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The Fraud Enforcement and Recovery Act (S. 386): Criminalizing Our Way out of the Financial Crisis

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Congress has many methods of responding to crises, yet some Members of Congress consistently choose a politically popular and expedient route: more and harsher criminal laws, criminal enforcement, and criminal punishment. The knee-jerk congressional response to virtually every crisis is to add to the over 4,400 federal criminal offenses already on the books and increase already harsh federal criminal penalties.

Not surprisingly, some Senators are bent on "solving" the subprime meltdown and the resulting financial crisis by adding more criminal offenses to the currently monstrous compilation of criminal laws. The faulty premise of the Fraud Enforcement and Recovery Act (S. 386) (FERA), co-sponsored by Senators Patrick Leahy (D–VT) and Charles Grassley (R–IA), is that criminal activity caused the financial mess America is facing and that criminal prosecution and punishment can fix it. This is precisely the sort of reflexive criminalization that is behind the current over-federalization of crime and that Members of Congress on both sides of the aisle have stated they abhor because it has contributed to the record federal prison population.

Financial Fraud Enforcement Hearings. To their credit, three federal law enforcement officials who testified at a February 11 Senate Judiciary Committee hearing on financial fraud enforcement did not quite accept the gambit that America needs more and harsher federal criminalization. As expected, all three federal officials—the Justice Department's Rita Glavin, the FBI's John Pistole, and the Treasury Department's new special inspector for the TARP program, Neil Barofsky—eagerly confirmed their respective agency's desire for the additional financial resources and manpower FERA promises. But they also made it clear that existing federal law is more than adequate to punish any actual criminal conduct associated with the current financial crisis.

These witnesses also offered a highly sensible recommendation: The key to combating continuing crisis-related crime, as well as preventing the next Bernard Madoff, will be more and better coordination among federal, state, and local law-enforcement officials—not tough-on-crime sound bites or the creation of new federal crimes. Congress should pursue practical recommendations, such this one, that make the most efficient use of scarce federal resources and do not contribute to the unrestrained federalization of crime.

Unnecessary Criminalization: Prosecutors Have the Tools They Need to Police Financial Markets. Is there really a need for more and harsher federal criminal laws? If criminality is determined to be a pervasive cause or feature of the market crisis, some additional resources in the form of money and man-

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power for federal, state, and local authorities may be warranted. In the meantime, however, FBI and Justice Department officials have independently confirmed that, when it comes to *criminal charging statutes*, they have what they need to prosecute any criminal activity associated with the financial crisis.

For example, Benton Campbell, the top federal prosecutor in New York's Eastern District, headquartered in Brooklyn—an area hit hard by the subprime mortgage crisis—has had a mortgage-fraud task force in place since early 2008. In discussing the types of criminal activity his prosecutors are encountering, he stated that the crimes "are fundamentally familiar to us" and are being adequately investigated and prosecuted under existing federal law.[1]

Further, federal law enforcement's two most popular criminal offenses for prosecuting fraud—the federal mail and wire fraud statutes—are so exceedingly broad they can cover an almost unimaginable range of financial wrongdoing. Indeed, general federal fraud statutes, such as the mail and wire fraud statutes, are available to address *any* crimes related to the subprime market and market crisis.

For instance, the federal courts' expansive reading of the mail fraud statute "has made it possible for the federal government to attack a remarkable range of criminal activity even though some of the underlying wrongdoing does not rest comfortably within traditional notions of fraud."[2] Leading commentators agree that "scheme to defraud," the key phrase of the mail fraud and wire fraud statutes, "has long served…as a charter of authority for courts to decide, retroactively, what forms of unfair or questionable conduct in commercial, public, and even private life, should be deemed criminal. In so doing, this phrase has provided more expansive interpretations from prosecutors and judges than probably any other phrase in the federal criminal law."[3]

Virtually all bank frauds are also mail frauds, wire frauds, or both and, unlike the federal bank fraud statute, the mail and wire fraud statutes are not limited in their application to frauds "perpetrated against a financial institution." And regardless of which federal fraud statute a prosecutor uses to charge a defendant, the potential penalty is substantial. Mail and wire fraud violations already carry a maximum penalty of 20 years imprisonment, and any mail or wire fraud that "affects" a financial institution increases the maximum possible prison sentence to 30 years. By comparison, the maximum federal penalty for attempted murder is 20 years, and the maximum for voluntary manslaughter is 15 years.[4]

It should be noted that, unlike the elements of the bank fraud statute, conduct qualifying for the enhanced penalty must merely "affect" a financial institution; it need not be perpetrated *against* a financial institution in order to draw the increased penalties. Thus, even if a fraud perpetrated against a "mortgage lending business" could not be characterized as bank fraud, the fraud inevitably "affects" a financial institution such that the 30-year maximum sentence under the mail and wire fraud statutes would apply.

Beyond Wall Street. Looking beyond Wall Street, federal prosecutors have a multitude of tools to use on whatever "retail-level" mortgage fraud schemes have been carried out on Main Street. The largest area of mortgage fraud activity identified so far consists of what could be called white-collar street crime—i.e., traditional white-collar crime, such as mail fraud and wire fraud, on an individual and personal level. Because of this, the same prosecutorial tools can be used for criminal conduct allegedly committed on Wall Street or on Main Street. The FBI itself recently identified nine "applicable Federal criminal statutes which may be charged in connection with mortgage fraud"—including Chapters 47 (fraud and false statements), 63 (mail fraud), and 73 (obstruction) of Title 18 of

1. Noeleen G. Walder, "Criminal Prosecutions Predicted to Surge Over Financial Crisis," *New York Law Journal*, October 9, 2008, at *http://www.law.com/jsp/article.jsp?id=1202425138326* (March 3, 2009).
2. Julie O'Sullivan, *Federal White Collar Crime: Case and Materials* (Eagan, MN: West Group Publishing, 2d ed. 2003), p. 483.
3. John C. Coffee, Jr., and Charles K. Whitehead, "The Federalization of Fraud: Mail and Wire Fraud Statutes," in *White Collar Crime: Business and Regulatory Offenses*, Vol. 1, Sec, 9.01 (2002).
4. 18 U.S.C. §§ 1112 (manslaughter), 1113 (attempted murder).

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the United States Code,[5] the same provisions used to charge financial crimes committed on Wall Street.

Congress should take note of the FBI's public acknowledgement that it is in no way hindered by a lack of charging statutes in its pursuit of allegedly criminal conduct associated with the financial meltdown. If, as unlikely as this may be under the exceedingly expansive federal law, some wrongful conduct is beyond the jurisdiction of federal prosecutors, it can almost always be prosecuted on the state and local level. Criminal conduct need not go unpunished even if it is not addressed by a federal statute.

Indeed, in many instances the case is strong for increased state-level activity as an alternative to federal prosecutions. At both the state and local levels, prosecutors have been aggressively battling retail-level fraud perpetrated by individual brokers, real estate agents, lenders, buyers, and borrowers.[6] Like the federal government, the states have ample legal authority to prosecute fraud. In addition, states—*not* the federal government—are the primary regulators of mortgage brokers and the insurance industry. Thus, conduct that takes place entirely on the state or local level and that is within the state's jurisdiction should be investigated and prosecuted by state and local officials. As the U.S. Supreme Court has frequently recognized, the federal government does not have a plenary police power.[7] Nor does this nation have a nationalized police force.

Section 2 of FERA Is Unnecessary and Counterproductive. Considering the many charging statutes that are already available to federal prosecutors, the new criminalization in Section 2 of FERA is not only redundant but also an inappropriate expansion of federal authority undertaken at the expense of state and local law enforcement operations and based on the thinnest of Commerce Clause jurisdictional hooks. While the purpose of FERA may be laudable, identical goals can be realized through existing federal and state statutory authorities, as well as through whatever percentage of the increased funding proposed under FERA Section 3 can be justified by the hard evidence of criminal conduct that is available to date. Section 2 accomplishes little, if anything, that is not already possible under current law.

Section 2 is a predictable reaction from lawmakers. In 2006, then-Senator Barack Obama told *The New York Times* how common it was for members of the Illinois state legislature to consider election-year politics when deciding when and how much to increase criminal penalties.[8] Indeed, a 1998 American Bar Association task force reported that because lawmakers consider new and harsher federal crimes to be so popular, some will not vote against such legislation "even if it is misguided, unnecessary, and…harmful."[9] The criminal law provisions in Section 2 of FERA are an example of such unnecessary and potentially harmful legislation. If passed

5. Press release, "FBI Issues Mortgage Fraud Notice in Conjunction with Mortgage Bankers Association," Federal Bureau of Investigation, March 8, 2007, at *http://www.fbi.gov/pressrel/pressrel07/mortgagefraud030807.htm* (March 3, 2009). The list includes the following statutes: (1) 18 U.S.C. § 1001—Statements or entries generally, (2) 18 U.S.C. § 1010—HUD and Federal Housing Administration Transactions, (3) 18 U.S.C. § 1014—Loan and credit applications generally, (4) 18 U.S.C. § 1028—Fraud and related activity in connection with identification documents, (5) 18 U.S.C. § 1341—Frauds and swindles by Mail, (6) 18 U.S.C. 1342—Fictitious name or address, (7) 18 U.S.C. § 1343—Fraud by wire, (8) 18 U.S.C. § 1344—Bank Fraud, and (9) 42 U.S.C. § 408(a)—False Social Security Number.
6. Press release, "More Than 400 Defendants Charged for Roles in Mortgage Fraud Schemes as Part of Operation 'Malicious Mortgage,'" Federal Bureau of Investigation, June 19, 2008, at *http://www.fbi.gov/pressrel/pressrel08/mortgagefraud061908.htm* (March 3, 2009).
7. See *United States v. Morrison*, 529 U.S. 598, 618 (2000).
8. See Chris Sullentrop, "The Right Has a Jailhouse Conversion," *The New York Times*, December 24, 2006, at *http://www.nytimes.com/2006/12/24/magazine/24GOP.t.html* (March 4, 2009).
9. American Bar Association, Criminal Justice Section, Task Force on the Federalization of Criminal Law, "The Federalization of Criminal Law," p. 2 (1998). The ABA Task Force was composed of 17 academics, former prosecutors, Justice Department officials who served in Republican and Democratic Administrations, and Members of Congress of both major parties. Its final report was unanimous.

into law, these provisions will contribute substantially to the hyper-expansion of federal criminal law that Senators and Representatives of both major parties claim they hope to end.

A Better Role for Congress. Investigators and prosecutors at all levels of government are sufficiently armed with the tools necessary to investigate and prosecute mortgage fraud, financial fraud, and related crimes. Unless and until it is demonstrated that a *new* and heretofore *unidentified* form of criminality is associated with the subprime mortgage meltdown and resulting financial crisis—and that this criminality is not adequately addressed by existing state or federal criminal law—Congress should devote its time and energy to:

- Assisting federal, state, and local officials in developing better coordination and cooperation for the investigation and prosecution of financial crimes; and
- Investigating and resolving the fundamental economic and policy problems that caused the current crisis.

Members of Congress should not embrace harmful or misguided legislation simply to show they are "doing something" to "solve" the subprime meltdown and resulting financial crisis.

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