial system, which had relied heavily on the issuance of residential mortgages to fuel the growth of asset-backed securities.¹⁷ Falling housing prices caused the seizure of credit, which in turn caused the assets, held by the large investment banks and backed by the failing mortgages, to disintegrate.¹⁸ The utilization of derivatives magnified the losses.¹⁹ The origins, scope, and effects of the financial crisis can be understood best by examining the financial industry's regulatory environment and structure.

1. *"The Sentries Were Not at Their Posts"*²⁰

Many associate the financial crisis with the greed and corruption of the financial industry,²¹ but the failures of financial regulatory agencies and

15. Arthur E. Wilmarth, Jr., *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 CONN. L. REV. 963, 966 (2009). Wilmarth outlined the effects of the financial crisis and noted that the financial crisis triggered a world-wide recession. *Id.* at 967. He explained that:

Global stock market values declined by \$35 trillion during 2008 and early 2009, and global economic output [fell] in 2009 for the first time since World War II. In the United States . . . markets for stocks and homes [] suffered their steepest downturns since the 1930s and dr[ove] the domestic economy into a steep and prolonged recession. The total market value of publically-traded U.S. stocks slumped by more than \$10 trillion from October 2007 through February 2009.

Id. at 967.

16. See generally Adam J. Levitin & Susan M. Wachter, *Explaining the Housing Bubble*, 100 GEO. L.J. 1177, 1185–87 (2012) (exploring potential causes of the housing bubble that sparked the financial crisis). The housing bubble formed during a period of easily available credit and rising housing prices. Robert T. Miller, *Morals in a Market Bubble*, 35 U. DAYTON L. REV. 113, 120 (2009). Housing prices increased by 188% over the course between 1997 and 2006. Levitin & Wachter, *supra*, at 1179.

17. THE FINANCIAL CRISIS INQUIRY REPORT, *supra* note 1, at xxiv (explaining that the panic caused by the housing bubble's collapse was ultimately responsible for the stock market's implosion and a world-wide recession).

18. See *id.* at xxiii–iv.

19. *Id.* at xxiv; see generally INTERNATIONAL MONETARY FUND, FINANCIAL DERIVATIVES: A SUPPLEMENT TO THE FIFTH EDITION OF THE BALANCE OF PAYMENTS MANUAL (2000) available at <http://www.imf.org/external/pubs/ft/fd/2000/index.htm> (explaining financial derivatives). The investment banks created these financial instruments and derived their values from the mortgage-backed securities. THE FINANCIAL CRISIS INQUIRY REPORT, *supra* note 1, at xxiii. So, when the underlying security lost value, the derivative also lost value, sending the stock market into a tailspin. *Id.* at xxiv.

20. THE FINANCIAL CRISIS INQUIRY REPORT, *supra* note 1, at xxiii.

21. See e.g., Rachele Younglai et al., *Financial Crises Caused by "Stupidity and Greed"*: Geithner, REUTERS, Apr. 25, 2012, <http://www.reuters.com/article/2012/04/26/us-usa-economy-geithner-idUSBRE83P01P20120426>.

government policies are also to blame.²² During the latter part of the twentieth century, government policies encouraged the consolidation of the financial services industry into large banking conglomerates.²³ Additionally, commercial banks were authorized to securitize loans and underwrite or invest in asset-backed securities, which permitted them to compete directly with investment banks.²⁴ Regulators widely believed that the market would self-correct and that financial institutions could effectively police themselves through market discipline and the banks' internal risk models.²⁵ However, this regulatory environment failed to control the banks' tendency to take unreasonable risks, while ignoring harmful relationships between banks and investors.²⁶ The financial institutions "made, bought, and sold mortgage securities they never examined, did not care to examine, or knew to be defective," which exposed them to severe risk.²⁷

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.²⁸ Organizations tasked with the regulation and oversight of mortgages and the housing industry, such as the Federal Reserve, failed to stop these practices.²⁹ This environment created a moral hazard problem in which the banks, encouraged by the government and regulators, took on risky bets.³⁰ When the entire system collapsed, the federal government faced the quandary of whether to allow the system to fail or to bail out the financial industry.³¹ The federal government chose to save the financial institutions, having determined that they were "too systematically important to fail."³²

22. See *infra* Part I.A.1–2.

23. Wilmarth, *supra* note 15, at 969.

24. *Id.* at 987.

25. *Id.* at 1001–02. See also Andrew Crockett, Gen. Manager of the Bank for Int'l Settlements and Chairman of the Fin. Stability Forum, Market Discipline and Fin. Stability (May 23–25, 2001), <http://www.bis.org/speeches/sp010523.htm> (defining market discipline as the "internal and external governance mechanisms in a free-market economy in the absence of direct government intervention," and explaining the strengths and limitations of market discipline).

26. Wilmarth, *supra* note 15, at 971, 1024–26.

27. THE FINANCIAL CRISIS INQUIRY REPORT, *supra* note 1, at xvii.

28. See MARTIN NEIL BAILY, ROBERT E. LITAN & MATTHEW S. JOHNSON, THE ORIGINS OF THE FINANCIAL CRISIS 20–21 (2008), available at http://www.brookings.edu/~media/research/files/papers/2008/11/origin%20crisis%20baily%20litan/11_origins_crisis_baily_litan.pdf.

29. THE FINANCIAL CRISIS INQUIRY REPORT, *supra* note 1, at xvii.

30. *Id.* at xxiv–xxv.

31. *Id.* at xvi.

32. *Id.*

2. Residential Mortgage-Backed Securities Fraud

The involvement of the investment banks in the RMBS scheme is considered to have been a catalyst for the financial crisis.³³ A RMBS is a security comprised of various debts associated with mortgage loans.³⁴ There is inherent risk associated with the purchase of such securities, and the government does not protect investors from loss.³⁵ This scheme began to unravel in 2007 when the prices of homes began to decline.³⁶ Until that point, the system had relied on increasing home values and a steady stream of mortgage payments.³⁷ When homeowners could no longer afford to make their growing mortgage payments or refinance, “the losses . . . rushed through the pipeline” and affected every part of the chain causing massive market losses.³⁸

There were many instances of fraud associated with the RMBS scheme. First, mortgage lenders made risky loans to people who likely could not afford to repay the mortgage.³⁹ Second, when packaging the mortgages into securities for sale to investors, the banks mischaracterized the risk associated with the loans.⁴⁰ Third, there were instances of fraud in the rating of the RMBSs.⁴¹ The rating

33. Wilmarth, *supra* note 15, at 1043.

34. *See id.* at 984–89 (discussing the origins and evolution of RMBSs). In creating a RMBS, a bank would originate consumer and corporate loans, package these loans into asset-backed securities and collateralized debt obligations, create over-the-counter derivatives whose values were derived from loans, and distribute the securities and other financial instruments to investors. *Id.* at 995. The securitization of the residential mortgages allowed banks to increase their business by lending to a larger number of consumers and commercial enterprises. *Id.* at 984. Banks relied less on traditional deposits and had the opportunity to fund loans through the capital market. *Id.* Through the securitization process, banks “converted illiquid loans into asset-backed securities [] that could be sold to investors,” which allowed banks to avoid the regulatory capital requirements.” *Id.* at 985.

35. *Insured or Not Insured?*, FED. DEPOSIT INS. CORP., <http://www.fdic.gov/consumers/consumer/information/fdicior.html> (last updated Oct. 17, 2013).

36. Wilmarth, *supra* note 15, at 970 (explaining that “[w]hen home prices . . . collapsed in 2007, nonprime homeowners could not refinance, defaults skyrocketed, and the subprime financial crisis began”).

37. THE FINANCIAL CRISIS INQUIRY REPORT, *supra* note 1, at xxiv (“[E]ach step in the mortgage securitization pipeline depended on the next step to keep demand going.”).

38. *Id.*

39. *See* David Reiss, *Subprime Standardization: How Rating Agencies Allow Predatory Lending to Flourish in the Secondary Mortgage Market*, 33 FLA. ST. U. L. REV. 985, 997–1001 (2006) (discussing predatory lending practices to subprime borrowers). These predatory lending practices took unfair advantage of borrowers, often using deception, fraud, or manipulation through abusive loan terms. *Id.* at 998–1001.

40. *See* THE FINANCIAL CRISIS INQUIRY REPORT, *supra* note 1, at xxii.

41. *See* United States v. McGraw-Hill Co., No. CV 13–0779 DOC (JCGx), 2013 WL 3762259, at *1 (C.D. Cal. July 16, 2013) (finding sufficient evidence of credit-rating fraud to proceed with the case and, therefore, rejected the defendant’s motion to dismiss); *see also* THE FINANCIAL CRISIS INQUIRY REPORT, *supra* note 1, at xxv (noting that credit rating companies’ misrepresentation and fraud played a crucial role in the financial disaster); David A. Mass, Comment, *Policing the Ratings Agencies: The Case for Stronger Criminal Disincentives in the Credit Rating Market*, 101 J. CRIM. L. & CRIMINOLOGY 1005, 1009–10 (2011) (arguing for

agencies gave these subprime mortgage comprised securities very high ratings to attract investors, but the underlying risk was not accounted for in the price of the security.⁴² 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.

B. Effects from the Financial Crisis on Federally Insured Deposits and Banks

The banking industry, businesses, communities, and consumers were devastated by the financial crisis.⁴³ By 2013, more than 400 financial institutions had failed; several more required capital injections and other forms of government aid “to remain solvent.”⁴⁴ When the housing market collapsed and the credit market froze, “hundreds of billions of dollars in losses in mortgages and mortgage-related securities” threatened the viability of financial institutions that had significant exposure to toxic mortgages, had invested substantial funds in the RMBSs or similar assets, and had borrowed heavily against these liabilities.⁴⁵ In response to bank failures, the Federal Depositary Insurance Company (FDIC), through the Deposit Insurance Fund (DIF), provided massive amounts of capital to insure the deposits at these failed banks.⁴⁶ Between 2007 and 2008, the DIF reserves were depleted by over 63 percent.⁴⁷ By the third quarter in 2009, the DIF “had a negative balance of \$8.2 billion.”⁴⁸ As part of the Dodd-Frank Act, the standard maximum deposit insurance amount increased from \$100,000 to \$250,000.⁴⁹ Regulators and

stronger criminal deterrence of credit rating fraud by requiring only a mens rea of recklessness in financial fraud cases).

42. Wilmarth, *supra* note 15, at 1028–30. Investors relied on the credit ratings to accurately access the risk associated with their investment. *Id.* at 1026.

43. FED. DEPOSIT INS. CORP. OFFICE OF INSPECTOR GEN., REPORT TO CONGRESS: COMPREHENSIVE STUDY ON THE IMPACT OF THE FAILURE OF INSURED DEPOSITORY INSTITUTIONS ii (2013) available at <http://www.fdicoinc.gov/reports13%5C13-002EV.pdf>.

44. *Id.*

45. *Id.* at 1–2.

46. *Deposit Insurance Fund*, FED. DEPOSIT INS. CORP., <http://www.fdic.gov/deposit/insurance/> (last updated Jan. 7, 2014) (“The primary purposes of the Deposit Insurance Fund (DIF) are: (1) to insure the deposits and protect the depositors of insured banks and (2) to resolve failed banks.”).

47. Damian Paletta, *Congress Raises FDIC Limits*, WALL ST. J., May 21, 2009, <http://online.wsj.com/news/articles/SB124276506015836059>. At the end of 2007, the deposit-insurance fund consisted of \$52.4 billion, and by the end of 2008, it consisted of only \$19 billion. *Id.*

48. Eric Dash, *As Bank Failures Rise, Insurance Fund Falls Into Red*, N.Y. TIMES, Nov. 25, 2009, at B4.

49. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 335(a), 124 Stat. 1376, 1540 (2010) (codified at 12 U.S.C. § 1821(a)(1)(E)). This increased limit “applies per depositor, per insured depository institution for each account ownership category.” Press Release, Fed. Reserve Ins. Corp., Basic FDIC Insurance Coverage Permanently Increased to \$250,000 Per Depositor (July 21, 2010), <http://www.fdic.gov/news/news/press/2010/pr10161.html>. The insured amount had been \$100,000. 12 U.S.C. § 1821(a)(1)(E) (2012). *See*

Congress intended the insurance increase to boost confidence in the banking system as a means to assist the recovery.⁵⁰

II. GOVERNMENT'S RESPONSE: FINANCIAL FRAUD ENFORCEMENT TASK FORCE AND THE USE OF THE FIRREA CIVIL PENALTIES PROVISION

A. History of FIRREA

In response to the Savings and Loan Crisis⁵¹, Congress enacted FIRREA to recover the costs the FDIC incurred to meet its obligations on the insured deposits depleted because of the crisis.⁵² FIRREA brought important reforms to the system of insuring federally insured deposits and the regulations and enforcement of the financial industry.⁵³ Congress passed FIRREA as a means “to control the ‘outright fraud and insider abuse’ that had pervaded the thrift industry and that it found to have been a significant contributor to the [Savings

also *Changes in FDIC Deposit Insurance Coverage*, FED. DEPOSIT INS. CORP., <http://www.fdic.gov/deposit/deposits/changes.html> (last updated Jan. 1, 2013).

50. See Paletta, *supra* note 47; see also, Sandra Block, *FDIC Deposit Insurance Limit Could Bump Up to \$250,000*, USA TODAY, Oct. 1, 2008, http://usatoday30.usatoday.com/money/industries/banking/2008-09-30-fdic-insurance_n.htm (explaining that Congress increased the insurance amount to boost confidence in the banking system at a time when banks were failing due to the financial crisis).

51. See 1 [An Examination of the Banking Crises of the 1980s and Early 1990s] FED. DEPOSIT INS. CORP., HISTORY OF THE EIGHTIES—LESSONS FOR THE FUTURE 167–88 (1997), available at http://www.fdic.gov/bank/historical/history/167_188.pdf (explaining the origins and outcome of the Savings and Loan Crisis and its effect on the banking industry) [hereinafter HISTORY OF THE EIGHTIES]. A savings and loan association, also known as a thrift, is a type of financial institution “that primarily makes home-mortgage loans,” but also provides “checking accounts and [] other bank services” to members. BLACK’S LAW DICTIONARY 668 (4th Pocket ed. 2011). After flourishing under post-World War II economic growth, in the 1970s and 1980s the Savings and Loan (S&L) industry faced competition from investments promising higher returns from the higher interest rates. Nicole Fradete et al., *Project: Regulatory Reform: A Survey of the Impact of Reregulation and Deregulation on Selected Industries and Sectors, How A Good Idea Went Wrong: Deregulation and the Savings and Loan Crisis*, 47 ADMIN. L. REV. 643, 647 (1995). In an effort to protect the S&L industry, the main source of funding for “home construction and purchasing, which many would argue is the bedrock of a healthy national economy,” the government chose to deregulate the industry. *Id.* This deregulation attracted investors and encouraged excessive risk-taking because of the potential for large profits. HISTORY OF THE EIGHTIES, *supra* at 179. Additionally, it created an incentive structure that led to “hundreds of [S&Ls] [making] a torrent of bad loans,” that resulted in “a government takeover and bailout that ultimately cost taxpayers over \$120 billion.” *Savings and Loan Associations*, N.Y. TIMES, http://topics.nytimes.com/top/reference/timestopics/subjects/s/savings_and_loan_associations/.

52. Melinda M. Ward, *FIRREA-Finally Resolved?*, 67 UMKC L. REV. 407, 411 (1998).

53. Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. 101-73, 103 Stat 183 (1989) (“An Act to reform, recapitalize, and consolidate the Federal deposit insurance system, to enhance the regulatory and enforcement powers of Federal financial institution regulatory agencies, and for other purposes.”). FIRREA was enacted to strengthen the financial system by increasing accountability, lowering risky behaviors, and promoting more responsible reform. *Id.*

and Loan Crisis].”⁵⁴ The legislative history of FIRREA also shows that Congress believed that the depositors and federal taxpayers put at risk by the thrifts’ fraudulent behavior were the victims, and that Congress sought to protect the depositors and taxpayers from future crises.⁵⁵ Congress intended FIRREA to give federal regulators a greater ability to regulate depository institutions and to increase civil and criminal penalties for those who seek to defraud or damage those institutions.⁵⁶

B. FIRREA Civil Penalties Provision as a Valuable Enforcement Tool

In response to the financial crisis, the DOJ and other government agencies have utilized various tools to prosecute fraud and bring civil actions against institutions and persons involved in fraudulent schemes.⁵⁷ Federal prosecutors find FIRREA, the Savings and Loan era statute, particularly useful because it provides leeway to impose heavy penalties on banks for alleged fraud.⁵⁸

One of the many components of FIRREA is the civil penalties provision, codified at 12 U.S.C. § 1833a.⁵⁹ In pertinent part, this provision permits the Attorney General to commence civil actions to recover penalties from those who violate, or conspire to violate “section 287, 1001, 1032, 1341 or 1343 of Title

54. *United States v. Bank of N.Y. Mellon*, 941 F. Supp. 2d 438, 454 (S.D.N.Y. 2013) (citing H.R. REP. NO. 101–54(I) at 294 (1989)).

55. *See* H.R. REP. NO. 101–54(I) at 301–01 (1989).

56. Charles L. O’Brien & Lisa M. Cavage, *FIRREA: Retroactive Application, Due Process Issues, Right-Duty Analysis and the Statute of Limitations*, 108 BANKING L.J. 308, 308–09 (1991) (examining the scope of regulatory power under FIRREA).

57. Jay Williams, Valarie Hays & Mir Ali, *FIRREA: An Old Acronym is Turning into the Government’s New Hammer on Banks and Financial Institutions*, 129 BANKING L.J. 579, 583 (2012) (noting that the government’s “[r]enewed interest in FIRREA seems to have been sparked in the wake of ‘Operation Stolen Dreams,’ a nationwide effort” of the Financial Fraud Enforcement Task Force’s RMBS working group). In 2009, President Obama established the Financial Fraud Enforcement Task Force to hold those involved in the financial crisis accountable and to prevent exploitation of the current financial situation. *See* Exec. Order No. 13,519, 3 C.F.R. 271 (2009); *About the Task Force*, FIN. FRAUD ENFORCEMENT TASK FORCE, <http://www.stopfraud.gov/about.html> (last visited Feb. 7, 2014). The Task Force is a coalition of federal departments, agencies, and offices with law enforcement, investigative, and regulatory functions, and is comprised of various working groups such as the Residential Mortgage-Backed Securities Working Group. *Id.*; *Report Residential Mortgage-Backed Securities Fraud*, FIN. FRAUD ENFORCEMENT TASK FORCE, <http://www.stopfraud.gov/rmbs.html> (last visited Feb. 7, 2014).

58. Williams, *supra* note 57, at 579–80.

59. 12 U.S.C. § 1833a (2012).

18 affecting a federally insured financial institution.”⁶⁰ Section 1813 provides the definitions for the chapter.⁶¹

The scope of FIRREA’s civil penalties provisions appears to be broad, because it allows the government to commence civil actions based on a wide variety of fraudulent activities, including those relating to mail, electronics, banking, improper gifts, use of funds, and “making misrepresentations to the government.”⁶² The government may pursue civil penalties against alleged violations of the enumerated criminal provisions when the conduct “affect[s] federally insured financial institutions or involve[s] false statements to the Federal Deposit Insurance Corporation [], the Department of Housing and Urban Development [], and other federal entities.”⁶³

The DOJ has found FIRREA to be a particularly valuable tool in its efforts to fight financial fraud for a number of reasons.⁶⁴ First, the government is held to the less burdensome civil standard of proof even though the statute incorporates a number of criminal statutes, such as mail and wire fraud.⁶⁵ The less demanding standard of proof, along with the grant of subpoena authority to DOJ civil attorneys and the ability to disclose grand jury material to civil prosecutors, allows government attorneys to prove financial fraud crimes more easily.⁶⁶ Additionally, FIRREA has a greater reach than other fraud statutes, such as the False Claims Act,⁶⁷ because FIRREA authorizes civil remedies even when fraud

60. *Id.* Sections (c)(1) and (3) do not include the modifying requirement that the enumerated crime “[affect] a federally insured financial institution.” *Id.* This Comment will discuss only section (c)(2). *See id.* Section (c)(2) enumerates the following predicate crimes: Making false, fictitious, or fraudulent claims in violation of 18 U.S.C. § 287; misrepresenting material facts to the U.S. government in violation of 18 U.S.C. § 1001; hiding assets or property from conservators, receivers, or liquidating agents in violation of 18 U.S.C. § 1032; devising schemes to defraud or swindle in violation of 18 U.S.C. § 1341; or, using wire, radio, or television to engages in fraud that affects a federally insured financial institution in violation of 18 U.S.C. § 1343. *See* 12 U.S.C. § 1833a(c)(2).

61. 12 U.S.C. § 1813 (2012).

62. Williams, *supra* note 57, at 580; *see also* 12 U.S.C. § 1833a(c)(2).

63. Williams, *supra* note 57, at 580; *see also* 12 U.S.C. § 1833a(c)(2).

64. *See* Andrew W. Schilling, *Understanding FIRREA’s Reach: When Does Fraud “Affect” a Financial Institution?*, 99 BANKING REP. (BNA) 186, July 24, 2012, at 1, *available at* <http://www.buckleysandler.com/uploads/36/doc/understanding-firreas-reach.pdf>.

65. *See* 12 U.S.C. § 1833a (holding the government to a “preponderance of the evidence” standard rather than the stricter criminal “beyond a reasonable doubt” standard); *see also* Schilling, *supra* note 64, at 2; Williams, *supra* note 57, at 580 (“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.”).

66. *See* Schilling, *supra* note 64, at 2; Williams, *supra* note 57, at 579–80. As these representatives of the banking industry highlight, the FIRREA civil penalties provision provides the government a particularly effective tool as the government can “obtain hefty fines against banks for alleged criminal acts while intentionally leveraging the benefits of civil law’s less rigorous burden of proof and more generous discovery rules.” Williams, *supra* note 57, at 579.

67. 31 U.S.C. §§ 3729–3733 (2012).

is not necessarily directed at the U.S. Government.⁶⁸ This broad application allows the DOJ to investigate and prosecute financial fraud, including fraud associated with the RMBS industry.⁶⁹ Additionally, this provision serves to strongly deter risky and potentially fraudulent conduct.⁷⁰ Although FIRREA's civil penalties provision covers many criminal statutes, including the broadly construed mail and wire fraud statutes⁷¹, under § 1833a(c)(2) there is a limitation: the fraud must “affect[] a federally insured financial institution.”⁷²

C. Similar Provisions Requiring Effects on Financial Institutions

There are other federal criminal statutes that also provide a limiting phrase to the application of wire or mail fraud similar to the one found in 12 U.S.C.

68. Schilling, *supra* note 64, at 2. Conversely, under the False Claims Act, a defendant can be held liable if he submits false or fraudulent claims for payment to the U.S. Government. 31 U.S.C. § 3729 (2012).

69. Schilling, *supra* note 64, at 2.

70. *Id.*; see also Williams, *supra* note 57, at 582 (explaining that these provisions give the government a “tactical advantage[] . . . to stage FIRREA attacks against virtually any financial institution . . . accused of fraud or related misconduct”).

71. The offense of mail fraud prohibits activities in which a person utilizes the U.S. Mail system in furtherance of a fraudulent scheme. 18 U.S.C. § 1341 (2012). The offense of wire fraud prohibits using electronic communications or communication facilities to commit fraudulent conduct. 18 U.S.C. § 1343 (2012). Accordingly, in order to convict someone of mail or wire fraud: [T]he government must show beyond a reasonable doubt that the defendant perpetrated: (i) a scheme to defraud that includes a material deception; (ii) with the intent to defraud; (iii) while using the mails, private commercial carriers, and/or wires in furtherance of that scheme; (iv) that did result or would have resulted in the loss of money or property or the deprivation of honest services.

William M. Sloan, *Mail and Wire Fraud*, 48 AM. CRIM. L. REV. 905, 908 (2011). Further, a wire fraud conviction “also requires proof that the communication at issue crossed state lines.” *Id.* The mail fraud statute was implemented “with the initial purpose of securing the integrity of United States Postal Service.” *Id.* at 906. The development of new technologies have led to the expansion of “the mail and wire fraud statutes . . . to cover a number of modes of communication such as facsimile, telex, modem, and Internet transmissions.” *Id.* at 907 (footnotes omitted).

These provisions have been widely interpreted and applied to a number of fraudulent activities and conduct. *Id.* at 905–08 (providing a detailed overview of the mail and wire fraud offenses and the extent to which prosecutors have utilized them). Prosecutors find the mail and wire fraud statutes to be “powerful tools” because they allow for the prosecution of “a wide range of conduct.” *Id.* at 905–06. These laws also serve as “‘stopgap’ device[s]” in that they allow prosecutors to pursue “new forms of fraud” until legislation is passed that criminalizes the conduct. *Id.* at 906. These statutes allow the federal prosecutors to pursue a “full range of consumer frauds, stock frauds, land frauds, bank frauds, insurance frauds, and commodity frauds, but [also] . . . such areas as blackmail, counterfeiting, election fraud, and bribery.” *Id.* at 907 (internal quotation marks omitted) (quoting Jed S. Rakoff, *The Federal Mail Fraud Statute (Part I)*, 18 DUQ. L. REV. 771, 772 (1980)). The mail and wire fraud laws are also used as predicate offenses to bring a claim under the Racketeer Influenced and Corrupt Organizations Act (“RICO”). *Id.* at 907; see also 18 U.S.C. §§ 1961–1968 (2012) (criminalizing RICO).

72. 12 U.S.C. § 1833a(c)(2) (2012).

§ 1833a(c)(2).⁷³ However, in none of these other statutes must the crime affect a *federally insured* financial institution.⁷⁴ In determining the appropriate scope of the phrase “affecting a federally insured financial institution,” parties and courts have relied on the language of these criminal statutes to form the basis of their analysis.⁷⁵ In Section 961 (I)(1) of FIRREA, the Act established an extended statute of limitations for financial institution offenses.⁷⁶ Courts have examined the applicability and scope of the phrase “if the offense affects a financial institution.”⁷⁷ The term “financial institution” is defined by 18 U.S.C. § 20, which is applicable to the sections included in Title 18 of the United States Code.⁷⁸

1. Broad Application to Fraudulent Conduct

a. Relationship Between a Parent and its Wholly-Owned Subsidiary

Courts have examined the extent of the alleged effects within the defendant’s corporate structure. In *United States v. Pelullo*,⁷⁹ the defendant was convicted of forty-nine counts of wire fraud and one count of racketeering.⁸⁰ Pellulo was the chief executive officer of a publicly held corporation, The Royale Group, Ltd.⁸¹ Six hotels, owned by the Royale Group, borrowed \$13.5 million from FCA Mortgage Corporation, which was “a wholly owned subsidiary of American Savings and Loan Association.”⁸² The loan permitted Royale to draw loan money to pay for costs associated with the renovation work on the hotels.⁸³ Pellulo misrepresented the amount of money that was needed for the renovations, in order to receive greater payments from American.⁸⁴ In regards

73. See, e.g., 18 U.S.C. § 225 (2012) (defining the crime of a “continuing financial crimes enterprise” to include series of mail or wire frauds “affecting a financial institution”); 18 U.S.C. § 982(a)(2)(A) (2012) (authorizing forfeiture for certain fraud offenses “affecting a financial institution”); 18 U.S.C. § 3293 (2012) (extending that statute of limitation for claims of mail or wire fraud is extended from five to ten years if the offense “affects a financial institution”).

74. See *supra* note 73.

75. See *infra* Part III.

76. Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. 101-73, § 961, 103 Stat 183, 499–500 (codified at 18 U.S.C. § 3293 (2012)) (increasing the criminal penalties for certain financial institution offenses).

77. See e.g., *United States v. Pelullo*, 964 F.3d 193, 215–16 (3d Cir. 1992) (examining how 18 U.S.C. § 3293 should be interpreted when deciding if a fraud “affects a financial institution”).

78. See 18 U.S.C. § 20 (2012).

79. 964 F.3d 193 (3d Cir. 1992).

80. *Id.* at 197.

81. *Id.*

82. *Id.*

83. *Id.* at 197–98.

84. *Id.* at 198. Under the terms of the loan for the hotels, \$10 million had been earmarked for the costs of buying the hotels and approximately \$6.2 million from the loan would be used for renovations. *Id.* at 197. American would keep the renovation funds and disburse them to the defendant upon submission of an itemized assessment of costs. *Id.* at 197–98.

to his wire fraud charges, the government “alleged that Pelullo defrauded American, Royale and Royale’s shareholders of approximately \$1.6 million by submitting false documentation in connection with certain draw requests on the project,” and “divert[ed] cash from one of [Royale’s] subsidiaries to repay a debt Pelullo owed to a loanshark connected with the Philadelphia mafia.”⁸⁵ Pelullo argued that the wire fraud charges should have been barred because “FCA Mortgage, a wholly-owned subsidiary of American, and not American, was the party to the . . . loan agreement and hence the ten-year limitations period [was] inapplicable.”⁸⁶ In determining whether the charges were barred, the court examined the applicability of 18 U.S.C. § 3293(2), which extends the statute of limitations by ten years when the “applicable offense affects a financial institution.”⁸⁷ Pelullo argued that the extended limitations period did not apply to subsidiaries based on the definitional distinctions between a “financial institution” and a “subsidiary,” which indicated “Congress’ intent to treat financial institutions and subsidiaries differently for purposes of the statute of limitations.”⁸⁸

The U.S. Court of Appeals for the Third Circuit held that “fraud perpetrated against a [parent] financial institution’s wholly owned subsidiary” can be said to “affect the parent.”⁸⁹ In *Pelullo*, the subsidiary was a mortgage lending company, which was wholly-owned by its parent company, a savings and loan association.⁹⁰ The Third Circuit rejected the argument that the fraud must be directly aimed at a financial institution.⁹¹ Further, the court distinguished *Pelullo* from a potential scenario in which the effect on the parent might be unreasonably remote, where “the fraud was directed against a customer of the

85. *Id.* at 198.

86. *Id.* at 214.

87. *Id.*

88. *Id.* As the defendant observed, the term “financial institution” includes the following definitions: “an insured depository institution,” 12 U.S.C. § 1813(c)(2) (2012), and “a depository institution holding company,” § 1813(w)(1). *Pelullo*, 964 F.3d at 214 (internal quotation marks omitted) (quoting 18 U.S.C. § 20(1) (2012)). The defendant highlighted that a subsidiary is defined as “any service corporation owned in whole or part by an insured depository institution or any subsidiary of such a service corporation.” *Id.* (internal quotation marks omitted) (quoting 12 U.S.C. § 1813(w)(4)(B) (2012)).

89. *Id.* at 215 (disregarding the defendant’s argument that fraud cannot affect a parent company when the fraud is perpetrated against its wholly owned subsidiary).

90. *Id.* at 197. A savings and loan (S&L) association is a “financial institution—often organized and chartered like a bank—that primarily makes home-mortgage loans but also [usually] maintains checking accounts and provides other banking services.” BLACK’S LAW DICTIONARY 1461 (9th ed. 2009). By the late 1980s, S&L associations had become a dominant players in the residential mortgage and secondary mortgage markets. Ward, *supra* note 52, at 410. This dominant position resulted from Congress’ policy of promoting homeownership. *Id.* However, the resulting S&L Crisis, caused by the change of monetary policy from the Federal Reserve and the highly-risky reaction of the S&L industry, resulted in the diminished importance of S&L associations in the current mortgage lending environment. *Id.*

91. *Pelullo*, 964 F.3d at 216.

depository institution which was then prejudiced in its dealings with the institution.”⁹² Ultimately, the court reasoned that “[u]nder the facts of this case, it would have been impossible for Pelullo to have intended to defraud [the subsidiary] without intending to defraud [the parent].”⁹³

This distinction between a parent and its wholly-owned subsidiary was also at issue in *United States v. Bouyea*.⁹⁴ The defendant had been convicted of “wire fraud for . . . fraudulently obtain[ing] \$150,000 . . . from the Center Capital Corporation . . . in a manner affecting Centerbank, a financial institution of which Center Capital is a wholly-owned subsidiary.”⁹⁵ On appeal, the defendant argued the government could not prove that defrauding the wholly-owned subsidiary “‘affected a financial institution’ within the meaning of 18 U.S.C. § 3293(2).”⁹⁶

Like the Third Circuit’s decision in *Pelullo*, the U.S. Court of Appeals for the Second Circuit held that even though the subsidiary was not itself a financial institution the defendant’s fraudulent conduct directed at the wholly-owned subsidiary “affected a financial institution.”⁹⁷ Important for the court’s “affects” analysis was the evidence that the subsidiary borrowed money from its parent corporation.⁹⁸ Consequently, the Second Circuit found that “the effect of the wire fraud on [the financial institution] was sufficiently direct so as to support . . . the jury’s [] that the wire fraud affected a financial institution.”⁹⁹

b. Effects Do Not Need to be Negative or Directed

Defendants have attempted to evade FIRREA’s extended statute of limitations by arguing that the effects on a financial institution had to be negative. For instance, in *United States v. Serpico*,¹⁰⁰ the defendant argued that in order for fraud to have affected a financial institution, the financial institution must have experienced negative effects and could not have been an active participant in the scheme.¹⁰¹ The defendant, Serpico, managed a member unions’ money, but

92. *Id.*

93. *Id.* at 217.

94. 152 F.3d 192, 194 (2d Cir. 1998) (per curiam).

95. *Id.*

96. *Id.*

97. *Id.* at 195. As explained in the Court’s decision, “[t]he defrauded institution, Center Capital, is a wholly-owned subsidiary of Centerbank, which is a financial institution,” but, “Center Capital is not itself a financial institution within the meaning of the statute.” *Id.*

98. *Id.* The subsidiary, Center Capital, had borrowed the money for the transaction from its parent, Centerbank. *Id.* Evidence showed that Centerbank was affected by Center Capital’s \$150,000 loss due to the defendant’s fraud. *Id.*

99. *Id.* (citations omitted). The *Bouyea* court discussed the *Pelullo* court’s hypothetical to explain what actions would be unreasonably remote. *Id.* (discussing the prejudiced customer hypothetical); see also *supra* text accompanying note 92.

100. 320 F.3d 691 (7th Cir. 2003).

101. *Id.* at 691–95.

misappropriated the funds through multiple loan and kickback schemes.¹⁰² Appealing his wire fraud conviction, the defendant argued that the U.S. Court of Appeals for the Seventh Circuit should reverse his conviction, because his fraudulent acts “did not ‘affect’ a financial institution.”¹⁰³ Further, the defendant contended that even if financial institutions were affected, the banks willfully participated and benefited from the scheme.¹⁰⁴

The Seventh Circuit rejected the defendant’s argument that effects on the financial institutions must be negative and direct.¹⁰⁵ Instead, the court held that a financial institution is affected even if the institution benefits from the fraud.¹⁰⁶ Also, the court found that active “participation in a scheme [that] is in a bank’s best interest does not necessarily mean that [the bank] is not exposed to additional risks and is not affected.”¹⁰⁷ The Court held that the increased risk of loss is sufficient to find that the fraud affected a financial institution.¹⁰⁸ Increased risk can be characterized as a bank making risky loans that it never would have made absent the fraudulent scheme.¹⁰⁹ The illegality of the kickback scheme itself increased the financial institution’s risk.¹¹⁰

In *United States v. Ohle*,¹¹¹ the U.S. District Court for the Southern District of New York applied the holdings of *Bouyea* and *Serpico* to determine whether a financial institution had been affected by the alleged fraud when it actively participated in the scheme, was not the object of the fraud, and was not directly affected by the fraud.¹¹² The government charged the defendant with tax evasion and fraud offenses and alleged that the defendant created tax shelters to cheat the federal government out of millions of dollars.¹¹³ The scheme was profitable for all participants as it generated fee income and bonuses.¹¹⁴ However, the scheme significantly increased the bank’s risk and resulted in actual losses in the form of settlements and attorney’s fees.¹¹⁵

102. *Id.* at 693. Under the “loan-for-deposits” scheme, the defendant had received inappropriately favorable terms and conditions on personal loans in exchange for depositing large amounts of the Union’s funds in several banks. *Id.* Under the hotel loan kickback scheme, defendant loaned union funds to a group that needed a mortgage in order to obtain financing to construct a hotel. *Id.* Because the developers obtained this mortgage, Mid-City Bank agreed to give the developers a loan for the hotel construction. *Id.*

103. *Id.* at 694.

104. *Id.* at 695.

105. *Id.* at 694.

106. *Id.*

107. *Id.* at 695 (internal quotation marks omitted).

108. *Id.* at 694.

109. *Id.* at 695.

110. *Id.*

111. 678 F. Supp. 2d 215 (S.D.N.Y. 2010).

112. *Id.* at 228–29.

113. *Id.* at 218.

114. *Id.* at 219.

115. *Id.* at 229.

The defendant did not contest that the bank was a financial institution; rather, he argued that § 3293(2) did not apply because the bank had been “an active participant in the fraud, not the object of the fraud, and not directly affected by the fraud.”¹¹⁶ The court, similar to *Serpico*, interpreted the statute broadly,¹¹⁷ and determined that even though a financial institution willingly participated in a fraudulent scheme, the institution’s participation did not mean that it was not negatively affected.¹¹⁸ Further, the court found that, although the financial institution need not be the object of the fraud, the “effect on the financial institution [must] be ‘sufficiently direct’” in order to apply the extended statute of limitations.¹¹⁹

c. Increased Risk of Loss Enough to Constitute an Effect

Courts also determined the kind and degree of the effects that would be sufficient to find a defendant liable under the statute. In *United States v. Mullen*,¹²⁰ the defendants defrauded the U.S. Department of Housing and Urban Development (HUD) by obtaining loans insured by the Federal Housing Administration (FHA) through the use of false information on loan applications.¹²¹ The defendants used two mortgage companies that were wholly-owned subsidiaries of federally insured banks in their scheme.¹²² This scheme heightened the “risk of loss” for both the lender and its parent financial institution, because it caused the lender to loan borrowers more money than they could actually pay back.¹²³

The U.S. Court of Appeals for the Tenth Circuit concluded that the “increased risk of loss [was] plainly a material, detrimental effect on a financial institution” and was sufficient to find that the fraud affected a financial institution.¹²⁴ The court recognized that there might be a point where the effects on a financial

116. *Id.* at 228.

117. *Id.* at 229 (adopting the Second Circuit’s holding in *Bouyea* that gives the statute a broad application).

118. *Id.* at 228.

119. *Id.* at 229 (citing *United States v. Bouyea*, 152 F.3d 192, 195 (2d Cir. 1998) (finding that Bank A was directly affected because it was exposed to substantial risk and experienced actual losses)).

120. 613 F.3d 1273 (10th Cir. 2010).

121. *Id.* at 1276. The defendants would create fake documents for prospective homebuyers to help buyers support their applications for mortgage loans. *Id.*

122. *Id.* at 1279.

123. *Id.*

124. *Id.* at 1278–79 (internal quotation marks omitted). The Seventh Circuit found this reasoning to serve the statute’s purpose of deterring fraudulent conduct, including fraud on financial institutions. *Id.* at 1279 (citing *United States v. Serpico*, 320 F.3d 691, 694–95 (7th Cir. 2003)). The court also pointed to other cases where it had found that the potential risk of loss to a financial institution was sufficient to prove a fraudulent scheme. *Id.* (citing *United States v. Swanson*, 360 F.3d 1155, 1161 (10th Cir. 2004); *United States v. Young*, 952 F.2d 1252, 1257 (10th Cir. 1991)).

institution become too attenuated and ancillary such that “it does not in any meaningful sense ‘affect’ the institution.”¹²⁵

In *United States v. Ghavami*,¹²⁶ the defendants were charged with wire fraud for schemes to defraud investors of municipal bonds and various government departments.¹²⁷ The complaint alleged that defendants, who worked for a financial services company, colluded with other bidders as well as “third-party broker[s] to manipulate and control the bidding process in exchange for kickback payments.”¹²⁸ The government argued that a financial institution is affected when it suffers a risk of financial loss or an actual financial loss in the form of settlements or non-prosecution agreements.¹²⁹ In contrast, the defendant argued that when the benefits a financial institution receives from the fraudulent schemes outweighs the negative effects, the statute does not apply.¹³⁰ The defendant also argued that settlements and non-prosecution agreements do not have any bearing on whether the financial institution was or was not affected by the charged conduct.¹³¹

The U.S. District Court for the Southern District of New York adopted the rulings of the Seventh and Tenth Circuits, holding that exposure to a risk of loss alone is sufficient to constitute an effect under § 3293(2).¹³² It ruled that the application of § 3293(2) was not barred just because a financial institution was not “the [direct] object or victim of the scheme to defraud.”¹³³ The court also rejected the defendant’s netbenefit argument as it would “perversely incentivize financial institutions to participate in frauds in which they expect[ed] to earn a net benefit.”¹³⁴ Further, the court found that actual losses could come in the form of settlement costs and attorney’s fees.¹³⁵

125. *Mullins*, 613 F.3d at 1278. Merely using the financial institution to transfer funds that did not create risk of loss to the institution is too attenuated. *Id.* (citing *United States v. Ubakanma*, 215 F.3d 421, 426 (4th Cir. 2000)).

126. No. 10 Cr. 1217(KMW), 2012 WL 2878126, at *1 (S.D.N.Y. July 13, 2012).

127. *Id.*

128. *Id.*

129. *Id.* at *4. The Government argued that the losses the financial institution experienced included money lost in settlements with various regulatory agencies, as well as attorney’s fees for negotiating non-prosecution agreements with DOJ’s Antitrust Division to avoid criminal penalties. *Id.*

130. *Id.*

131. *Id.*

132. *Id.* at *5–6 (citing *United States v. Bouyea*, 152 F.3d 192, 195 (2d Cir. 1998) (per curiam)). The court adopted the Second Circuit’s approach to the “affects” analysis. *Id.*

133. *Id.* at *5 (citing *United States v. Ohle*, 678 F. Supp. 2d 215, 228–29 (S.D.N.Y. 2010)); see also *United States v. Serpico*, 320 F.3d 691, 695 (7th Cir. 2003) (holding, like the *Ghavami* court, that § 3293(2) applies if the financial institution is exposed to higher risk, regardless of whether the institution benefitted from the fraud).

134. *Ghavami*, 2012 WL 2878126, at *6.

135. *Id.* (citing *United States v. Rubin/Chambers, Dunhill Ins. Servs.*, 831 F. Supp. 2d 779, 781–82 (S.D.N.Y. 2011)).

Therefore, courts have applied the FIRREA civil penalties provision broadly. Under these cases, financial institution can be affected either directly or via its parent or subsidiary. It can also be affected when the financial institution benefitted from or was harmed by a fraudulent scheme, and when it experienced even the mere the risk of loss.

2. *Mere Utilization of a Financial Institution is Insufficient*

Despite broad rulings with respect to increased risk constituting an “effect,” courts have so far been unwilling to extend the statute of limitations to situations in which the financial institutions were merely utilized in the fraudulent scheme. In *United States v. Agne*,¹³⁶ in an issue of first impression for the U.S. Court of Appeals for the First Circuit, the court held that the defendant’s use of fraudulent documents to draw on the buyer’s funds through a letter of credit did not “affect” a financial institution and, therefore, did not extend the statute of limitations for wire fraud charges.¹³⁷

After examining the transaction, the First Circuit found that the issuing bank did not suffer “actual financial loss and experienced no realistic prospect of loss.”¹³⁸ The Court found that “at minimum there need[ed] to be some impact on the financial institution to support a conviction,” and, in *Agne*, “the consequence to the bank, if any, [was] too remote to sustain the conviction” for wire fraud.¹³⁹ The Court rejected the government’s suggestion that the potential loss of clients and a damaged reputation would be sufficient to find that the fraud affected a financial institution.¹⁴⁰ The court relied on the *Pelullo* decision to determine the limit of the statute’s reach.¹⁴¹

In a U.S. Court of Appeals for the Fourth Circuit case, *United States v. Ubakanma*,¹⁴² the defendant was convicted of wire fraud relating to a scheme in which he used fake contracts to solicit victims to invest money in the Nigerian government.¹⁴³ The defendant utilized financial institutions to wire funds in and

136. 214 F.3d 47 (1st Cir. 2000).

137. *Id.* at 51–53. Under the letter of credit, the buyer, R.G. Engineering, said it would pay the bank for all withdrawals by the beneficiary, and R.G. Engineering offered its assets as security for drafts. *Id.* at 52. Under this financing structure, the issuing bank is protected from suit for wrongfully honoring a letter of credit. *Id.* For more explanation about letters of credit, see Christopher Leon, *Letters of Credit: A Primer*, 45 MD. L. REV. 432, 462 (1986) (providing an explanation of a letter of credit transactions).

138. *Agne*, 214 F.3d at 53. The funds in the defendant’s account remained adequate during the transaction, and the letter of credit transaction protected the issuing bank from risk. *Id.*

139. *Id.* at 52 (“Even assuming, without deciding, that being exposed to a risk of loss is sufficient to ‘affect’ a bank, within the ordinary meaning of that term, we cannot agree with the district court that this defendant created such a risk.”).

140. *Id.* at 52–53 (explaining that reading a criminal statute so broadly as to encompass the mere possibility of damage would be improper).

141. *Id.* at 52.

142. 215 F.3d 421 (4th Cir. 2000).

143. *Id.* at 423.

out of various accounts; however, the government did not present any evidence that the fraud intended to harm or actually harmed the financial institutions.¹⁴⁴ The Fourth Circuit held that the mere utilization of a financial institution, without actual or risk of harm, was insufficient to find that the defendant's fraud "affected" a financial institution.¹⁴⁵

These cases are illustrative for the interpretation of the civil penalties provision of FIRREA, because they developed the courts' jurisprudence regarding the ways in which a financial institution could be affected by fraud.

III. FIRREA IN POST-FINANCIAL CRISIS ENVIRONMENT

A. Effects on a Federally Insured Financial Institution

In resolving an issue of first impression, the court in *United States v. Bank of N.Y. Mellon*¹⁴⁶ held that "a federally insured financial institution may be held civilly liable [under FIRREA] for allegedly engaging in fraudulent conduct 'affecting' that same institution."¹⁴⁷ The government argued that the defendants defrauded the bank's customers by misrepresenting the bank's ability to execute foreign exchange trade pricing.¹⁴⁸ The government alleged that the bank experienced the following negative consequences as a result of the fraudulent scheme: actual losses in attorney's fees, the prospect of civil liability, loss of clients, reputational harm, and the bank was "forc[ed] [] to accept a less profitable business model."¹⁴⁹

The defendant argued two theories on the limitations of the "affecting" clause.¹⁵⁰ First, the defendant contended that the federally insured financial institution must be the victim of fraud directed at that institution.¹⁵¹ Second, the defendant argued that the "affecting" clause could cover indirect harm, but only if the harm is caused by a third party.¹⁵² In other words, a bank could not indirectly harm itself.¹⁵³

144. *Id.* at 426.

145. *Id.*

146. 941 F. Supp. 2d 438 (S.D.N.Y. 2013).

147. *Id.* at 443 ("In fact, this decision marks the first occasion upon which a court has been called to interpret the meaning of the phrase 'affecting a federally insured financial institution' under [section 951 of FIRREA].").

148. *Id.* at 442. For an explanation of foreign exchange trade, see Stephen C. Veltri, *Should Foreign Exchange Be "Foreign" to Article Two of the Uniform Commercial Code?*, 27 CORNELL INT'L L.J. 343, 343-44, 350-51 (1994) (arguing for a narrow interpretation of Article 2 of the Uniform Commercial Code to confine its scope to the sales of goods and not the foreign exchange market).

149. *Bank of N.Y. Mellon*, 941 F. Supp. 2d at 458.

150. *Id.* at 451.

151. *Id.*

152. *Id.*

153. *Id.*

The U.S. District Court rejected the defendant's arguments that a financial institution must be victimized or at least an innocent bystander in order to impose the civil penalty.¹⁵⁴ The court held that the financial institution's participation in the fraud does not preclude the possibility that it can be affected by the fraud.¹⁵⁵ Further, the court determined that the bank's possible profits do not neutralize any negative effects from the fraudulent conduct.¹⁵⁶

First, the court rejected the defendant's textual arguments based on the language of the provision.¹⁵⁷ The court found that if Congress had intended the statute to apply only when financial institutions were victimized, it would have expressly stated so in the language of the statute.¹⁵⁸ The court also rejected the defendant's argument that the negative effects might be outweighed by the institution's profits as such a rule "would perversely incentivize financial institutions to participate in frauds in which they expect to earn a net benefit, which is behavior that the statute seeks to discourage."¹⁵⁹

Further, the court dismissed the defendant's statutory structure argument, finding that, if anything, the structure buttresses a broader reading of the statutes provisions.¹⁶⁰ The court suggested that the statutory structure indicated that the provision was intended to have a broader application by pointing out that the applicable section of FIRREA was entitled "Civil Penalties for Violations Involving Financial Institutions."¹⁶¹ Finally, the court also emphasized Congress's intent to protect federally insured deposits from risk associated with fraudulent behavior.¹⁶² The Court determined that the text and structure of the provision clearly supported the government's argument that the provision has a broad application, and the evidence of legislative intent failed to dispel such a finding.¹⁶³ Nonetheless, the Court remained "mindful that the effects must be 'sufficiently direct'"¹⁶⁴ and that at some point, the defendant's fraudulent

154. *Id.* at 456–57.

155. *Id.* at 457.

156. *Id.* at 460.

157. *Id.* at 451.

158. *Id.* at 460.

159. *Id.* (internal citations omitted) (quoting *United States v. Ghavami*, No. 10 Cr. 1217(KMW), 2012 WL 2878126, at *6 (S.D.N.Y. July 13, 2012)).

160. *Id.* at 452–53.

161. *Id.* at 454 ("Indeed, that 'affecting' might mean something closer to 'involving' is supported by the heading of the subtitle. Section 1833a came from Section 951 of FIRREA, which was the only section of Subtitle E of Title IX of FIRREA. Subtitle E was entitled 'Civil Penalties for Violations *Involving* Financial Institutions.'").

162. *Id.* at 443 (noting that the purpose of the statute was to lower risk to federally insured deposits, which naturally would include risk created by the institution's own risk-increasing fraudulent activity). The court also cited the statute's legislative history, in which Congress advocated for more supervision of savings and loan associations to prevent risky conduct. *Id.* at 455–45 (citing H.R. Rep. 101-54(I), at 301).

163. *Id.* at 463.

164. *Id.* at 459–60 (quoting *United States v. Bouyea*, 152 F.3d 192, 195 (2d Cir. 1998)).

conduct would become “so attenuated, so remote, [and] so indirect” that it would not be considered to “affect the [financial] institution.”¹⁶⁵

In *United States v. Countrywide Financial Corp.*,¹⁶⁶ the government alleged that the defendants committed fraudulent origination loan practices in an effort to increase its revenue from the sale of loans to Fannie Mae and Freddie Mac.¹⁶⁷ When the financial crisis caused the value of the loans to drop drastically, Fannie Mae and Freddie Mac were no longer able to meet their financial obligations, and the government initiated the conservatorship process, which eliminated the investments of preferred shareholders, including many federally insured banks.¹⁶⁸

The government made two arguments regarding the effects on financial institutions.¹⁶⁹ First, the government argued that, under the self-affecting theory, the defendants’ fraudulent loan origination practices caused Countrywide’s parent, Bank of America N.A, a federally insured financial institution, to lose billions of dollars in legal settlements with Fannie Mae and Freddie Mac.¹⁷⁰ This greatly affected Bank of America and its shareholders.¹⁷¹ Second, under the derivative effects theory, the government argued that the defendants’ misconduct affected those federally insured banks whose investments in Fannie Mae and Freddie Mac were wiped out as a result of the loan defaults.¹⁷² The defendants dismissed both theories and argued that such a broad reading of the FIRREA statute would result in limitless liability, contrary to existing judicial precedent.¹⁷³

The U.S. District Court for the Southern District of New York held that the sale of loans to Fannie Mae and Freddie Mac affected a federally insured financial institution under the self-effect theory.¹⁷⁴ The court found the plain language of the statute to be dispositive in determining the scope of the term “affects” and dismissed the defendants’ structural and legislative history

165. *Id.* (internal quotation marks omitted) (quoting *United States v. Mullins*, 613 F.3d 1273, 1278 (10th Cir. 2010)).

166. No. 12 Civ. 1422(JSR), 2013 WL 4437232 (S.D.N.Y. Aug. 16, 2013).

167. *Id.* at *1.

168. *Countrywide Fin. Corp.*, 2013 WL 4437232, at *4. The federally insured community banks had invested in Fannie Mae and Freddie Mac stock because it was widely believed that they were safe investments. *Id.*

169. *Id.* at *5.

170. *Id.* at *5–6.

171. *Id.*

172. *Id.*; see also Stephen F.J. Ornstein, Matthew S. Yoon & John P. Holahan, *Fannie Mae and Freddie Mac Conservatorship and Liquidity Support*, 62 CONSUMER FIN. L. Q. REP. 52, 52–53 (2008) (explaining the conservatorship of Fannie Mae and Freddie Mac following the financial crisis); *2008-2013 Strategic Plan: Receivership Management*, FED. DEPOSIT INS. CORP., (last updated Nov. 21, 2008), <http://www.fdic.gov/about/strategic/strategic/receivership.html> (explaining the receivership management process for failed financial institutions under the FDIC).

173. *Countrywide Fin. Corp.*, 2013 WL 4437232, at *5–6.

174. *Id.* at *5.

arguments.¹⁷⁵ Importantly, the Court suggested that there might be a limit to the application of the civil penalties provision.¹⁷⁶

Acknowledging the defendants' arguments about the derivative effects, the court noted that the statute does not include "the modifying language 'directly or indirectly' that [Congress] typically employs to reach derivative effects."¹⁷⁷ In this case, however, the court determined that the derivative effects on the federally insured banks that held investments in Fannie Mae and Freddie Mac were "both substantial and foreseeable, the classic components of proximate cause."¹⁷⁸ However, the Court did not resolve whether the derivative effects would be sufficient to constitute a violation of the FIRREA civil penalties provision.¹⁷⁹

In *United States v. Wells Fargo Bank, N.A.*,¹⁸⁰ another case involving mortgage fraud, the government alleged fraud in the origination and underwriting practices of a residential mortgage lender for government-insured home mortgage loans, which affected HUD.¹⁸¹ The government further alleged that the defendant, a federally insured financial institution, experienced an increased risk of harm and suffered actual harm as a result of its own fraudulent conduct.¹⁸² The government contended that the defendant's fraud allowed it to make loans to borrowers while disregarding regulations put in place by HUD, which created "a higher risk of default."¹⁸³ This resulted in the defendant's indemnification of HUD for hundreds of loans.¹⁸⁴ Additionally, the government alleged that the bank was exposed to substantial legal liability and noteworthy legal expenditures.¹⁸⁵ The defendant argued against the self-affecting theory of the statute, stating that it contradicted the plain text, structure, and intent of the statute.¹⁸⁶

The U.S. District Court for the Southern District of New York held that the plain text of the statute supports a reading that a financial institution can affect itself.¹⁸⁷ Following its decisions in *Bank of N.Y. Mellon* and *Countrywide*, the

175. *Id.*

176. *Id.*

177. *Id.* at *5–6.

178. *Id.* at *6.

179. *Id.*

180. No. 12 Civ. 7527(JMF), 2013 WL 5312564 (S.D.N.Y. Sept. 24, 2013).

181. *Id.* at *1–2.

182. *Id.*

183. *Id.* at *29.

184. *Id.*

185. *Id.*

186. *Id.* at *28.

187. *Id.* The U.S. District Court for the Southern District of New York relied on its decision in *Countrywide*, where it held that "the plain language of section 1833a(c)(2) . . . is as unambiguous as it is dispositive," and thus a federally insured financial institution may violate FIRREA by conduct that affects itself. *United States v. Countrywide Fin. Corp.*, No. 12 Civ. 1422(JSR), 2013 WL 4437232, at *5–6 (S.D.N.Y. Aug. 16, 2013).

court determined that “an institution that participates in a fraud may also be affected by [the fraud] within the meaning of [the provision].”¹⁸⁸ The court found that, by exposing itself to considerable liability through a risk of default on the loans and the risk of litigation, the defendant’s fraud affected itself, a financial institution, in violation of the FIRREA provision.¹⁸⁹

IV. INTERPRETING THE FIRREA CIVIL PENALTIES PROVISION

A. Text of the Statute Supports a Limited Application

When interpreting a statute, one first looks to its text.¹⁹⁰ The courts have defined “affect” to mean “‘to act upon’ as in ‘to produce an effect ... upon,’ ‘to produce a material influence upon or alteration in,’ or possibly ‘to have a detrimental influence on.’”¹⁹¹ These literal dictionary definitions support a natural reading of the phrase “affecting a federally insured financial institution.”¹⁹² Therefore, the range of effects the courts have reached through this interpretation of “affecting” appears to be supported by the statute’s plain meaning.¹⁹³ The U.S. District Court for the Southern District of New York

188. *Wells Fargo Bank*, 2013 WL 5312564, at *28 (citing *United States v. Bank of N.Y. Mellon*, 941 F. Supp. 2d 438, 456–58 (S.D.N.Y. 2013)); see also *Countrywide Fin. Corp.*, 2013 WL 4437232, at *5–6.

189. *Id.* at *28–29.

190. See *Schindler Elevator Corp. v. United States ex rel. Kirk*, 131 S. Ct. 1885, 1891 (2011) (citing *Gross v. FBL Fin. Servs., Inc.*, 557 U.S. 169, 175 (2009); *Asgrow Seed Co. v. Winterboer*, 513 U.S. 179, 187 (1995)) (interpreting the statute in question by looking to its plain meaning and providing all undefined terms their ordinary construction); ANTONIN SCALIA & BRYAN A. GARNER, *READING LAW: THE INTERPRETATION OF LEGAL TEXTS* 53–58 (2012). Two of the fundamental principles of interpretation are (1) “[e]very application of a text to particular circumstances entails interpretation,” *id.* at 53, and (2) “[t]he words of a governing text are of paramount concern, and what they convey, in their context, is what the text means,” *id.* at 56.

191. *Bank of N.Y. Mellon*, 941 F. Supp. 2d at 451 (quoting WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY 35 (1993)).

192. 12 U.S.C. § 1833a(c)(2) (2012). Under the ordinary-meaning canon of statutory interpretation, “[w]ords are to be understood in their ordinary everyday meanings—unless the context indicates that they bear a technical sense.” SCALIA & GARNER, *supra* note 190, at 69.

193. See Schilling, *supra* note 64, at 1 (explaining the range of situations in which courts have held that fraud affected a financial institution). The courts in financial fraud cases in the post-financial crisis environment have adopted this plain meaning of “affects” in its decisions. See *supra* Part III. There are many “affects” theories throughout these cases. See *supra* Part III. Under a “Direct Effects” theory, a court would find that the FIRREA civil penalties provision covers a criminal action purposefully directed at a financial institution. 12 U.S.C. § 1833a(c). Although, this is the most basic reading of the statutory provision, parties have argued over whether the effects must be negative in order to justify the use of the provision. See *United States v. Bouyea*, 152 F.3d 192, 195 (2d Cir. 1998) (per curiam) (holding that the statute’s application is not limited to circumstances in which the financial institution is the object or victim of fraud scheme). For instance, defendants contend that for the effects on a financial institution to be negative, the financial institution must have been the object or target of the fraud. See *id.* at 195. This “Negative Direct Effects” or the “Victimization” theory suggests that the civil penalties provision only applies if the direct effects cause the financial institution to suffer some harm as a result of the fraud. See

found this to be a broad definition, and that Congress must have intended to apply this provision to a wide variety of fraudulent activity.¹⁹⁴ If Congress had wanted to limit the application of the provision to fraud that victimizes an institution, as argued by the defendant, Congress would have included limiting language.¹⁹⁵ Any limitation on the statute's applicability is "absent from the plain language of the statute."¹⁹⁶ However, the scope of the "affects" language is necessarily limited to those effects that are reasonably foreseeable.¹⁹⁷ Typically, Congress includes the language of "directly or indirectly" when it intends for a statute to apply to derivative effects.¹⁹⁸ This language is notably absent from the text of FIRREA's civil penalties provision and courts have not ruled decisively on whether these effects are sufficient to constitute liability under the statute.¹⁹⁹ The fraud itself must cause the effects on the federally insured financial institution.²⁰⁰ Contrary to the various court holdings that

id. Courts have consistently rejected this theory because the fraud could, and often does, benefit the financial institution. *See, e.g.,* *United States v. Serpico*, 320 F.3d 691, 694–95 (7th Cir. 2003) (explaining that the mere fact that participation in a scheme benefits the bank's does not necessarily mean that the bank is not exposed to additional risks and is not "affected"). To hold otherwise would encourage the financial institutions to pursue fraudulent activities as long as they made profit or other gains. *See United States v. Ghavami*, No. 10 Cr. 1217(KMW), 2012 WL 2878126, at *6 (S.D.N.Y. July 13, 2012). The courts have also held that under a "Self-Affecting" theory, a financial institution is not immune from the civil penalties provision if its actions affect itself; instead, courts find that the word "affects" can be reflexive, and if a financial institution allegedly commits an enumerated crime and it affects itself, the financial institution can be liable under the provision. *See Bank of N.Y. Mellon*, 941 F. Supp. 2d at 461–62; *Countrywide Fin. Corp.*, 2013 WL 4437232, *5.

194. *Bank of N.Y. Mellon*, 941 F. Supp. 2d at 451.

195. *Id.*

196. *See United States v. Dagerdas*, No. S3 09 Cr. 581(WHP), 2011 WL 6020113, at *1 (S.D.N.Y. Apr. 5, 2011).

197. *See Countrywide Fin. Corp.*, 2013 WL 4437232, at *6; *see also* *United States v. Ohle*, 678 F. Supp. 2d 215, 228–29 (S.D.N.Y. 2010). Under the "Derivative Effects" theory, the alleged fraud can cause indirect effects sufficient to establish liability under the statute if those effects were reasonably foreseeable. *Countrywide Fin. Corp.*, 2013 WL 4437332, at *6.

198. *See Countrywide Fin. Corp.*, 2013 WL 4437332, at *6 (internal quotation marks omitted).

199. *Id.* The text of § 1833a(c)(2) reads: "This section applies to a violation of, or a conspiracy to violate . . . section 287, 1001, 1032, 1341 or 1343 of title 18 affecting a federally insured financial institution . . ." 12 U.S.C. § 1833a(c)(2) (2012). The modifying language to indicate derivative effects, that is, the phrase "directly, or indirectly" is missing from the text. For an example of a U.S. Code provision that contemplates derivative effects using the "directly or indirectly" language, *see* 47 U.S.C. § 314 (2006) (prohibiting certain individuals from "directly, or indirectly" controlling, purchasing, or otherwise acquiring certain technology affecting interstate commerce).

200. *See SCALIA & GARNER, supra note 190* at 140 (2012) ("[T]he rules of grammar govern unless they contradict legislative intent or purpose."). The natural reading of the statutory provision requires that the enumerated crime caused the effects to the federally insured financial institution. *Id.* The subject, the enumerated crimes, must affect the object, the federally insured financial institutions. *See* 12 U.S.C. § 1833a(c)(2). As a transitive verb, "affect" must link the subject and the object. *See id.* Therefore, the enumerated crime itself, not the action taken by the prosecutorial authority, must cause the effects on the federally insured financial institution. *See id.*

settlements and attorneys' fees constitute effects, a natural reading of the statute indicates that the enumerated crimes themselves must cause the effects.²⁰¹

However, an important distinction the courts have failed to account for is the modifying phrase "federally insured."²⁰² This modifying phrase is not found in the comparable statutes.²⁰³ Under a surplusage argument, Congress must have intended a specific application when it added this phrase to civil penalties provision, in contrast to § 3293(2).²⁰⁴ The courts have failed to differentiate between the language of § 3293 and the civil penalties provision.²⁰⁵ Under the civil penalties provision, the fraud must affect a federally insured financial institution, which limits the statute's applicability to those institutions that have federally insured deposits.²⁰⁶ The FDIC insurance is provided to protect the deposits.²⁰⁷ Therefore, the fraud must affect the deposits or a depositor in some way.²⁰⁸

B. The Provision's Structure Shows an Intent to Protect Deposits and Depositors

When the statute's plain language is not dispositive, one looks to the structure of the provision to give context.²⁰⁹ The structure of the civil penalties provision, in relation to the rest of FIRREA, and in comparison to § 3293(2), supports Congress' intent to protect depositors through § 1833a.²¹⁰ Because the structure

201. *Contra* United States v. Ghavami, No. 10 Cr. 1217(KMW), 2012 WL 2878126, at *6 (S.D.N.Y. July 13, 2012); United States v. Ohle, 687 F. Supp. 2d 215, 229 (S.D.N.Y. 2010). The natural reading of the statute would not support these cases' holdings that the effects on the federally insured financial institution from the initiation of a lawsuit would be the kind of effects contemplated by the drafters of the civil penalties provision. *See* 12 U.S.C. § 1833a(c)(2). Instead, the commission of the enumerated crimes, such as mail and wire fraud, must cause the effects on the federally insured financial institution. *See supra* note 200.

202. *See* 12 U.S.C. § 1833a(c)(2) (2012).

203. *See supra* Part II.C.

204. *See* SCALIA & GARNER, *supra* note 190, at 174 (explaining that no word in a statute should be overlooked or ignored when interpreting the statute). Therefore, the inclusion of the "federally insured" modifier is of consequence and must be considered in the analysis of the statute's application. *See id.*

205. *See supra* Part III.A.

206. *See supra* note 34.

207. *See supra* note 34.

208. *See supra* note 34; *see also supra* notes 199–204 and accompanying text.

209. *See* United States v. Bank of N.Y. Mellon, 941 F. Supp. 2d 438, 452 (S.D.N.Y. 2013) (noting the defendant's argument that, if the court finds the statute's text unclear, the court should construe the "victimization" limitation by examining 12 U.S.C. § 1833a's structure); *see generally* R. Randall Kelso, *Statutory Interpretation Doctrine on the Modern Supreme Court and Four Doctrinal Approaches to Judicial Decision-Making*, 25 PEPP. L. REV. 37, 37–41 (1997) (examining the various approaches to statutory interpretation applied by the members of the Supreme Court).

210. *See* WILLIAM N. ESKRIDGE, JR., PHILIP P. FRICKEY & ELIZABETH GARRETT, *LEGISLATION AND STATUTORY INTERPRETATION* 263 (2000) (describing the "whole act rule" for statutory interpretation and stating that "[a] provision that may seem ambiguous in isolation is

and terms used in § 3293(2) are similar to § 1833a, it is logical to conclude that the “affects” analysis under the § 3293(2) cases is applicable to cases under § 1833a.²¹¹ As the court held in *Bank of N.Y. Mellon*, the term “affecting” might have a closer meaning to the word “involving” because the subtitle of the provision in FIRREA was entitled “Civil Penalties for Violations *Involving* Financial Institutions.”²¹² Therefore, the court concluded that because the text of the act referred to violations involving financial institutions, the civil penalties provision should have a similar reading.²¹³ Such a reading supports the courts’ holdings and the textual argument that the effects can be broad, and also limited by reasonable foreseeability and attenuated circumstances.

However, the phrase “federally insured” is unique to § 1833a.²¹⁴ Because this phrase is absent from § 3293(2), it must mean that the civil penalties provision requires something more than an effect on a financial institution.²¹⁵ Therefore, in order to be liable, the defendant must have committed an enumerated crime that affected federally insured deposits.²¹⁶ The “federally insured” requirement clearly focuses on the effects on deposits and depositors and the health and strength of the depository institution.²¹⁷ While some may argue that the modifier is intended to identify a subset of financial institutions to which this civil penalties provision will apply;²¹⁸ such an argument relies on the specific characteristic of these types of financial institutions, i.e., these institutions hold federally insured deposits. In addition, the statute is located within Chapter 16 of Title 12 of the United States Code, which is titled “Federal Deposit Insurance Corporation.”²¹⁹ The location of the statute further supports the structural argument that the provision is focused on the effects on deposits.²²⁰

often clarified by the remainder of the statutory scheme”) (quoting *United Savings Ass’n of Texas v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371 (1988) (internal quotation marks omitted)).

211. *United States v. Wells Fargo Bank, N.A.*, No. 12 Civ. 7527(JMF), 2013 WL 5312564, at *28 (S.D.N.Y. Sept. 24, 2013) (citing *Desert Palace, Inc. v. Costa*, 539 U.S. 90, 101 (2003)). The court used Supreme Court precedent to “explain[] that where the same term is used in two different provisions of the same statute, it is ‘logical to assume that the [same] term . . . would carry the same meaning with respect to both provisions.’” *Id.* (quoting *Costa*, 539 U.S. at 101). *See also* ESKRIDGE, *supra* note 210, at 283.

212. *Bank of N.Y. Mellon*, 941 F. Supp. 2d at 454 (internal quotation marks omitted); *see also* ESKRIDGE, *supra* note 210, at 272.

213. *Bank of N.Y. Mellon*, 941 F. Supp. 2d at 454.

214. 12 U.S.C. § 1833a (2012). This phrase is absent from the comparative statutes, such as 18 U.S.C. § 3293(2). 18 U.S.C. § 3293(2) (2012). *See also supra* Part II.C.

215. *See supra* note 204.

216. *See supra* Part IV.A.

217. *See supra* notes 34 and 45.

218. *See supra* note 204 and accompanying text.

219. *See* 12 U.S.C. § 1833a. Title 12 of the U.S. Code is “Banks and Banking” and Chapter 16, which includes the civil penalties provision, covers the FDIC. *See* 12 U.S.C. (2012).

220. *FDIC Mission, Vision, and Values*, FED. DEPOSIT INS. CORP., <http://www.fdic.gov/about/mission/> (last updated May 4, 2009) (noting that the FDIC is primarily concerned with protecting the deposits at insured financial institutions).

Additionally, because “financial institution,” as defined in 12 U.S.C. § 1813, is modified by “federally insured,” only certain statutory definitions will apply, that is, the statute applies only to institutions whose deposits are insured.²²¹ These definitions focus on the deposits and depository status of the institution.²²² Therefore, while the structure of the civil penalties provision supports a broad reading of the “affects” element, the statute’s structure shows that the provision requires that the fraud affect the federally insured deposits.²²³

C. Congress Intended to Protect Depositors and Their Deposits

The legislative intent bolsters the reading of the statute to focus on depositors.²²⁴ Like the text and structure of FIRREA, the legislative intent focuses on protecting deposits and depositors, not the financial institution itself.²²⁵ FIRREA sets forth the following general purposes of the statute:

(3) To curtail investments and other activities of savings associations that pose unacceptable risks to the Federal deposit insurance funds. . . . (5) To put the Federal deposit insurance funds on a sound financial footing. . . . (8) To provide funds from public and private sources to deal expeditiously with failed depository institutions. . . . (9) To strengthen the enforcement powers of Federal regulators of depository institutions. . . . (10) To strengthen the civil sanctions and criminal penalties for defrauding or otherwise damaging depository institutions and their depositors.²²⁶

The statute’s stated purpose and legislative concerns shows that Congress aimed to protect the federal deposits from fraudulent conduct by imposing civil penalties under § 1833a.²²⁷ The provision would protect depositors and federal taxpayers from future risks of crises resulting from fraudulent behavior.²²⁸ Therefore, a reading of the civil penalties provision requiring that the enumerated fraud affect federal deposits is consistent with legislative intent.²²⁹

221. See 12 U.S.C. § 1813(c)(1)–(4), (h) (2012) (providing definitions of depository institutions and related terms).

222. *Id.*

223. See *supra* notes 209–23.

224. See ESKRIDGE, *supra* note 210, at 213–14, 295 (defining legislative history as the “record of deliberations surrounding, and generally prior to, the law’s enforcement”).

225. See *infra* notes 244–47.

226. Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, § 101(3),(5),(8)–(10), 103 Stat. 183, 187.

227. See *supra* Part II.A–B.

228. See *supra* note 162 and accompanying text.

229. See *supra* note 162 and accompanying text.

V. A LIMITED READING OF THE FIRREA CIVIL PENALTIES PROVISION

Based on the plain text of the statute, its structure, and the legislative intent, the civil penalties provision must be read broadly.²³⁰ However, courts must determine whether the enumerated crimes actually affected federally insured deposits. These effects must be sufficiently direct,²³¹ reasonably foreseeable,²³² and not too attenuated.²³³ Therefore, in the application to RMBS fraud and other alleged fraud associated with the financial crisis, the scope of the civil penalties provision must be read with these limitations in mind. Courts should determine if the alleged fraudulent conduct affected a federally insured financial institution in such a way that threatened the security of deposits or the viability of the federal depository institution itself. However, courts need to be mindful of attenuation concerns.²³⁴ For instance, including such broad effects like subjection to litigation and attorneys' costs would not be sufficient to constitute an effect on the federally insured deposits.²³⁵ However, because the deposits are federally insured, fraudulent behavior may result in potential effects on the Deposit Insurance Fund, which could be sufficient to find a violation.²³⁶

The pre-crisis financial industry was heavily interdependent because of the structure of the RMBSs.²³⁷ When considering the effect of allegedly fraudulent conduct in mortgage lending, securitization, or sales of RMBSs, courts must determine whether it was reasonably foreseeable that any fraudulent behavior could or would have an effect on deposits.²³⁸ The regulatory environment and lack of government oversight created a moral hazard problem in which the risky lending and securitization practices were encouraged and overlooked.²³⁹ The structure created an interdependent network based on the mortgage loans, and the risks were shared at each level.²⁴⁰ The structure of the large holding companies, like Bank of America, N.A., with mortgage and securities

230. *See supra* Part IV.

231. *See supra* note 119 and accompanying text.

232. *See supra* note 197 and accompanying text.

233. *See supra* note 197 and accompanying text.

234. *See United States v. Agne*, 214 F.3d 47, 53 (1st Cir. 2000) (stating that increased risk alone could be sufficient to "affect" a federally insured financial institution, but the risk cannot be too attenuated from the fraudulent conduct); *United States v. Ubakanma*, 215 F.3d 421, 426 (4th Cir. 2000) (holding that a financial institution is not affected by wire fraud if the institution is not a victim of fraud).

235. *Contra United States v. Ohle*, 678 F. Supp. 2d 215, 229 (S.D.N.Y. 2010) (finding that a financial institution was affected when it was required to pay attorneys' fees and a settlement). If the provision is read as requiring an effect on the federally insured deposits, then attorneys fees' and settlement costs would not affect the federally insured deposits. *See supra* notes 200–01 and accompanying text.

236. *See supra* notes 45–48 and accompanying text.

237. *See supra* Part I.A.

238. *See supra* note 197 and accompanying text.

239. *See supra* Part I.A.1.

240. *See supra* notes 34–45 and accompanying text.

subsidiaries, plays an important role in the analysis of whether the fraudulent conduct affected the deposits held by other subsidiaries or the parent company.²⁴¹ In essence, the government, defense lawyers, and courts will need to examine the structure of the financial institution, the shared risk of the various components of the company, and the effects on the deposits or the federally insured depository institutions. Merely alleging highly attenuated, indirect effects on the institution caused by alleged fraud, such as harm to reputation, high settlement costs, or the payment of attorneys' fees, is inconsistent with the text, structure, and legislative intent of the civil penalties provision.²⁴²

VI. CONCLUSION

The DOJ's use of FIRREA's civil penalties provision in situations of alleged RMBS fraud is likely to prove effective in combating the fraud that permeated our financial system and led to the world-wide recession. However, courts have recognized there are certain limitations to FIRREA's applicability. Considering FIRREA's purpose and language, the application of the civil penalties provision must be limited to situations where the fraud affected federally insured deposits or depositors. This is an important legal issue because the government will need to assess the implications of the potential limitations on the provision's applicability when considering using the civil penalty provision as part of the government's fraud enforcement scheme. In addition, the banking industry is sure to face future claims and will need to know how to properly shape or defend its conduct. Therefore, a more careful reading of the statutory language of FIRREA, along with a closer inspection of the statute's legislative intent, both by the government and the banking industry, will guide both towards a more appropriate application of FIRREA's civil penalties provision.

241. See Complaint, *supra* note 7, at *18–26 (explaining the structure of Bank of America, N.A., the parent company, and its subsidiary companies).

242. See *supra* text accompanying notes 230–35.

