



presents

Financial Services Transactions: Increased Exposure Under FERA and False Claims Act Ensuring Compliance to Withstand Aggressive Government Enforcement

A Live 90-Minute Webinar/Audio Conference with Interactive Q&A

Today's panel features:

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Wednesday, July 15, 2009

The conference begins at:

1 pm Eastern

12 pm Central

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**Fraud Enforcement and Recovery Act of 2009
Strafford FERA/False Claim Act CLE Program
July 15, 2009**

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FERA Overview

- Signed into law on May 20, 2009
- Stated Purpose of FERA:
To improve “enforcement of mortgage fraud, securities and commodities fraud, financial institution fraud, and other frauds related to federal assistance and relief programs, for the recovery of funds lost to these frauds.”

Fraud In Connection With Economic Stimulus Plans

- FERA specifically targets fraud by recipients of funds under TARP, the Emergency Troubled Asset Relief Program, and any other economic stimulus plan.
- FERA extends the coverage of the federal statute criminalizing major fraud schemes, 18 USC § 1031, to “any...form of Federal assistance, including through the Troubled Asset Relief Program, and economic stimulus, recovery or rescue plan provided by the Government, or the Government’s purchase of any troubled asset as defined in the Emergency Economic Stabilization Act of 2008.”

Fraud Committed by Any Recipient of Federal Assistance

- Before FERA, Section 1031 covered only prime contractors, subcontractors, and suppliers under procurement contracts with the United States
- After FERA, Section 1031 now covers all recipients of federal assistance, not merely contractors, subcontractors, and suppliers in procurement cases.

Mortgage Lending Business

- FERA extends certain federal fraud laws to private mortgage brokers and lenders. Previously, only federally regulated and insured mortgage businesses were covered.
- FERA introduces “mortgage lending business” into the Criminal Code, defining it as “an organization which finances or refinances any debt secured by an interest in real estate, including private mortgage companies . . . whose activities affect interstate or foreign commerce.”

Mortgage Lending Business

- FERA expands the definition of “financial institution” in the federal criminal code, 18 USC § 20, to include any “mortgage lending business” or “any person or entity that makes in whole or in part a federally related mortgage loan as defined in section 3 of the Real Estate Settlement Procedures Act of 1974.”
- FERA amends 18 U.S.C. § 1014, which makes falsifying loan documents to a range of financial institutions a felony, to include mortgage lending businesses.

Expansion of Money Laundering Statutes

- FERA broadens the scope of crimes covered by the federal money laundering statutes, 18 USC § 1956 and 18 USC § 1957, which make it a crime to conduct financial transactions involving the “proceeds” of a crime.
- FERA defines proceeds in 18 USC §§ 1956 and 1957 as any property obtained or retained through unlawful activity, including the “gross receipts” of that activity. The term “proceeds” was previously limited by the Supreme Court to cover the profits of a crime, not its gross receipts.

Recommended Approval and Reporting Requirements In Money Laundering Cases

- FERA recommends, as the “sense of Congress,” that prosecutions under §§ 1956 and 1957 be approved by senior Justice Department officials where the conduct to be charged as a “specified unlawful activity” is “so closely connected with the conduct to be charged as [another] offense that there is no clear delineation between the two offenses.”
- Present DOJ policy does not require approval in such cases.
- FERA also recommends that the Attorney General provide annual reports to Congress to confirm compliance with the recommended approval process.

Department of Justice Enforcement Efforts

- Huge Infusions of Resources for FBI and DOJ for White Collar/Mortgage Fraud Investigations and Enforcement
- \$330 Million Over Next Two Years
- DOJ Funding Goes to U.S. Attorneys' Offices, as Well as Main Justice Divisions (Criminal, Civil, Tax)
- Substantial Funding Also for U.S. Postal Inspectors (\$30 million in 2010 and again in 2011); HUD-OIG (same); and U.S. Secret Service (\$20 million in 2010 and again in 2011)
- Substantial Funding Also for the Securities and Exchange Commission (\$20 million in 2010 and again in 2011)

Department of Justice Enforcement Efforts

- Recipients Will Need to Report to Congress About How Funds Used for Enforcement and Training
- Since 2007, Number of FBI Agents Dedicated to Mortgage Fraud Has More Than Doubled (120 to 250). This Number Will Surely Grow in The Future. The DOJ and FBI Now Participate in 18 Mortgage Fraud Task Forces and 47 Working Groups Across the USA. These Numbers Will Surely Grow Too.
- Prosecutions Will Likely Address Both Retail-Level Alleged Fraud (e.g., Dishonest Appraisers, Dishonest Brokers) and Wholesale-Level Alleged Fraud (e.g., Prosecutive Theory in E.D.N.Y. for 2008 Bears Stearns, Credit Suisse Case)
- DOJ Also Will Surely Coordinate With the Special Inspector General for TARP Programs (SIG-TARP) To Make TARP- Related Frauds and Misstatements Prosecutive Priorities

Financial Crisis Inquiry Commission

- Will Have Ten Members
 - Three Each Appointed By Majority Leader of Senate and Speaker of the House of Representatives
 - Two Each Appointed By the Minority Leader of the Senate and the Minority Leader of the House
 - Cannot Be Members of Congress or Officers or Employees of State or Federal Government
 - Chair Will Be Selected By the Senate Majority Leader and Speaker of the House; Vice Chair By Minority Leaders of Senate and House

Financial Crisis Inquiry Commission

- Very Broad Mandate: “To Examine the Causes of the Current Financial and Economic Crisis in the United States,” Including Topics Such As:
 - Fraud and Abuse in the Financial Sector
 - Monetary Policy and the Availability and Terms of Credit
 - Accounting Practices in the Financial Sector
 - Tax Treatment of Financial Products and Investments
 - Capital Requirements for the Financial Markets
 - Lending and Securitization Practices
 - Compensation Structures in the Financial World
 - The Legal and Regulatory Structure of the U.S. Housing Markets and Financial Markets

Financial Crisis Inquiry Commission

- Must Submit a Report on These Topics To Congress By December 2010; Will Testify Before Congress in Spring 2011
- Can Refer to U.S. Attorney General or Any Appropriate State Attorney General Any Seeming Violation of Laws in Relation to the Current Financial Crisis
- Can Hold Hearings, Receive Evidence, and Issue Subpoenas
- Need Element of Bipartisanship to Issue Subpoena. Either Chair and Vice-Chair Must Agree, or at a Meeting With a Quorum Present, There Must be a Majority Supporting Vote With at Least One “Yes” Vote From a Person Appointed by Each of the Two Political Parties.

Best Practices: Establish an Effective Compliance Program

- In deciding whether to charge a company, prosecutors must consider nine factors, only one of which the company can substantially control before an investigation begins: “the existence and effectiveness of the corporation’s pre-existing compliance program.” (U.S. Atty’s Manual Chap. 9-28.300A.)
- Even after an investigation begins, prosecutors consider “the corporation’s remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one.” (U.S. Atty’s Manual Chap. 9-28.300A.)

Best Practices: Potential Elements of an Effective Compliance Program

- Clearly communicated explanation of FERA and other industry-specific laws and regulations
- Standards and procedures to be followed by directors, officers, employees, and even business partners
- Oversight responsibility assigned to at least one senior corporate official
- Audit and/or ethics committee that ensures compliance with policies
- Training programs and certifications of compliance

Best Practices: Potential Elements of an Effective Compliance Program

- Systems and whistleblower protections for those who report policy and/or criminal violations, including telephone hotlines
- An established investigation process for assessing the validity and severity of potential violations
- Disciplinary procedures to address consequences of criminal and/or policy violations
- Extensive due diligence requirements, including post-retention oversight, for business partners

Best Practices: Potential Elements of an Effective Compliance Program

- A system of internal accounting controls, including the creation and maintenance of accurate books and records
- Standard provisions in all agreements with business partners that are designed to prevent violations of the law
- Periodic audits conducted by independent parties
- Updated policies when weaknesses in existing policies are discovered

FERA, Securities Fraud, Derivatives and the Role of the SEC

Carolyn Nussbaum
July 15, 2009

NIXON PEABODY



President Obama:

“...the federal government’s ability to investigate and prosecute securities and other financial frauds is severely hindered by outdated laws and a lack of resources.”



The SEC and Derivatives: A Dilemma

- Market participants generally structure CDSs to fall within the statutory exclusion of swaps from the securities laws.
- The SEC has only its authority to enforce anti-fraud provisions of the securities laws with respect to “security-based swap agreements”.
- Investigations have been hampered by lack of record-keeping and reporting of trades.
- OTC derivatives that are securities (and subject to SEC regulatory authority) include OTC security options, certain OTC notes and forward contracts on securities.



FERA and Securities Fraud

- “An Act to improve enforcement of ...securities and commodities fraud...”:
 - Section 1348 of Title 18 is amended to revise the caption to read “Securities and Commodities Fraud”
 - Paragraphs (1) and (2) now include the following language: “any commodity for future delivery, or any option on a commodity for future delivery”



The History of Section 1348

- Added by Section 807 of the Sarbanes-Oxley Act in July 2002
- Before 2002, securities crimes were prosecuted under a patchwork of criminalized technical statutory violations, or as mail and wire fraud.
- Section 1348 criminalized securities fraud, with a 25-year penalty.
- There are few reported criminal cases under the Commodities Exchange Act.
- NB: FERA amends only the criminal securities fraud statute, and does not directly affect the civil anti-fraud statutes and rules or SEC jurisdiction and authority over commodities and derivatives.

Show Me the Money

- \$500,000,000 over the next two years to enforcement agencies to combat mortgage fraud, securities and commodities fraud, and other frauds involving federal economic assistance, including:
 - \$20,000,000 to the SEC
 - \$140,000,000 to the FBI
 - \$100,000,000 to the United States Attorneys
 - \$40,000,000 to the Department of Justice, Criminal Division
 - \$30,000,000 to the Department of Justice, Civil Division



The SEC and Securities and Derivatives Fraud

- Treasury Secretary Geithner (May 13, 2009):

Market integrity concerns should be addressed by making whatever amendments to the CEA and the securities laws which are necessary to ensure that the CFTC and the SEC, consistent with their respective missions, have clear, unimpeded authority to police fraud, market manipulation, and other market abuses involving all OTC derivatives.



The SEC and Derivatives

- *SEC v. Rorech* – insider trading claims against market professionals who traded in credit default swaps, allegedly on the basis of inside information
- *SEC v Lee* – actions by CFTC, SEC and DOJ against commodities trader (employee of subsidiary of publicly traded Bank of Montreal) and employees of publicly held commodities brokerage based on alleged falsified valuations of bank positions that inflated bank financial results, and deceived shareholders of the bank and the brokerage.



The Treasury Role and the Prospective Role of the SEC

- The Treasury White Paper recommends:
 - SEC regulatory authority over certain derivatives (to be shared and “harmonized” with CFTC regulations)
 - Expanded authority to promote transparency in investor disclosures
 - Recordkeeping and reporting obligations on all OTC derivative trades
 - Conservative capital requirements, business conduct standards
 - Additional disclosure or standards of care when marketing to less sophisticated counterparties



The Treasury White Paper (June 17, 2009)

- Additional recommendations:
 - Fiduciary duties for broker-dealers offering investment advice
 - Harmonizing regulation of investment advisors and broker-dealers
 - Strengthen regulatory framework for money market funds
 - Add transparency to securitization markets
 - Increase regulation of rating agencies
 - Ability to compensate tipsters (expanded beyond insider trading)
 - Regulatory authority over hedge fund advisors



The SEC's View of its Role

SEC Chair Mary Schapiro (June 22, 2009):

- Primary responsibility for “securities-related OTC derivatives would be retained by the SEC...”
- “Securities-related OTC derivatives” are those that reference:
 - An entity that is an issuer of securities (such as a public company)
 - A security
 - A group or index of securities or issuers
 - Based on related aspects of a security or group or index of securities or issuers



The View From the SEC (cont'd)

- OTC derivatives markets are interconnected with the regulated securities markets.
- Existing regulatory framework is broad and flexible enough to regulate securities-related OTC derivatives and trading venues.
- Congress could make discrete amendments to the definition of a security to cover securities-related OTC derivatives and remove the current exclusion for swaps.



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False Claims Act Presentation

Increased Exposure of Financial Services Transactions to the FCA

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July 15, 2009

OVERVIEW



- Federal FCA is old statute, passed in 1863, to punish contractors that defrauded the Union Army
- Three major amendments
 - 1943
 - Intended to avoid abuse and parasitic lawsuits by *qui tam* relators/whistleblowers
 - 1986
 - Intended to expand both FCA liabilities and *qui tam* enforcement
 - 2009 (FERA)
 - Intended to overturn recent cases limiting scope of FCA
 - Intended to make certain that the FCA and covers false claims/overpayments relating to TARP and economic stimulus funds
- 22 states now have their own false claims laws
 - Modeled on Federal FCA
 - Increasing aggressiveness by state AGs
 - Primary focus on healthcare (Medicaid)

DOJ Statistics



YEAR	<i>Qui Tam</i> Filed Cases	Total FCA Recoveries (<i>Qui Tam</i> and non- <i>Qui Tam</i>)	Recoveries Without US Intervention
1987	31	\$ 86,479,949	\$ 0
1994	219	\$ 1,087,863,425	\$ 2,822,323
2000	364	\$ 1,577,946,842	\$ 1,688,957
2001	311	\$ 1,792,615,911	\$128,587,151
2002	318	\$ 1,223,558,455	\$ 25,786,140
2003	335	\$ 2,247,546,563	\$ 5,185,911
2004	430	\$ 685,895,404	\$ 9,261,879
2005	406	\$ 1,433,043,650	\$ 7,081,143
2006	384	\$ 3,224,303,929	\$ 22,661,363
2007	364	\$ 1,997,284,306	\$159,510,459
2008	<u>375</u>	<u>\$ 1,341,672,451</u>	<u>\$ 5,956,644</u>
TOTALS	6,199	\$21,605,658,699	\$432,898,568

Key Fundamentals



- Treble damages (damage defined as loss to government)
- Plus penalties per violation
- “Recklessness” standard of intent/knowledge
- Enforcement
 - DOJ (Civil Division) and U.S. Attorney’s Offices (Civil Division)
 - Agency IGs
 - FBI
 - DCAA and other Federal auditors
 - *Qui tam* enforcement -- private enforcers of FCA
 - Standing as assignee of U.S.
 - 15-30% of recovery
 - Attorneys’ fees and costs
- *Qui tam* now dominates DOJ agenda

1986 Amendments

- Raised damages from double to triple
- Raised penalties from \$2,000 per violation to \$5,500 to \$11,000 per violation
- Added “reverse” false claim provision
- Lowered intent to “recklessness” -- no “specific intent to defraud” needed
- Established burden of proof at “preponderance of evidence”
- Allowed Civil Investigative Demands only if approved by Attorney General
- Expanded *qui tam* enforcement
 - Reversed 1943 amendments intended to overturn *United States ex rel. Marcus v. Hess*
 - Increased recovery to 30%
 - Added retaliation provision
 - Allowed *qui tam* participation after U.S. intervention
 - Encouraged U.S. intervention if U.S. declined to intervene

FERA Amendments



- FCA amendments began in 2008 (S. 2041 and H.R. 4854)
 - Very favorable to *qui tam* relators (eliminate defenses)
 - Passed both House and Senate Judiciary Committees
 - DOJ Comment Letter to Congress “opposed” amendments but suggested further amendments on liability provisions to reverse decisions favorable to defendants
 - No further action
- Similar bills introduced in 2009 (S. 358 and H.R. 1788)
- FERA took DOJ proposals and included them in Section 4

THE FEDERAL FALSE CLAIMS ACT

31 U.S.C. §§ 3729-3733



Reflecting proposed amendments in S. 386, the Fraud Enforcement and Recovery Act of 2009,
as passed by the U.S. House of Representatives on May 6, 2009

§ 3729. False claims

(a) LIABILITY FOR CERTAIN ACTS.—Any

~~(1) IN GENERAL.—Subject to paragraph (2), any person who—~~

- ~~(1A)~~ knowingly presents, or causes to be presented, ~~to an officer or employee of the United States Government or a member of the Armed Forces of the United States~~ a false or fraudulent claim for payment or approval;
- ~~(2B)~~ knowingly makes, uses, or causes to be made or used, a false record or statement material ~~to get a false or fraudulent claim paid or approved by the Government;~~
- ~~(3C)~~ conspires to ~~defraud the Government by getting a false or fraudulent claim allowed or paid~~ commit a violation of subparagraph (A), (B), (D), (E), (F), or (G);

* * *

- ~~(7G)~~ knowingly makes, uses, or causes to be made or used, a false record or statement material ~~to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government,~~

is liable to the United States Government for a civil penalty of not less than \$5,000 and not more than \$10,000, as adjusted by the Federal Civil Penalties Inflation Adjustment Act of 1990 (28 U.S.C. 2461 note; Public Law 104-410), plus 3 times the amount of damages which the Government sustains because of the act of that person...

* * *

THE FEDERAL FALSE CLAIMS ACT

31 U.S.C. §§ 3729-3733 (cont'd)



(b) ~~KNOWING AND KNOWINGLY DEFINED DEFINITIONS.~~—For purposes of this section, ~~—~~

~~(1) the terms~~ terms “knowing” and “knowingly” ~~—~~

(A) mean that a person, with respect to information—

(1i) has actual knowledge of the information;

(2ii) acts in deliberate ignorance of the truth or falsity of the information; or

(3iii) acts in reckless disregard of the truth or falsity of the information; and

(B) require no proof of specific intent to defraud is required.;

~~(c) CLAIM DEFINED.~~—For purposes of this section, ~~(2)~~ the term “claim” includes ~~—~~

(A) means any request or demand, whether under a contract or otherwise, for money or property which and whether or not the United States has title to the money or property, that—

(i) is presented to an officer, employee, or agent of the United States; or

(ii) is made to a contractor, grantee, or other recipient, if the money or property is to be spent or used on the Government’s behalf or to advance a Government program or interest, and if the United States Government —

(I) provides or has provided any portion of the money or property which is requested or demanded; or if the Government

(II) will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested or demanded; and

(B) does not include requests or demands for money or property that the Government has paid to an individual as compensation for Federal employment or as an income subsidy with no restrictions on that individual’s use of the money or property;

(3) the term “obligation” means an established duty, whether or not fixed, arising from an express or implied contractual, grantor-grantee, or licensor-licensee relationship, from a fee-based or similar relationship, from statute or regulation, or from the retention of any overpayment; and

(4) the term “material” means having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property.

Major Changes to FCA in FERA



LIABILITY

1. Eliminate *Allison Engine* intent requirement
2. Apply FCA wherever there is Federal money ("Federal interest")
3. Establish "materiality" standard as "capable of influencing""
4. Extend conspiracy to reverse false claim
5. Establish FCA liabilities for overpayment without fraudulent act
6. Expand definition of "obligation" to overturn language in *United States ex rel. ATMI v. The Limited*

Major Changes to FCA in FERA



PROCEDURE

1. Expands CID power
2. Allows CID materials to be shared with *qui tam* relators
3. Provides for "relation back" of Government complaint
4. Changes retaliation provision

FCA and Financial Services Industry



- New World
 - New set of regulators
 - DOJ/United States Attorney
 - *Qui tam* lawyers
- New Liabilities
 - Treble damages and penalties
 - False certifications for Federal money
 - Decline to repay overpayments

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