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New Tools for the Government's Fight Against Financial Fraud

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Financial crises tend to breed congressional responses—some worthwhile, some less so. An increasingly common response to such crises is to broaden the search for "fraud" and to fashion new, more potent tools for prosecutors and investigators to carry out that hunt. In keeping with this pattern, on May 18, 2009, the House passed the final version, which has been harmonized with the earlier Senate bill, of the Fraud Enforcement and Recovery Act of 2009 (FERA). President Obama is expected today to sign the bill, which authorizes increased funding for law enforcement by nearly $500 million over the next two years. The legislation would also expand the scope of certain criminal and civil fraud statutes by, among other things:

- Broadening the definition in Title 18 of "financial institution" to include mortgage lending businesses. This will increase the number of entities subject to liability for false statement claims, bank fraud and bank bribery;
- Expanding certain anti-fraud provisions relating to securities fraud and federal program fraud. FERA would amend 18 U.S.C. § 1031 to cover major frauds occurring in connection with the TARP program and the economic stimulus package. It also would amend 18 U.S.C. § 1348 to cover fraud schemes in connection with commodities futures and options, including derivatives involving mortgage-backed securities;
- Expanding the reach of anti-money laundering laws to cover all proceeds, not simply the profits, of crimes; and
- Clarifying the False Claims Act to correct interpretations of the law which had limited re-

coveries in certain cases involving government payments through subcontractors.

The legislation will also authorize the creation of a ten-member Financial Crisis Inquiry Commission charged with examining and reporting, in December 2010, upon "the causes, domestic and global, of the current financial and economic crisis in the United States," including the causes of the collapse of each financial institution that has failed or was rescued from possible failure during the credit and equity market meltdown. This Commission will have broad power to hold hearings, issue subpoenas and take testimony. The Commission also may refer to the Attorney General and any appropriate state attorney general any person that the Commission finds may have violated the law in connection with the crisis.

Other similar bills have been introduced in Congress. The Supplemental Anti-Fraud Enforcement for our Markets Act would authorize the hiring of additional FBI agents, Assistant U.S. Attorneys, and SEC staff members dedicated to prosecuting violations of law relating to U.S. financial markets. Similarly, the FBI Priorities Act of 2009 would authorize funds for the hiring of 1,000 additional field agents to investigate financial fraud.

President Obama's proposed budget for 2010 seeks $1.03 billion for the SEC, a 6.8% increase from last year. For DOJ, the proposed budget would allocate $26.7 billion, including $62.6 million for additional FBI agents, federal prosecutors and civil litigators who will focus on problems that contributed to, and that are caused by, the current financial crisis. These legislative developments make it highly likely that there will be a significant increase in enforcement activity. The current list of financial fraud investigations is likely to expand and pending investigations may be widened in scope.

Public outrage at apparent corporate misdeeds often spurs a burst of legislative activity aimed at increasing regulatory oversight and empowering enforcement agencies to pursue those viewed as responsible. This trend of ever-expanding criminal liability and constant ramping up of the enforcement machinery ultimately may not prove to be an entirely well-advised response to the current global economic and credit crisis. Criminal investigations are notoriously blunt instruments and they impose enormous collateral costs upon corporations seeking to respond in good faith to them. Alternative regulatory responses are available, and in the current financial crisis, they could well be a more prudent way to correct misconduct effectively but do so in a less burdensome manner. In any event, in the near term, it seems unavoidable that there will be more prosecutors pursuing more investigations.

In light of this political reality, there are certain key steps a company can take to position itself to avoid pitfalls in this rapidly evolving enforcement environment:

- Investing in preventing and detecting potential problems before they arise can pay huge dividends. Keys to this are: maintaining and regularly communicating a proper ethical tone at the top; having an effective compliance regime in place; designing and promoting mechanisms to encourage employees to identify issues and address them promptly; and ensuring that employees receive adequate training;
- As part of the effort to prevent problems from arising, firms should periodically create and/or review an inventory of regulatory requirements to ensure that the company thoroughly understands the legal and regulatory framework in which its businesses operate. A periodic report assessing the company's capacity to comply with that framework should be made to the Board; and
- If a problem does surface, there must be a well-coordinated, rapid, thoughtful response so that the problem does not expand in scope. Responses should include effectively stopping the misconduct, developing comprehensive remedial measures, and consideration of whether to self-report.

Advance planning and appropriate compliance measures can help prevent problems from occurring and keep the problems that do develop from becoming unmanageable.

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