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The Securities Industry and Financial Markets Association ("SIFMA")[1] urges the Department of Justice ("DOJ") to reconsider its novel and unprecedented use of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") to extract tens of billions of dollars from issuers and underwriters of residential mortgage-backed securities ("RMBS"). DOJ continues to misuse FIRREA in pursuing lawsuits and investigations more than 10 years after the events in question, and its actions threaten significant, far-reaching harm not only to RMBS markets, but to securities markets generally. The new DOJ leadership has already shown its willingness to reevaluate prior interpretations of FIRREA that were contrary to FIRREA's text and intent and harmful to the U.S. financial markets and economy. SIFMA respectfully requests that DOJ do so again with respect to the application of FIRREA to securities issuances.

INTRODUCTION

Following the 2007-2008 financial crisis, DOJ began sweeping investigations of virtually every financial institution that issued or underwrote RMBS. Investigations into the issuance and underwriting of RMBS and other securities ordinarily are conducted pursuant to *securities* laws, but because the applicable statutes of limitations under those laws had expired, DOJ's past leadership turned to FIRREA, a statute designed to protect financial institutions with federally insured deposits ("federally insured financial institutions" or "FIFIs") from fraud or other harm perpetrated by insiders. FIRREA had never before been applied to securities issuances, but its 10-

[1] SIFMA is an association of more than 500 securities firms, banks, and asset managers, including many of the largest financial institutions in the United States. Member Directory, SIFMA, https://www.sifma.org/about/member-directory/. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation, and economic growth, while building trust and confidence in the securities markets.

year statute of limitations allowed DOJ to avoid dismissal of its claims as time-barred. Faced with the prospect of DOJ lawsuits seeking massively inflated and company-threatening FIRREA penalties, several RMBS issuers and underwriters made the business judgment to pay penalties that, while enormous and not justified under FIRREA, could be paid without risking their existence. To date, DOJ has extracted more than $21 billion in FIRREA penalties in connection with these RMBS investigations, based on an unprecedented reading of FIRREA that is contrary to the statute's text and intent.[2]

DOJ continues to advance its flawed interpretation of FIRREA in RMBS-related lawsuits against Barclays and a former employee of Deutsche Bank, and in ongoing RMBS-related investigations of HSBC, Nomura, RBS, UBS, and Wells Fargo. DOJ's actions have imposed additional burdens on the securitization market, which the Treasury Department recently described as "a vital financial tool to facilitate growth."[3] The effects of DOJ's actions are not limited to the RMBS or even the securitization markets: DOJ's aggressive interpretation extends FIRREA to cover alleged fraud in any securities offering that directly or indirectly "affected" a FIFI or FIFI affiliate. Given that nearly all securities offerings involve FIFIs or FIFI affiliates in some fashion, issuers, underwriters, and other securities market participants could face massive penalties for the

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[2] DOJ obtained $21 billion in penalties through cash payments in settlements with J.P. Morgan ($2 billion), Citibank ($4 billion), Bank of America ($5 billion), Morgan Stanley ($2.6 billion), Goldman Sachs ($2.385 billion), Ally ($52 million), Deutsche Bank ($3.1 billion), Credit Suisse ($2.48 billion), and SocGen ($50 million). The total face value of the settlements with those nine financial institutions, including consumer relief and related settlements with states that were members of the Financial Fraud Enforcement Task Force (the "Task Force") and federal investors such as the Federal Deposit Insurance Corporation ("FDIC") and Federal Housing Finance Agency, is nearly $60 billion.

[3] Dep't of the Treasury, *A Financial System That Creates Economic Opportunities: Capital Markets* at 91 (Oct. 2017) (hereinafter "Treasury Capital Markets Report").

entirety of FIRREA's 10-year statute of limitations in connection with *any* offering in which they participate. Such an interpretation is inconsistent with the text and intent of FIRREA. Even if FIRREA did cover such a broad range of conduct (and it does not), DOJ should—at a minimum—acknowledge that FIRREA limits DOJ's potential recovery (i) to losses incurred *by FIFIs* and actually *caused by* the fraud, or (ii) to the wrongdoer's net profit from sales to FIFIs.

Unless and until DOJ reconsiders its interpretation and application of FIRREA, DOJ's misuse of this statute will continue to pose unacceptable risks to issuers, underwriters, and other participants in the securities markets and to disrupt the carefully-honed balance between the development of the capital markets and investor protection established by Congress in the federal securities laws, and will chill securities offerings going forward.

DOJ's misuse of FIRREA threatens to cause severe damage to the RMBS and securities markets. FIRREA was enacted following the savings-and-loan crisis of the late-1980s, and generally empowers DOJ to protect FIFIs from criminal fraud, embezzlement, and other harms. FIRREA enables DOJ to recover civil monetary penalties for violations of certain criminal statutes (the "predicate offenses") which, either by their terms or by express limitation under FIRREA, must "affect[]" a FIFI or, for some predicate offenses, victimize other specified financial institutions.[4] Congress was concerned in FIRREA with (i) *criminal* conduct—*not* negligence, and

[4] FIRREA, Pub. L. No. 101-73, 103 Stat. 183 (1989); 12 U.S.C. § 1833a(c)(2). Certain of FIRREA's predicate offenses, such as bank fraud, encompass criminal conduct targeting FIFIs as well as a slightly broader group of covered financial institutions (*e.g.*, Federal Home Loan Banks or Federal Reserve Banks).

(ii) the injury to FIFIs or other covered financial institutions resulting from that conduct—*not* injury to other market participants.[5]

Prior to 2009, DOJ interpreted FIRREA in line with its text and intent to impose penalties on individuals who had committed criminal fraud targeting FIFIs—typically insiders who had looted or defrauded their own failed financial institutions. Several years after the 2007-2008 financial crisis, however, DOJ sought to repurpose FIRREA as a general anti-fraud statute that allows DOJ "to impose civil penalties ***against*** financial institutions"[6] for virtually any alleged fraud. DOJ's interpretation ignores—indeed contradicts—Congress's intent that FIRREA ***protect*** FIFIs from rogue employees or third parties out to harm the institutions. Despite never having brought a single criminal case against a financial institution or executive in connection with RMBS issuance or underwriting,[7] DOJ has contended in its post-crisis FIRREA investigations that

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5 *See infra* Discussion I.A. Deputy Attorney General Rod J. Rosenstein also recently affirmed that "the government should not use criminal authority unfairly to extract civil payments" and indicated DOJ would be reevaluating its corporate enforcement policies, including "the mandate of the [Task Force]." Rod J. Rosenstein, Deputy Attorney General, Keynote Address at the NYU Program on Corporate Compliance & Enforcement, New York University Law School (Oct. 6, 2016), *available at* https://wp.nyu.edu/compliance_enforcement/2017/10/06/nyu-program-on-corporate-compliance-enforcement-keynote-address-october-6-2017/.

6 Press Release, DOJ, Deutsche Bank Agrees to Pay $7.2 Billion for Misleading Investors in its Sale of Residential Mortgage-Backed Securities (Jan. 17, 2017), *available at* https://www.justice.gov/opa/pr/deutsche-bank-agrees-pay-72-billion-misleading-investors-its-sale-residential-mortgage-backed (emphasis added).

7 The only RMBS-related criminal conviction of a bank employee involved an RMBS trader who had *defrauded his employer* by overstating the value of the RMBS he had purchased in order to increase his bonus. *See* Todd Haugh, *The Most Senior Wall Street Official: Evaluating the State of Financial Crisis Prosecutions*, 9 Va. L. & Bus. Rev. 153, 161–68 (2015). DOJ also accused two Bear Stearns hedge fund managers of defrauding investors in the firm's mortgage-related hedge funds, but those claims did not arise out of RMBS issuance or underwriting, and a jury in the Eastern District of New York acquitted the defendants. *See id.* at 168 ("Prosecutors alleged the pair misled investors as to the health of their fund, which was made up mostly of

virtually every issuer and underwriter of RMBS—including Ally, Bank of America, Barclays, Citibank, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, J.P. Morgan, Morgan Stanley, Nomura, RBS, SocGen, UBS, and Wells Fargo—independently and coincidentally engaged in a similar type of criminal mail and wire fraud scheme. According to DOJ, these financial institutions systematically defrauded RMBS investors—and, implausibly, themselves and each other[8]—by making material misrepresentations regarding the mortgage loans underlying the RMBS they issued or underwrote.

DOJ's misuse of FIRREA raises four main issues of concern to SIFMA. *First*, DOJ has taken the novel position that FIRREA authorizes penalties based on allegedly fraudulent sales to *all* investors in a securities offering—whether or not those investors were FIFIs—so long as a single FIFI (or even its affiliate) bought a single security in the offering or was otherwise connected to it (no matter how tangentially). DOJ has taken the position that if a single FIFI, or even a FIFI affiliate, purchased $25,000 of RMBS issued in connection with a billion-dollar RMBS offering, DOJ can impose a FIRREA penalty based on *all investors'* losses on *all* securities sold in the offering, or based on the issuer's or underwriter's gross gains in connection with the entire billion-dollar offering. Indeed, DOJ has gone even further, arguing that it can impose such a penalty even where no security was ever offered or sold to a FIFI (or its affiliate), so long as a FIFI (or its affiliate) played any role in the offering, no matter how minor. Congress never intended that

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subprime mortgage-backed securities."); *see also* Zachary Kouwe & Dan Slater, *2 Bear Stearns Fund Leaders Are Acquitted*, N.Y. Times, Nov. 11, 2009, at A1.

[8] In addition to issuing and underwriting RMBS, those firms invested in their own RMBS and purchased large amounts of RMBS from each other. These investments and purchases led to billions of dollars in losses for many of those firms, making them both the alleged perpetrators and victims of the same supposed fraud.

FIRREA would be used this way; DOJ's boundless interpretation of FIRREA threatens the securities industry as a whole, by subjecting issuers and underwriters to massive FIRREA penalties in connection with virtually every offering. Importantly, DOJ's position applies to any and all securities, not just RMBS, which were simply a target of opportunity for DOJ. This misuse of FIRREA is directly contrary to the Treasury Department's recently stated policy to encourage increased use of RMBS and other securities markets that have been burdened by excessive litigation risk and regulatory requirements.

Second, DOJ has interpreted the inclusion of mail and wire fraud as predicate criminal offenses under FIRREA as vesting in DOJ the authority to bring essentially the same civil securities fraud claims that the SEC is authorized to assert, but with much larger penalties and a much longer statute of limitations.[9] DOJ's interpretation of FIRREA upends the civil securities fraud enforcement regime, displacing the SEC's regulation of the capital markets and setting up FIRREA as a nuclear option for DOJ. Nothing in FIRREA's text or legislative history suggests that its purpose was to give DOJ the power to impose penalties on the basis of garden-variety securities claims against issuers and underwriters in registered securities offerings.

Third, DOJ has even argued that it can obtain a FIRREA penalty from a FIFI where the mail or wire fraud allegedly carried out by the FIFI, through the actions of its employees, adversely "affected" the FIFI itself by subjecting it to the risk of harm.[10] FIRREA was enacted to protect

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[9] Originally, securities law violations were subject to a 10-year statute of repose. Securities Act of 1933, Section 13, 48 Stat. 74, 84 (1933). Only one year later, Congress shortened the repose period to three years. Securities Exchange Act of 1934, Section 207, 48 Stat. 881, 908 (1934); *see also infra* notes 62–63 and accompanying text.

[10] *See, e.g.*, *United States ex rel. O'Donnell* v. *Countrywide Home Loans Inc.*, 33 F. Supp. 3d 494 (S.D.N.Y. 2014), *rev'd,* 822 F.3d 650 (2d Cir. 2016); *United States* v. *Wells Fargo Bank, N.A.*,

FIFIs from the sort of insider fraud and abuse that decimated the savings-and-loan industry in the 1980s, not to inflict massive penalties on FIFIs themselves. DOJ's "self-affecting" theory does the very opposite; it transforms FIRREA from a statute designed to protect FIFIs into a weapon to penalize them for fraud they allegedly committed.

Fourth, DOJ has misinterpreted FIRREA's penalty provisions and used them to extract massive penalties far beyond anything Congress intended. DOJ has claimed that FIRREA authorizes penalties based on either (i) *all* losses suffered by *all* purchasers in a securities offering, including losses unrelated to the underlying fraud, or (ii) the *gross revenues* from the allegedly fraudulent sales. But FIRREA limits the maximum penalties to (i) losses *to FIFIs* that were *caused by* the alleged fraud, or (ii) *net gains* to the wrongdoer attributable to the alleged fraud.[11] DOJ's interpretation would punish securities issuers and underwriters for losses caused by factors completely outside of their control, such as the unexpected and unprecedented decline in housing prices that was the primary contributor to RMBS investor losses, and would allow DOJ to seek penalties far in excess of actual profits realized from an alleged fraud.

DOJ's interpretation of FIRREA is not supported by the text or intent of the statute. DOJ recently reconsidered its former misuse of FIRREA in the context of another series of investigations targeting financial institutions,[12] and should now make clear its policy on the correct use of FIRREA with respect to securities issuers and underwriters. A failure to do so would present a serious threat to the continued efficient operation of the securities markets. The Treasury

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972 F. Supp. 2d 593, 629–30 (S.D.N.Y. 2013); *United States* v. *Bank of New York Mellon*, 941 F. Supp. 438, 457 (S.D.N.Y. 2013).

[11] *See* 12 U.S.C. § 1833a(b)(3).

[12] *See infra* Discussion I.D.

Department recently issued a report underscoring the importance to the securities markets of a "predictable and consistently applied rule of law," and concluded that "a well-designed regulatory structure, one that promotes fairness, predictability, and efficiency for investors and companies alike, is crucial to healthy capital markets."[13] DOJ can advance these important objectives by interpreting FIRREA in accordance with its text and intent.

BACKGROUND

A. The U.S. Government's Involvement in the Housing Market.

In the years leading up to the 2007-2008 financial crisis, U.S. government policies promoting homeownership encouraged the loosening of mortgage loan underwriting guidelines.[14] For example, the Housing and Community Development Act of 1992 directed the Department of Housing and Urban Development ("HUD") to set housing goals for government-sponsored enterprises ("GSEs"), including Fannie Mae and Freddie Mac, to boost lending to low-income borrowers.[15] The Act also instructed the GSEs to study how mortgage lenders (or "originators") could promote homeownership by, for example, reducing down payment requirements from the traditional 20% to 5% or less, and by "approv[ing] borrowers who have a credit history of

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[13] Treasury Capital Markets Report, *supra* note 3 at 21.

[14] *See* Staff of H. Comm. on Oversight and Gov't Reform, 111th Cong., The Role of Government Affordable Housing Policy in Creating the Global Financial Crisis of 2008 at 1 (Comm. Print 2009) ("The housing bubble that burst in 2007 and led to a financial crisis can be traced back to federal government intervention in the U.S. housing market intended to help provide homeownership opportunities for more Americans."); Andrea J. Boyack, *Laudable Goals and Unintended Consequences: The Role and Control of Fannie Mae and Freddie Mac*, 60 Am. U. L. Rev. 1489, 1514–15 (2011); Jeffrey T. Dinwoodie, *Ignorance Is Not Bliss: Financial Illiteracy, the Mortgage Market Collapse, and the Global Economic Crisis*, 18 U. Miami Bus. L. Rev. 181, 190 (2010).

[15] Pub. L. No. 102-550, 106 Stat. 3672, 3956 (1992).

delinquencies."[16] In 1995, HUD published "The National Homeownership Strategy: Partners in the American Dream," which stated that increased levels of homeownership would be achieved primarily through the "use of flexible underwriting criteria" and by encouraging originators "to use compensating factors in underwriting loans."[17] By 2004, HUD understood that the GSEs—by far the largest players in the mortgage market—"w[ould] have to stretch to reach certain Housing Goals," and were being forced to "reach deeper into the subprime market" (*i.e.*, to buy RMBS backed by mortgages to borrowers who historically were considered not to be creditworthy).[18]

The U.S. government's policies encouraging the loosening of underwriting guidelines and incentivizing the GSEs to purchase enormous amounts of RMBS supported by mortgages underwritten to those looser guidelines—including so-called "subprime" loans—were a significant cause of increased demand for such mortgages.[19] This increased demand in turn caused originators

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16 *Id.* at 3970.

17 Dep't of Housing and Urban Development, *The National Homeownership Strategy* 1-1 (1995).

18 Dep't of Housing and Urban Development, HUD's Housing Goals, 69 Fed. Reg. 63,580, 63,601 (Nov. 2, 2004).

19 The GSEs received credit toward meeting HUD's housing goals by purchasing RMBS backed by subprime loans, thus incentivizing the GSEs to purchase increasing amounts of subprime RMBS. 24 C.F.R. § 81.16(c)(2). *See* Christopher E. Herbert, Report to Congress on the Root Causes of the Foreclosure Crisis, HUD Office of Policy Development and Research 43 (Jan. 2010) ("Since subprime loans include a high share of low-income borrowers, purchasing the highest rated tranches of subprime MBS offered an easy way for the GSEs to obtain [housing] goal credits while seeming to minimize their risks."); Christopher L. Peterson, *Fannie Mae, Freddie Mac, and the Home Mortgage Foreclosure Crisis*, 10 Loy. J. Pub. Int. L 149, 162 (2009) ("Prior to 1997, the two companies purchased relatively few mortgage backed securities from third parties. However, since then, both Fannie Mae and Freddie Mac drastically increased their purchases of private label mortgage back securities."); *The Present Condition and Future Status of Fannie Mae and Freddie Mac: Hearing Before the Subcomm. on Capital Markets, Insurance and Government Sponsored Enterprises of the H. Financial Servs. Comm.*, 111th Cong. 146, 147 (2009) (statement of James B. Lockhart III, Director, Federal Housing Finance Agency) ("To maintain profitability of the retained portfolios and to meet HUD-designated affordable housing goals, each Enterprise

to offer mortgages to more borrowers who would not have qualified for mortgages under traditional underwriting standards, which in turn drove increased demand for homes.[20] When combined with low interest rates, these regulatory policies were a driving factor in causing home prices to nearly double between 2000 and 2006.[21] The increase in home prices led to lower default rates, because borrowers could easily refinance or sell their homes, and lower default rates further increased demand for RMBS, reinforcing the cycle and ultimately creating the housing bubble.[22]

B. RMBS Issuance and Underwriting.

RMBS make payments to investors based on payments by borrowers of residential mortgages held in a trust. RMBS investors purchase certificates that entitle them to receive monthly payments of principal and interest out of a pool of cash flows generated from the underlying payment of principal and interest on the mortgage loans. RMBS certificates are protected to varying degrees from losses on the underlying mortgage loans by "credit enhancements" such as subordination, overcollateralization, excess spread, and insurance.[23]

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increased purchases of [Private-Label Securities] backed by alternative mortgages and of high-risk whole loans."); Thomas Combs, *A Proposal for Regulation of the Government-Sponsored Enterprises*, 84 St. John's L. Rev. 759, 773 (2010) ("The GSEs became the largest purchasers of private-label subprime securities . . . , investing more than $400 billion in subprime-backed securities.").

[20] *See* Peter J. Wallison, Hidden in Plain Sight 240–41 (2016).

[21] S&P CoreLogic Case-Shiller U.S. National Home Price Index.

[22] *See* John B. Taylor, Getting Off Track 12 (2009). *Cf.* Dinwoodie, *supra* note 14 at 191.

[23] RMBS offerings with these credit enhancements protect investors in the RMBS by allocating cash flows among tranches using a waterfall structure (subordination), having a mortgage pool with an aggregate face value greater than that of the issued securities (overcollateralization), maintaining a cushion between the interest rates of the underlying mortgages and the coupon rates for the RMBS (excess spread), by entering into an agreement with a third party to guarantee payment on the RMBS (insurance), or by some combination of these enhancements.

Because of these features, RMBS investors have only an indirect exposure to the credit risk of borrowers and can be paid in full even if there are some losses on the underlying mortgages.

RMBS are issued pursuant to offering documents that disclose the structure of the securities, the nature and characteristics of the underlying mortgage loans, and associated risk factors. RMBS issuers and underwriters perform due diligence on the mortgages, including by reviewing samples of the mortgages to determine whether they generally comply with the originators' underwriting guidelines. Although the performance of RMBS depends in part on borrowers repaying their mortgages, it also depends in significant part on home prices and the broader economy, because even if a borrower defaults on his or her mortgage, RMBS investors can still recoup the principal on the mortgage if the collateral—the home—has sufficient value to repay the outstanding principal upon foreclosure. When the housing bubble burst, unprecedented home price declines led to steep declines in the prices of RMBS and ultimately the worst financial crisis since the Great Depression.[24]

C. DOJ's RMBS-Related FIRREA Investigations and Litigations.

DOJ has used FIRREA to investigate and sue RMBS issuers and underwriters, and their employees, under the theory that they committed fraud by making material misrepresentations relating to the quality of the mortgage loans underlying RMBS. DOJ has argued that issuers and underwriters defrauded investors by allegedly misrepresenting that the mortgages underlying the

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[24] *See* Jeff Holt, *A Summary of the Primary Causes of the Housing Bubble and the Resulting Credit Crisis: A Non-Technical Paper*, 8 U. Va. J. of Bus. Inquiry 120, 127, 128 (2009); S&P CoreLogic Case-Shiller U.S. National Home Price Index (U.S. housing prices declined by approximately 40% between 2006 and 2012); Ryan Bubb & Prasad Krishnamurthy, *Regulating Against Bubbles: How Mortgage Regulation Can Keep Main Street and Wall Street Safe—From Themselves*, 163 U. Pa. L. Rev. 1539, 1551 (2015) ("Beginning in 2006, house prices crashed, and, by 2012, they had fallen nationally almost 40% from their peak.").

RMBS generally complied with the underwriting guidelines of the lenders that originated those mortgages. In many instances, the RMBS issuers and underwriters that DOJ has investigated under FIRREA are "victims" of their own, and others', supposed fraud. This is because issuers and underwriters often retained the riskiest securities from the RMBS they issued and underwrote (referred to as the "residual" or "first-loss" positions), were among the largest purchasers of RMBS from each other, and suffered massive losses on those investments.

DOJ's FIRREA investigations have significantly impacted the securities markets. For example, on September 15, 2016, Deutsche Bank confirmed public reports that DOJ had demanded $14 billion to settle potential RMBS-related FIRREA claims.[25] News of DOJ's demand (which nearly equaled Deutsche Bank's $18 billion market capitalization) had dramatic results.[26] Deutsche Bank's stock dropped nearly 10 percent, major clients pulled billions of dollars from the bank, and the bank's counterparties expressed concerns not only about their exposure to Deutsche Bank, but about potentially systemic implications for the entire financial market as well.[27]

The amounts that RMBS issuers and underwriters have paid to DOJ to settle FIRREA claims represent tens of billions of dollars siphoned from the capital markets. Those funds could have been used to provide credit to businesses or consumers, return value to shareholders, or otherwise benefit the economy as a whole. The post-crisis regulatory capital framework has

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[25] Michael Dunst, Commerzbank, *Deutsche Bank Quick Bite Idea Analyst Report*, Oct. 11, 2016.

[26] *Who's the Systemic Risk Now*, Wall St. J., Sept. 29, 2016, at A12.

[27] *Id.*; Jenny Strasburg, *Deutsche Faces Plight of Capital*, Wall St. J., Sept. 17, 2016, at B1; Paul J. Davies, *Why Deutsche Bank Will Be Hurt by Mortgage Penalties*, Wall St. J., Sept. 17, 2016, at B12; Rob Copeland & Jenny Strasburg, *Deutsche Bank's Clients Move To Reduce Exposure*, Wall St. J., Sept. 30, 2016, at A1; Georgi Kantchev, *Deutsche Bank: What To Know*, Wall St. J., Oct. 1, 2016, at B2.

magnified the harmful effects of these settlements: financial institutions that have entered into settlements with DOJ or other regulators must carry significant amounts of excess capital for up to 10 years after the settlements, rather than allocating that capital to productive uses or investing it in efforts to minimize future risks.[28] These onerous capital charges apply even if the financial institutions have exited the RMBS issuance and underwriting businesses; indeed, in response to the litigation and regulatory changes stemming from the financial crisis, the market for private-label RMBS (*i.e.*, RMBS not issued by the GSEs) has virtually disappeared.[29]

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[28] Steve Marlin, *Nickel-and-Dimon: Why Bank CEOs Loathe Op Risk Capital*, Risk.net (Apr. 12, 2007), *available at* https://www.risk.net/our-take/4666686/nickel-and-dimon-why-bank-ceos-loathe-op-risk-capital ("An op risk capital framework based on historical loss patterns serves to deter forward-looking assessment . . . . A bank that incurs a multibillion fine for mortgage-backed securities (MBS) will need to maintain that level of op risk capital for up to 10 years after the events that triggered the fine took place—even if it exits that business line. By the time the fines roll off, a whole new set of risks wholly unrelated to MBS—including cyber—will have emerged, but because the bank's op risk capital is tied up by MBS, it will have that much less to invest in preventative measures to combat cyber risk.")

[29] *See id.*; Ben Lane, *Regulators Deny JPMorgan Chase, Redwood Trust Securitization Innovation*, HousingWire (Feb. 13, 2017), *available at* https://www.housingwire.com/articles/39200-regulators-deny-jpmorgan-chase-redwood-trust-securitization-innovation ("Thanks to the government-generated regulatory environment, nearly all of the mortgage securitizations since the crisis have come from government-controlled entities, like Fannie Mae and Freddie Mac. As the government-sponsored enterprises' share of the securitization market grew to outsized proportions, the private market all but disappeared."); Laurie Goodman, *The Rebirth of Securitization: Where Is the Private Label Mortgage Market?*, Housing Finance Policy Center Urban Institute (Sept. 2015), *available at* https://www.urban.org/sites/default/files/publication/65901/2000375-The-Rebirth-of-Securitization.pdf ("Though securitization has since resumed in most asset classes, . . . the private-label residential mortgage-backed securities market remains stagnant. . . . [T]he mortgage market experienced the most aggressive regulatory response to the crisis of any asset class. The policymakers' responses were designed to both keep borrowers in their homes and punish institutions for wrongdoing. In many cases, the mortgage-backed securities investors bore both the costs and uncertainty of these policy changes."); Christopher B. Killian & Joseph Cox, *The US Private Label Mortgage-Backed Securities Market in 2015*, SIFMA (June 2015), *available at* https://www.sifma.org/resources/news/the-us-private-label-mortgage-backed-securities-market-in-2015/ ("The PLS market has significantly shrunk over the last seven years. PLS issuance averaged US $368.7bn per year from 2001-07 but only averaged US $9.6bn per year from 2008-14. While the global economy has gained momentum since the financial crisis,

DISCUSSION

I. DOJ'S MISUSE OF FIRREA AFTER THE 2007-2008 FINANCIAL CRISIS CONFLICTS WITH FIRREA'S TEXT AND USAGE AND CONGRESS'S INTENT TO PROTECT FIFIS FROM CRIMINAL FRAUD.

A. FIRREA's Text, Legislative History, Structure, and Placement in the U.S. Code All Confirm That Congress Intended To Protect FIFIs.

In 1989, Congress enacted FIRREA to prosecute and deter crimes of fraud, embezzlement, and other insider abuse against financial institutions that had caused the failure of more than 1,000 FIFIs during the savings-and-loan crisis,[30] ultimately costing U.S. taxpayers more than $132 billion.[31] In particular, FIRREA permits DOJ to pursue civil monetary penalties for predicate criminal offenses that, either by their terms or by express limitation under FIRREA, "affect[]" a FIFI or victimize a slightly broader group of covered financial institutions (*e.g.*, Federal Home Loan Banks and Federal Reserve Banks).[32] FIRREA's legislative history confirms this

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and other securitisation markets (*e.g.*, collateralised loan obligations and auto-loan asset-backed securities) have seen restored issuance volumes, the PLS market has been fairly stagnant. . . . Examples of actions that have impacted the availability of credit are the GSEs' and FHA's enhanced put-back efforts and litigation against seller/servicers. These actions have caused lenders to become more risk averse so as to ensure they do not originate loans that they must buy back in the future.").

[30] Timothy Curry & Lynn Shibut, *The Cost of the Savings and Loan Crisis: Truth and Consequences*, 13 FDIC Banking Rev., no. 2, 2000, at 26.

[31] U.S. Gov't Accountability Off., GAO/AIMD-96-123, General Accounting Office: *Financial Audit, Resolution Trust Corporation's 1995 and 1994 Financial Statements* 13, Table 3 (1996). U.S. taxpayers were forced to pay for the losses of the savings-and-loan crisis through appropriations to fund the trust that insured those institutions. *Id.* at 7.

[32] *See* 12 U.S.C. § 1833a(c). In all instances, DOJ may obtain a civil monetary penalty only where there is a violation of a predicate offense that harms a narrow category of covered institutions. To obtain a civil penalty under FIRREA, DOJ must prove a violation of a predicate criminal offense by a preponderance of the evidence, as opposed to the "beyond a reasonable doubt" standard applicable in criminal actions. 12 U.S.C. § 1833a(f). As discussed *infra* Discussion II.A.1, the maximum penalty is limited to the harms caused to that narrow group of covered institutions, not to all investors.

overarching purpose.[33] The House and Senate Reports show that FIRREA was a direct response to the "fraud and insider abuse" committed *against* financial institutions that decimated the savings-and-loan industry, and that FIRREA's increased penalties were targeted at predicate criminal offenses committed *against* financial institutions.[34] For example, in the House Report, Congress stated that its objective in enacting FIRREA was to "restore the strength of the thrift industry and the deposit insurance funds,"[35] and that FIRREA was "absolutely essential to respond to a serious epidemic of financial institution insider abuse and criminal misconduct and to prevent its recurrence in the future."[36]

In short, in enacting FIRREA, Congress was concerned with *criminal* misconduct—*not* negligence—and with the resulting injury to depository institutions and their depositors from that conduct—*not* injury to other market participants who might be harmed by ordinary civil securities law violations. Nothing in FIRREA's legislative history, structure, or placement in the U.S. Code suggests that it was intended as a general anti-fraud provision to target financial institutions that

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33 *See, e.g.*, 135 Cong. Rec. 18,860 (1989) (statement of Sen. Chafee) ("Outright fraud and embezzlement led to one-third of all thrift failures. The legislation addresses this by increasing civil monetary penalties."); 135 Cong. Rec. 12,143 (1989) (statement of Rep. Richardson) (arguing for "severe penalties for the abuse, misuse or fraud against federally insured institutions"); 135 Cong. Rec. 11,785 (1989) (statement of Rep. Roukema) ("Most importantly this legislation will insure that a strong and viable thrift industry emerges for the future. . . . This bill also expands policing and enforcement authority and mandates tougher criminal and civil penalties for those former S&L owners and operators who are apprehended and convicted of fraud and abuse.").

34 H.R. Rep. No. 101-54, Pt. I, at 300 (1989), *reprinted in* 1989 U.S.C.C.A.N. 86, 96 ("[I]t is clear that fraud and insider abuse has been a major factor in a significant portion of thrift failures in the 1980s."); *accord* S. Rep. No. 101-19, Pt. I, at 9 (1989) ("Little doubt exists that fraud and insider abuse contributed substantially to the current crisis.")

35 H.R. Rep. No. 101-54, Pt. I, at 291, 1989 U.S.C.C.A.N. at 87.

36 *Id.* at 464, 1989 U.S.C.C.A.N. at 260.

sold securities to the market generally.[37] This makes sense: the general anti-fraud provisions of the federal securities laws, in particular Section 10(b) of the Securities Exchange Act of 1934, adequately protect participants in the securities markets, and the SEC has "complete autonomy" in civil enforcement of the securities laws.[38] DOJ's current interpretation of FIRREA alters the balance of the civil securities fraud enforcement regime, displacing this autonomy and setting up FIRREA as a nuclear option for DOJ to invoke at its discretion whenever a single FIFI purchases a single security in an offering, or has some other less direct involvement in an offering.

B. Until 2009, DOJ Applied FIRREA, as Intended, To Protect FIFIs.

For more than 20 years after FIRREA's passage, DOJ interpreted FIRREA consistently with its text and intent, bringing actions under FIRREA against individuals—mainly insiders—who had committed criminal fraud against FIFIs. In the 267 reported federal court decisions mentioning FIRREA penalties during the more than 20-year period between enactment of the FIRREA statute and the creation of the Task Force on November 17, 2009,[39] DOJ ***never*** (i) brought a case premised on the theory that the "affect[ed]" FIFI was the defendant itself;

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[37] FIRREA is a 370-page statute devoted to reforming, recapitalizing, and enhancing regulatory enforcement authority over the "Federal Deposit Insurance Corporation" (Title II), "Savings Associations" and "Thrifts" (Titles III-VI), and "Federal Home Loan Banks" (Title VII"). *See* FIRREA, Pub. L. No. 101-73, 103 Stat. 183 (1989). Congress also placed FIRREA's civil penalties provision within Chapter 16 of Title 12 of the United States Code, which relates to the "Federal Deposit Insurance Corporation," further confirming that Congress intended FIRREA specifically to protect FIFIs and the federal deposit insurance system. *See, e.g.*, *Yates* v. *United States*, 135 S. Ct. 1074, 1084 (2015) (relying on a statute's "position" in the U.S. Code as supporting the "view that Congress' conception of [a statute's] coverage was considerably more limited than the Government's").

[38] *S.E.C.* v. *Robert Collier & Co.*, 76 F.2d 939, 940 (2d Cir. 1935) (L. Hand, J.); *see also* 15 U.S.C. §§ 77t(d), 78u(d)(3); *United States* v. *Martoma*, 2014 WL 5361977, at *5 n.5 (S.D.N.Y. Jan. 8, 2014).

[39] Exec. Order No. 13519, 74 Fed. Reg. 60,123 (Nov. 17, 2009).

(ii) brought a case alleging that a FIFI was "affect[ed]" only as part of a broader group of supposed victims (as opposed to the intended victim of the fraud); or (iii) sought penalties for losses sustained by non-FIFIs.[40]

C. Following the 2007-2008 Financial Crisis, DOJ Began Using FIRREA in Ways Contrary to Its Terms and Purpose.

In his 2012 State of the Union address, President Obama directed DOJ to create a new working group within the Task Force specifically focused on potential wrongdoing by RMBS market participants.[41] Although DOJ investigated the RMBS-related activities of many financial institutions, DOJ did not prosecute a single financial institution or executive for any criminal activity relating to the issuance or underwriting of RMBS.[42] This stands in stark contrast to the years following the savings-and-loan crisis, during which more than 1,700 bank officials were

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40 *See Util. Air Regulatory Grp.* v. *EPA*, 134 S. Ct. 2427, 2444 (2014) ("When an agency claims to discover in a long-extant statute an unheralded power to regulate 'a significant portion of the American economy,' we typically greet its announcement with a measure of skepticism."); *Whitman* v. *Am. Trucking Ass'ns*, 531 U.S. 457, 468 (2001) ("Congress . . . does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes."); *see also* Nan S. Ellis, Steven B. Dow & David Safavian, *Use of FIRREA to Impose Liability in the Wake of the Global Financial Crisis: A New Weapon in the Arsenal to Prevent Financial Fraud*, 18 U. Pa. J. Bus. L. 119, 135 n.75 (2015) ("Although FIRREA was enacted in 1989, it was virtually ignored as a vehicle to address financial fraud until the [global financial crisis of 2008]. . . . Previously, FIRREA had been used primarily against officers and directors of failed financial institutions."); Robert Anello, *New Justice Department's FIRREA Cases Against Banks: Holding the Victim Responsible*, Forbes, May 16, 2013, *available at* http://www.forbes.com/sites/insider/2013/05/16/new-justice-departments-firrea-cases-against-banks-holding-the-victim-responsible ("In its 24 year history, the law typically has been used to bring suit against officers and directors of failed institutions.").

41 President Barack Obama, Remarks by the President in State of the Union Address (Jan. 24, 2012), available at https://obamawhitehouse.archives.gov/the-press-office/2012/01/24/remarks-president-state-union-address; *see also* Office of the Attorney General, Mem. to the Financial Fraud Enforcement Task Force (Jan. 27, 2012), *available at* https://www.justice.gov/sites/default/files/ag/legacy/2012/01/27/residential-mortgage-backed-securities.pdf.

42 *See supra* note 7 and accompanying text.

convicted of major financial frauds directed at FIFIs—primarily violations of or conspiracies to violate FIRREA's predicate criminal offenses—and sentenced to prison.[43] DOJ's decision not to bring such cases against RMBS issuers or underwriters (or their employees) is not surprising, given that DOJ appears to have concluded—like other knowledgeable observers—that RMBS losses did not result from a criminal conspiracy, but rather were caused primarily by the bursting of the housing bubble and subsequent decline in home prices.[44]

Notwithstanding that Congress intended FIRREA to protect FIFIs from *criminal fraud*, and that DOJ brought *no criminal prosecutions* related to RMBS issuance or underwriting, DOJ contends that virtually every issuer and underwriter of RMBS—including Ally, Bank of America, Barclays, Citibank, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, J.P. Morgan, Morgan Stanley, Nomura, RBS, SocGen, UBS, and Wells Fargo—independently engaged in similar, massive mail and wire fraud schemes. DOJ's allegations do not resemble criminal indictments; instead, they closely track the claims advanced in RMBS investor lawsuits brought under Sections 11 and 12 of the Securities Act of 1933 or their state "Blue Sky" law analogues. Those cases—

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[43] U.S. Gov't Accountability Office, GAO/GGD-93-48, General Accounting Office: *Bank and Thrift Criminal Fraud: The Federal Commitment Could Be Broadened*, 2–4, 12 n.1, 76–77 (1993); Filmon M. Sexton, IV, *The Financial Institutions Reform, Recovery, and Enforcement Act of 1989: The Effect of the "Self-Affecting" Theory on Financial Institutions*, 19 N.C. Banking Inst. 263, 269 (2015).

[44] *See generally*, Wallison, *supra* note 20 at Chapter 1 ("With the largest housing bubble in history deflating, and more than half of all mortgages made to borrowers who had weak credit, high debt ratios, or little equity in their homes, the number of delinquencies and defaults in 2008 was unprecedented. One immediate effect was the collapse of the market for private mortgage-backed securities."); *see also* Angela M. DiIenno, *Government Housing Policy and the Failure of the GSEs*, 35 Rev. Banking & Fin. L. 782, 803 (2016); Dinwoodie, *supra* note 14 at 191–92; Holt, *supra* note 24 at 128; Stan J. Liebowitz, *Anatomy of a Train Wreck: Causes of the Mortgage Meltdown*, Independent Policy Report, at 4 (Oct. 3, 2008), *available at* www.independent.org/pdf/policy_reports/2008-10-03-trainwreck.pdf (pointing to the "intentional weakening of the traditional mortgage-lending standards" as being central to the housing bubble).

based on strict liability or lack of reasonable care, and without any requirement that plaintiffs establish fraudulent intent—are grounded in the disclosures made to investors. For example, civil plaintiffs commonly asserted that issuers or underwriters had misstated in RMBS offering documents that the mortgage loans were originated generally in accordance with origination guidelines, or had failed to disclose that the appraised values of the homes securing the underlying mortgages were inflated.

Despite years of investigations seeking to develop claims against RMBS issuers and underwriters, DOJ brought no criminal prosecutions and ultimately was not able to develop a theory of liability that was materially different from the disclosure-based strict liability and negligence claims asserted in private securities law cases. Nevertheless, several financial institutions acceded to DOJ's inflated settlement demands rather than face what was viewed—at least at that time—as the existential threat of a DOJ lawsuit potentially seeking tens of billions of dollars in penalties. Nothing in FIRREA's text or legislative history suggests that its purpose is to give DOJ the power to extract penalties from issuers and underwriters in registered securities offerings on the basis of what are essentially garden-variety securities law claims. DOJ has thus turned FIRREA on its head—recasting this bank-protective statute as an all-purpose weapon to provide leverage to extract enormous settlements *from* financial institutions for alleged frauds against investors generally. DOJ's use of FIRREA in this context directly conflicts with Deputy Attorney General Rosenstein's recent statement that "the government should not use criminal authority unfairly to extract civil payments."[45]

[45] Rosenstein, *supra* note 5.

D. A Congressional Committee Found—and DOJ Has Agreed—That DOJ Improperly Used FIRREA in Operation Choke Point.

DOJ has not limited its overbroad interpretation of FIRREA in its Task Force activities to its RMBS-related investigations. In 2013, the Task Force announced a new initiative ("Operation Choke Point") intended to combat consumer fraud by preventing mass-marketing scammers' access to payment systems.[46] In connection with that initiative, DOJ issued more than 50 subpoenas pursuant to FIRREA to banks and payment processors, seeking information regarding a wide range of financial activities related to identified businesses and entities.[47] In response to the subpoenas and follow-on requests, many financial institutions began terminating banking relationships with lawful businesses due to fear of a FIRREA investigation or reputational harm.[48]

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[46] Michael J. Bresnick, Executive Director, Fin. Fraud Enf't Task Force, Address at the Exchequer Club of Washington, D.C. (Mar. 20, 2013), *available at* https://www.justice.gov/opa/speech/financial-fraud-enforcement-task-force-executive-director-michael-j-bresnick-exchequer (listing examples of mass-marketing fraud such as "deceptive payday loans, false offers of debt relief, fraudulent health care discount cards, and phony government grants, among other things -- that cause billions of dollars in consumer losses").

[47] Cong. Comm. on Oversight and Gov't Reform, The Department of Justice's "Operation Choke Point": Illegally Choking Off Legitimate Businesses? at 2, 8–9 (May 29, 2014), *available at* https://oversight.house.gov/wp-content/uploads/2014/05/Staff-Report-Operation-Choke-Point1.pdf (hereinafter "Operation Choke Point Report").

[48] *Id.* at 2, 8-9; *see also* Letter from R. Bruce Josten, Executive Vice President for Government Affairs, Chamber of Commerce of the United States of America (Mar. 19, 2015), *available at* https://www.uschamber.com/sites/default/files/150319_budgetresolution_operationchokepoint_crapo.pdf ("Enforcement agencies have the tools to root out fraud and predation directly, and the Chamber supports their efforts to do so, but under Operation Choke Point government officials punish entire categories of lawful businesses by instilling fear in the institutions that bank them. This has left banks with little choice but to terminate longstanding relationships with customers because of explicit or implicit threats from their regulator or the DOJ. Markets function best when there are clear rules, a level playing field, and targeted enforcement. Operation Choke Point is an end run around each of these principles and should be stopped.")

In May 2014, the House Committee on Oversight and Government Reform concluded that DOJ had "radically and inappropriately expanded its own authority under FIRREA."[49] Although Congress had enacted FIRREA "to give the [DOJ] the tools to pursue civil penalties against individuals and entities that commit fraud *against* depository institutions," the Committee found that DOJ had instead used FIRREA to "*forcibly conscript* banks to serve as the 'policemen and judges' of the commercial world" or potentially face an investigation or penalty for non-compliance.[50] The Committee concluded that this "radical reinterpretation of what constitutes an actionable violation under . . . FIRREA fundamentally distort[ed] Congress' intent in enacting the law."[51]

Under new leadership, DOJ recently reviewed Operation Choke Point, concluded that it was "a misguided initiative," and confirmed that it is no longer in effect.[52] DOJ also stated that it "is committed to bringing enforcement actions only where warranted by the facts and the applicable law, without regard to political preferences."[53] Consistent with that pledge, DOJ should reconsider its broader interpretation of FIRREA, including with respect to its RMBS-related lawsuits and investigations.

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49 Operation Choke Point Report, *supra* note 47 at 3.

50 *Id.* at 3, 4.

51 *Id.* at 11.

52 Letter from Stephen E. Boyd, Assistant Attorney General to The Honorable Bob Goodlatte, Chairman, Committee on the Judiciary, U.S. House of Representatives (Aug. 16, 2017), *available at* https://judiciary.house.gov/wp-content/uploads/2017/08/081617_Operation-Chokepoint.pdf (hereinafter "Boyd Letter").

53 *Id.*

II. DOJ'S INTERPRETATION VASTLY EXPANDS THE SCOPE OF FIRREA AND THE PENALTIES IT IMPOSES.

A. DOJ's Interpretation of FIRREA Is Based on Fundamental Distortions of FIRREA's Scope and Purpose.

1. FIRREA Liability Is Triggered Only If a FIFI Is Affected.

DOJ has asserted that FIRREA authorizes penalties for allegedly fraudulent sales to *all* investors in a securities offering—whether or not those investors were FIFIs—so long as a single FIFI (or its affiliate) bought a single security in the offering or was otherwise tangentially connected to it. Under DOJ's interpretation, RMBS issuers and underwriters could be subject to FIRREA penalties if (as is common) a FIFI or FIFI affiliate serves as RMBS trustee or loan servicer, even if not a single security is ever sold or offered to a FIFI.

DOJ's boundless interpretation of FIRREA threatens the entire securities industry. Indeed, DOJ's theory would bring within the statute's scope the entire initial public offering ("IPO") of any company if (i) a FIFI or FIFI affiliate purchased a single share of stock, (ii) a non-FIFI investor purchased stock using funds held in a custodial account at a FIFI, or (iii) a FIFI played any role at all in the offering (*e.g.*, as a co-underwriter, registrar, or transfer agent). DOJ's view is so expansive that almost every securities offering would give rise to potential FIRREA liability. FIRREA was never intended, nor was it drafted, to cover all purportedly fraudulent sales of securities to investors simply because a FIFI happened to be among the investors or played some role in the offering.

By its terms, FIRREA enables DOJ to obtain civil penalties for a violation of the mail or wire fraud statutes only if such violation "*affect[s] a federally insured financial institution*."[54] By requiring that the alleged fraud actually "affect[] a [FIFI],"[55] FIRREA imposes a substantive element that limits the nature of the violation by giving it a particular object, *i.e.*, a federal depository institution. To be "affected," a FIFI must, at a minimum, have "suffered an increased risk of loss *due to [the] conduct*."[56] False or misleading statements in connection with sales of RMBS cannot have subjected a FIFI to an increased risk of loss unless, at a minimum, that FIFI *actually relied on those statements and actually purchased* the RMBS at issue.[57] Exposing a FIFI that served as either an RMBS trustee or loan servicer to potential liability or reputational harm does not put a FIFI at risk in a manner sufficient to trigger FIRREA liability—the risk of loss, if any, is too attenuated and indirect.[58] Similarly, a fraudulent sale to a non-FIFI imposes no risk of

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54 12 U.S.C. § 1833a(c)(2) (emphasis added). Similarly, FIRREA's other predicate offenses require, by their terms, that a FIFI be "affect[ed]" or a slightly broader category of financial institution be victimized. *See supra* note 4. For example, the bank fraud statute expressly requires that a "financial institution," defined to include FIFIs and certain other financial institutions, have been defrauded. 18 U.S.C. § 1344. Where DOJ asserts violations of the bank fraud statute—or FIRREA's other predicate offenses which require an effect on a FIFI or that another specified category of financial institution be targeted—DOJ is limited to obtaining penalties for violations harming the FIFIs and the financial institutions covered by those statutes.

55 *Id.*

56 *Wells Fargo Bank*, 972 F. Supp. 2d at 630 (emphasis added).

57 *See United States* v. *Agne*, 214 F.3d 47, 53 (1st Cir. 2000) (To be affected, a financial institution must "experience[] a realistic prospect of loss."); *see also United States* v. *Mullins*, 613 F.3d 1273, 1278 (10th Cir. 2010) ("[T]he 'influence' a defendant's wire fraud has on a financial institution becomes so attenuated, so remote, so indirect that it . . . does not in any meaningful sense affect the institution."); *Bank of N.Y. Mellon*, 941 F. Supp. 2d at 459–60 (If an increased risk of loss is sufficient to trigger FIRREA, that risk cannot be "*so attenuated, so remote, so indirect* that . . . it does not in any meaningful sense affect the institution.") (emphasis added).

58 *See Agne*, 214 F.3d at 53; *Mullins*, 613 F.3d at 1278; *Bank of N.Y. Mellon*, 941 F. Supp. 2d at 459–60.

loss whatsoever on an unrelated FIFI, much less on the FDIC or any other federal insurance fund. FIRREA liability is thus limited to violations of the predicate criminal offenses in connection with the individual sales to FIFIs.[59] DOJ's interpretation of FIRREA essentially eradicates the substantive limitation imposed by Congress's requirement that the alleged fraud "affect[]" a FIFI.

2. FIRREA Was Not Intended To Displace the SEC's Enforcement of Civil Securities Laws or To Authorize Civil Penalties for Garden-Variety Securities Claims.

DOJ has interpreted the inclusion of mail and wire fraud as predicate criminal offenses under FIRREA as providing DOJ with a 10-year statute of limitations to bring virtually the same civil securities fraud claims that the SEC must bring within five years.[60] Having declined to bring any criminal fraud prosecutions relating to RMBS issuance or underwriting, DOJ instead has advanced what are essentially securities law claims with only the most threadbare scienter allegations. In enacting FIRREA, Congress did not intend to displace the SEC's regulation of the capital markets by creating a new, duplicative, longer-lasting, and potentially far more punitive civil liability regime for securities disclosures.[61] The SEC's authority is subject to constraints such as statutes of limitations and repose that guarantee finality to underwriters exposed to liability for selling securities. The certainty that no claim under the securities laws can be brought after expiration of the statute of repose is critical to the functioning of the capital markets. Indeed, the

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59 *See supra* note 54.

60 *Compare* 28 U.S.C. § 2462 (five-year statute of limitations for an SEC action) *with* 12 U.S.C. § 1833a(h) (10-year statute of limitations for a DOJ FIRREA action).

61 *See* Treasury Capital Markets Report, *supra* note 3 at 171 ("The U.S. capital markets regulatory system includes two federal regulators, the SEC and the CFTC. . . . In addition, federal, state, and local prosecutors may engage in enforcement of criminal laws related to the capital markets.")

Securities Act of 1933 originally provided for a 10-year statute of repose for Section 11 and 12 claims, but the Securities Act of 1934 shortened this repose period to three years[62] in response to the significant adverse effect that the original 10-year statute had on capital markets and the "fear that lingering liabilities would disrupt normal business and facilitate false claims."[63] To supplant those limitations and expose securities issuers and underwriters to potential liability under FIRREA for a decade would be contrary to Congress's intent in enacting FIRREA and would hinder the efficient operation of the capital markets by further burdening them with excessive regulation.[64]

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[62] *Compare* Securities Act of 1933, Section 13, 48 Stat. 74, 84 (1933) (10-year repose period) *with* Securities Exchange Act of 1934, Section 207, 48 Stat. 881, 908 (1934) (three-year repose period).

[63] *Norris* v. *Wirtz*, 818 F.2d 1329, 1332 (7th Cir. 1987), *overruled on other grounds by Short* v. *Belleville Shoe Mfg. Co.*, 908 F.2d 1385 (7th Cir. 1990) ("The legislative history in 1934 makes it pellucid that Congress included statutes of repose because of fear that lingering liabilities would disrupt normal business and facilitate false claims."); *see also* 78 Cong. Rec. 8283 (May 8, 1934) (statement of Sen. Walcott) ("From all sections of the country have come complaints that the Securities Act of 1933 has had the effect of retarding business recovery to a considerable extent."); Larry Bumgardner, *A Brief History of the 1930s Securities Laws in the United States – And the Potential Lessons for Today*, *available at* http://www.jgbm.org/page/5%20Larry%20Bumgardner.pdf ("The nation's economy had reached the lowest point of the Depression in early 1933."); Arthur H. Dean, *The Federal Securities Act: I*, 2 Fortune 50, 104, 106, 109 (Aug. 1933) (explaining that the Securities Act would hinder economic recovery and force securities issuers to seek capital abroad).

[64] *See*, *e.g.*, Treasury Capital Markets Report, *supra* note 3 at 175 ("A strong financial regulatory framework is vital to promote economic growth and financial stability and to protect the safety and soundness of U.S. financial institutions. Regulatory fragmentation, overlap, and duplication, however, can lead to ineffective regulatory oversight and inefficiencies that are costly to the taxpayers, consumers, and businesses."); *id.* at 189 ("[C]onflicting [regulatory] frameworks, whether it be within a jurisdiction or between them, can fragment markets, lead to unnecessary costs, distort price discovery, and reduce consumers' options.")

3. DOJ's "Self-Affecting" Theory Repudiates FIRREA's Purpose.

DOJ also has claimed that it can obtain a FIRREA penalty from a FIFI by establishing that mail or wire fraud engaged in by the FIFI adversely "affected" the FIFI itself. Under DOJ's theory, a FIFI can be both the perpetrator and the victim of the alleged fraud, and DOJ can take large sums of money from the FIFI for having victimized itself. For example, in *United States ex rel. O'Donnell* v. *Countrywide Home Loans Inc.*, 33 F. Supp. 3d 494 (S.D.N.Y. 2014), *rev'd*, 822 F.3d 650 (2d Cir. 2016), the only FIFIs that DOJ alleged were "affected" by defendants' alleged mail and wire fraud were two of the defendants themselves—Countrywide Bank, FSB, and Bank of America, N.A.[65] DOJ's allegations in *Countrywide* highlight the contradiction inherent in DOJ's "self-affecting" theory: FIRREA was intended to protect FIFIs, not subject them to increased penalties for fraud based on a longer statute of limitations and a lower burden of proof. Rather than trying to hide its distortion of Congress's intent in enacting FIRREA, DOJ touted its use of FIRREA "to impose civil penalties *against* financial institutions."[66] As one commentator has

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65 This issue remains unresolved: although the district court adopted DOJ's "self-affecting" theory, the Second Circuit did not address this issue on appeal, instead reversing the district court's decision on the ground that the evidence DOJ had introduced at trial was insufficient to prove fraudulent intent. *Countrywide*, 822 F.3d at 656; *see also Wells Fargo Bank*, 972 F. Supp. 2d at 629–30 (denying motion to dismiss based on "self-affecting" theory); *Bank of New York Mellon*, 941 F. Supp. at 457 (same). In *Countrywide*, the Second Circuit held that DOJ "ha[d] not proven the prerequisite violation necessary to sustain an award of penalties under FIRREA," and that DOJ's efforts to establish violations of the predicate offenses "reveal[ed] a basic deficiency in proof under the statutes," stating that "[i]n essence, the Government's theory would convert every intentional or willful breach of contract in which the mails or wires were used into criminal fraud, notwithstanding the lack of proof that the promisor intended to deceive the promisee into entering the contractual relationship." *Countrywide*, 822 F.3d at 656, 661, 666.

66 Press Release, DOJ, Deutsche Bank Agrees to Pay $7.2 Billion for Misleading Investors in its Sale of Residential Mortgage-Backed Securities (Jan. 17, 2017), *available at* https://www.justice.gov/opa/pr/deutsche-bank-agrees-pay-72-billion-misleading-investors-its-sale-residential-mortgage-backed (emphasis added).

noted, this is similar to "the government prosecuting someone for attempted murder after that person failed to commit suicide. The defendant might say that the government is converting a statute designed to shield individuals from other's criminal behavior into one that penalizes him for conduct 'affecting' himself."[67]

B. DOJ Incorrectly Interprets FIRREA as Permitting Penalties Based on Losses Not Caused by the Predicate Crime or Based on Gross Gains.

With respect to FIRREA's penalty provisions, DOJ has claimed that FIRREA authorizes penalties based on either (i) *all* losses suffered in connection with the relevant purchases, including losses caused by factors unrelated to the underlying fraud, or (ii) the *gross revenues* from the allegedly fraudulent sales. Both claims are incorrect.

FIRREA provides alternative methods for calculating *maximum* statutory penalties—a "per-violation" penalty or a penalty based on "pecuniary loss" or "pecuniary gain."[68] For violations of predicate offenses not resulting in a gain or loss, FIRREA sets the maximum penalty at $1.1 million per violation.[69] FIRREA penalties can exceed the $1.1 million cap "[i]f any person derives pecuniary gain from the violation, or if the violation results in pecuniary loss to a person other than the violator"; provided, however, that the maximum penalty under this alternative approach "may not exceed the amount of such gain or loss."[70] Thus, where a defendant's fraud causes a FIFI to sustain losses, or where a defendant profits from defrauding a FIFI, DOJ may seek

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67 Sexton, *supra* note 43 at 263.

68 12 U.S.C. § 1833a(a).

69 12 U.S.C. § 1833a(b)(1) (as adjusted by 28 C.F.R. § 85.3(a)(6)).

70 12 U.S.C. § 1833a(b)(3)(A).

a penalty up to the amount of either the FIFI's loss *resulting from* the violation or the defendant's *net* gain *derived from* the violation.

1. DOJ Must Prove Loss Causation for Penalties Based on a Violation That "Results in Pecuniary Loss."

With respect to the "pecuniary loss" provision of FIRREA, DOJ has asserted that it need not prove any causal connection between the underlying offense and the losses suffered by FIFIs on their investments (and indeed all investors in the offering) in order to impose penalties under FIRREA. DOJ has advanced the position that it may properly obtain as a FIRREA penalty *all* investor losses suffered in connection with an issuance of RMBS, without proving that the FIRREA predicate crime caused any of those losses. This is contrary to FIRREA's plain language, which authorizes penalties above the $1.1 million "per-violation" cap only "if the *violation results in* pecuniary loss."[71]

Courts have held in other contexts that the term "results in" and its equivalents—"resulted from" and "as a result of"—in other federal statutes require loss causation. For example, in *Paroline* v. *United States*, the Supreme Court held that a statute permitting restitution to crime victims for "loss sustained by a victim as a result of the offense" imposes a "proximate cause" requirement.[72] The Supreme Court held that "[t]he words 'as a result of' plainly suggest causation," explaining:

> The reference to 'costs incurred by the victim' is most naturally understood as costs stemming from the source that qualifies an individual as a 'victim' in the first place—namely, ones arising 'as a result of' the offense. Thus, as is typically the case with criminal restitution, [the statute at issue] is intended to compensate victims for *losses caused by the offense* of conviction. This is an important point,

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71 12 U.S.C. § 1833a(b)(3) (emphasis added).

72 134 S. Ct. 1710, 1719 (2014).

> for it means the central concern of the causal inquiry must be the conduct of the particular defendant from whom restitution is sought.[73]

Several other courts have reached the same conclusion. For instance, in interpreting a provision of the U.S. Sentencing Guidelines providing that a defendant is subject to punishment for "all harm that resulted from [defendant's] acts and omissions," the Third Circuit held that the "resulted from" language "establishes a causation requirement when determining actual loss."[74] Similarly, the Second Circuit has long acknowledged that loss causation principles in civil fraud cases also apply to the computation of fraud loss under U.S.S.G. § 2B1.1.[75] In interpreting a provision of the tax code providing that "income does not qualify as exempt . . . if it 'result[s] in' an account balance that is 'in excess' of the statutory account limit," the Federal Circuit held that "[t]he plain meaning of the term 'results in' is 'causes.'"[76]

Because loss causation requires proof "that the economic harm that [investors] suffered *occurred as a result of* the alleged misrepresentations,"[77] DOJ needs to prove that the issuers' and underwriters' alleged misrepresentations—rather than the unexpected and unprecedented decline in housing prices, or other factors—caused the losses on RMBS. Losses caused by such

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73 *Id*. at 1720 (emphasis added).

74 *United States* v. *Yeaman*, 194 F.3d 442, 456–57 (3d Cir. 1999) (citing U.S.S.G. § 1B1.3).

75 *See United States* v. *Rutkoske*, 506 F.3d 170, 179 (2d Cir. 2007) ("[W]e see no reason why considerations relevant to loss causation in a civil fraud case should not apply, at least as strongly, to a sentencing regime in which the amount of loss caused by a fraud is a critical determinant of the length of a defendant's sentence.").

76 *CNG Transmission Mgmt. VEBA* v. *United States*, 588 F.3d 1376, 1379 (Fed. Cir. 2009) (collecting cases).

77 *Citibank, N.A.* v. *K-H Corp.*, 968 F.2d 1489, 1495 (2d Cir. 1992).

macroeconomic factors that decimated nearly all RMBS in 2007 and 2008 are not losses caused by a FIRREA predicate crime, and thus are not properly included in a FIRREA civil penalty.[78]

Significantly, this issue is not limited to the RMBS market—for example, under DOJ's interpretation, underwriters accused of fraud in connection with an oil company's securities issuance could be liable for entirely unrelated losses caused by a general decline in oil prices. Similarly, underwriters accused of fraud in connection with a pharmaceutical company's securities issuance could be liable for entirely unrelated losses caused by a scientific discovery rendering the company's main product obsolete. This would expose securities issuers and underwriters to massive penalties far in excess of any losses caused by their alleged misconduct. This interpretation does not comport with the text or intent of the statute and should be rejected.

2. FIRREA Does Not Provide for Penalties Based on Gross Revenues.

DOJ also has argued that it could seek as a FIRREA penalty the *total face value* of securities sold in an offering. For violations resulting in a "pecuniary gain," FIRREA allows for a maximum penalty up to "the amount of such gain."[79] The term "pecuniary gain" is not defined in FIRREA and accordingly must be given its ordinary meaning.[80] Here, the ordinary—and

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78 *See Basis PAC-Rim Opportunity Fund (Master)* v. *TCW Asset Mgmt. Co.*, 2017 WL 809507, at *2 (1st Dep't Mar. 2, 2017) ("[W]hen the plaintiff's loss coincides with a marketwide phenomenon causing comparable losses to other investors, the prospect that the plaintiff's loss was caused by the fraud decreases, and a plaintiff's claim fails when it has not . . . proven . . . that its loss was caused by the alleged misstatements as opposed to intervening events. Indeed, when an investor suffers an investment loss due to a market crash [] of such dramatic proportions that [the] losses would have occurred at the same time and to the same extent regardless of the alleged fraud, loss causation is lacking." (alterations in original) (internal quotation marks and citations omitted)).

79 12 U.S.C. § 1833a(b)(3)(A).

80 *FCC* v. *AT&T Inc.*, 562 U.S. 397, 403 (2011) ("When a statute does not define a term, we typically 'give the phrase its ordinary meaning.'").

obvious—meaning of "pecuniary gain" is actual gain—*i.e.*, profit.[81] "Profit" or "gain" is the difference between the amount a person pays for something and the amount received when selling it, less any direct costs—a person who buys a home for $200,000 and sells it for $250,000 and pays a $10,000 broker's fee has "gained" $40,000, not $250,000. When Congress intends to depart from the ordinary meaning of the word "gain," it knows how to do so, and does so expressly by adding the modifier "gross" to "gain" in other statutes.[82] It did not do so in FIRREA.

Nevertheless, DOJ has argued that "pecuniary gain" as used in FIRREA should be interpreted to mean gross receipts from, or face value of, an entire RMBS securitization. As purported support for this tortured interpretation, DOJ relies on a single district court opinion that an appellate court reversed as flawed on other grounds. In *Countrywide*, the only major case in which DOJ's arguments regarding the scope of FIRREA were meaningfully tested in litigation, DOJ argued that the "gains" related to allegedly fraudulent loan sales should be calculated as the gross revenues from the sales.[83] DOJ obtained a verdict against the defendants and the district court (Rakoff, J.) imposed a FIRREA penalty based on the gross revenues from the sales of loans

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81 *See Webster's Third New Int'l Dictionary* at 928 ("gain" means "an increase in or addition to what is of profit, advantage, or benefit: resources or advantage acquired or increased: PROFIT"); *United States* v. *Sanford Ltd.*, 878 F. Supp. 2d 137, 148 (D.D.C. 2012) ("The word 'gain' . . . typically refers to the 'excess of receipts over expenditures or of sale price over cost,' *i.e.*, profit or 'net' income." (quoting BLACK'S LAW DICTIONARY 747 (9th ed. 2006)); *see also Feine* v. *McGowan*, 188 F.2d 738, 740 (2d Cir. 1951) ("[P]rofit means pecuniary gain.").

82 *See, e.g.*, 18 U.S.C. § 3571(d) (Criminal Fine Improvements Act of 1987, enacted less than two years before FIRREA, stating, "If any person derives pecuniary gain from the offense, . . . the defendant may be fined not more than the greater of twice the *gross gain*. . . ." (emphasis added); 15 U.S.C. § 77t(d)(2)(B) (Securities Enforcement Remedies and Penny Stock Reform Act of 1990, authorizing the SEC in certain circumstances to seek civil penalties up to "the *gross* amount of pecuniary gain to such defendant as a result of the violation") (emphasis added).

83 *Countrywide*, 33 F. Supp. 3d at 500–01, *rev'd*, 822 F.3d at 650.

deemed to be defective. As discussed above, defendants appealed the verdict and penalty to the U.S. Court of Appeals for the Second Circuit, which reversed the district court, holding that the evidence DOJ had introduced at trial was insufficient to prove fraudulent intent.[84] The Second Circuit did not have occasion to rule on DOJ's "gross revenues" theory because it rejected DOJ's case on more fundamental grounds, but the entire panel expressed skepticism of this penalty theory at oral argument.[85] The Second Circuit's skepticism was well-founded; such an interpretation would permit DOJ to seek as a penalty the full purchase price that each FIFI paid for the RMBS at issue (and, under DOJ's theory, each non-FIFI investor's purchase price as well), without subtracting the amount the RMBS issuer paid to acquire the underlying mortgages that it securitized, the amount the RMBS underwriter paid to acquire the RMBS that it sold in the offering, or the other expenses that the RMBS issuer and underwriter incurred in connection with issuing and underwriting the RMBS. This interpretation of FIRREA is incorrect and illogical.

DOJ's continued misinterpretation of the phrase "pecuniary gain" will have dire consequences. With the ability to file a complaint seeking as a penalty the total face value of securities sold in the offerings at issue, which can be tens of billions of dollars, DOJ can effectively

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84 *Countrywide*, 822 F.3d at 663–66.

85 *See* Oral Argument at 1:07:05–1:08:55, 1:11:55, 2:00:30–2:09:42, *United States ex rel. O'Donnell* v. *Countrywide Home Loans, Inc., et al.*, 822 F.3d 650, 666 (2d Cir. 2016) ("I'm not sure that the amount they got paid is an accurate assessment of their gain." (Raggi, J.)); *id.* at 2:03:05-2:03:27 ("The value of the asset is very important. In other words, Fannie Mae gets full repayment of that loan. How is that a gain? How is the entire amount of the loan a gain?" (Droney, J.)); *id.* at 2:05:58-2:06:07 ("[W]e certainly are expressing concern about the calculation that was made by the District Court." (Wesley, J.)); *id.* at 2:07:03-2:07:25 ("[T]he GSEs got X in value and Countrywide got X plus something else. Why isn't the plus something else the gain as opposed to all X plus? That's the court's theory. That can't be right. That's an interesting level of accounting." (Wesley, J.)).

threaten the continued existence of issuers, underwriters, and other securities market participants that refuse to agree to DOJ's inflated settlement demands. This blatant distortion of FIRREA's text threatens to chill the operation of the securities markets by undermining the "fairness, predictability, and efficiency" necessary for "healthy capital markets" and disrupting the established regulatory framework.[86]

CONCLUSION

DOJ recently affirmed that it "is committed to bringing enforcement actions only where warranted by the facts and the applicable law, without regard to political preferences."[87] DOJ also recently committed to reviewing its corporate enforcement policies—including "the mandate of the [Task Force]"—and indicated that any policy changes would "reflect input from stakeholders inside and outside [DOJ]."[88] To that end, and for the reasons stated above, SIFMA respectfully requests that DOJ reconsider its misinterpretation of FIRREA and instead apply FIRREA consistently with its statutory text and purpose. FIRREA does not apply to alleged fraud in connection with all securities offerings simply because a FIFI was among the purchasers or somehow involved in the offering. DOJ also is limited under FIRREA to seeking civil penalties based on (i) losses *to FIFIs* that were actually *caused by* the alleged fraud, or (ii) the wrongdoer's net profit from the FIFIs' purchases.

DOJ's overbroad interpretation of FIRREA threatens the efficient and optimal operation of the securities markets. The number of securities issuances in the United States has been

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[86] Treasury Capital Markets Report, *supra* note 3, at 21.

[87] Boyd Letter, *supra* note 52.

[88] Rosenstein, *supra* note 5.

dropping precipitously, in part because of concerns of overregulation and the threat of securities lawsuits.[89] As has been noted, "[n]o one sophisticated about markets believes that multiplying liability is free of cost."[90] DOJ's continued misuse of FIRREA will significantly exacerbate this effect by (i) expanding the number of regulators that investigate and pursue civil claims based on securities issuances, (ii) sharply increasing the potential monetary exposure of financial institutions targeted in such investigations and litigations by inflating the maximum penalties permitted under FIRREA, and (iii) lengthening the time period that market participants may be subject to such investigations and suits. DOJ should interpret FIRREA consistently with its text and intent to avoid such detrimental effects on the securities markets.

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[89] *See*, *e.g*., Treasury Capital Markets Report, *supra* note 3 at 21 (noting that the number of domestic public companies listed in the United States has declined by nearly 50% over the last 20 years"); *id.* at 33 (describing the risk of shareholder class action lawsuits as a potential factor in the reduction of public companies in the U.S., and noting that the recent increase in such lawsuits "is particularly notable given the smaller number of public companies, meaning that securities issuers face a greater likelihood of lawsuits"); Fin. Servs. Forum, *2007 Global Capital Markets Survey* 8 (2007) (senior executive from nine of ten foreign companies that delisted from the United States between 2003 and 2007 cited litigation risk as a factor); James R. Copland, *What Do We Mean By a "Pro-Business" Court—And Should We Care?*, 67 Case W. Res. L. Rev. 743, 748 (2017) ("Although there is disagreement about the underlying causes of [the reduction in IPOs and publicly-traded companies in the United States], there is little doubt that they have a significant effect on the broader economy."); Michael J. Mauboussin, Dan Callahan, & Darius Majd, Credit Suisse, The Incredible Shrinking Universe of Stocks: The Causes and Consequences of Fewer U.S. Equities (Mar. 22, 2017) (analyzing the steep decline in public companies between 1996-2016 and stating that "[r]egulation has increased the cost of listing and facilitated meaningful M&A"); Michael S. Piwowar, Commissioner, Securities Exchange Commission, Opening Remarks at SEC-NYU Dialogue on Securities Market Regulation: Reviving the U.S. IPO Market (May 10, 2017), *available at* https://www.sec.gov/news/speech/opening-remarks-sec-nyu-dialogue-securities-market-regulation-reviving-us-ipo-market ("Strikingly, the fraction of worldwide IPOs occurring on U.S. markets fell below 10% between 2007 and 2011.").

[90] *S.E.C.* v. *Tambone*, 597 F.3d 436, 452 (1st Cir. 2010) (Boudin, J., concurring); *see also* Treasury Capital Markets Report, *supra* note 3 at 21.

Respectfully submitted,

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