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### FHFA

## FHFA Inspector General Emerging as Key Enforcement Player: What to Expect in 2014



By ANDREW W. SCHILLING

These days, there is certainly no shortage of investigators, auditors, regulators, and prosecutors inundating the financial services industry with audits, inquiries, civil investigative demands, and subpoenas. Some of these inquiries, such as audits by an entity's regulator, are familiar territory, and companies know the drill in responding to them. What companies find more unnerving is the unfamiliar, such as Civil Investigative Demands from the Consumer Financial Protection Bureau (CFPB) or subpoenas from the New York State Department of Financial Services (DFS). These

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entities didn't even exist five years ago, and companies and their counsel are only now beginning to understand the expectations of these relatively new players in the enforcement space.

One such late arrival to this already crowded field is the Office of Inspector General (OIG) of the Federal Housing Finance Agency (FHFA). Like the CFPB and the DFS, the FHFA didn't exist five years ago; the FHFA came into existence in 2008 with the enactment of the Housing and Economic Recovery Act (HERA). And the Inspector General of the FHFA arrived on the scene even later: the agency's first Inspector General, former federal prosecutor Steve Linick, wasn't nominated and confirmed until 2010.<sup>1</sup>

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But while it showed up late to the party, the FHFA-OIG has been active since then. Its investigators have played a prominent role in several recent, nationally significant enforcement cases, most notably the investigation leading to the historic \$13 billion settlement between the Justice Department, several state attorneys general, and JP Morgan Chase.<sup>2</sup> The FHFA-OIG also

<sup>1</sup> FHFA-OIG, Semiannual Report to the Congress: October 1, 2012 through March 31, 2013 ("Fifth Semiannual Report"), at 6, available at <http://fhfaog.gov/Content/Files/FifthSemiannualReport.pdf>.

<sup>2</sup> Press Release, FHFA-OIG, Justice Department, Federal and State Partners Secure Record \$13 Billion Global Settlement with JPMorgan for Misleading Investors About Securities Containing Toxic Mortgages (Nov. 9, 2013), <http://fhfaog.gov/>

played a “key role” in the investigation leading to the New York Attorney General’s Martin Act suit against Credit Suisse (USA) LLC,<sup>3</sup> provided “extraordinary assistance” to the U.S. Attorney’s Office in Manhattan in the investigation leading to the first FIRREA suit to go to verdict,<sup>4</sup> and worked with the Justice Department in its major mortgage fraud prosecution of individuals connected to Taylor, Bean & Whitaker Mortgage Corporation.<sup>5</sup> Also, its auditors and evaluators have been prolific, publishing dozens of reports and recommendations regarding the FHFA’s oversight of Fannie Mae and Freddie Mac (the Enterprises).<sup>6</sup> Most recently, the FHFA-OIG announced that it has teamed up with United States Attorneys’ Offices to pursue a new “Civil Fraud Initiative,” that will examine the origination practices of mortgage lenders.<sup>7</sup>

More and more mortgage lenders and servicers are finding themselves on the receiving end of inquiries and subpoenas from this new agency. In fact, the FHFA-OIG issued 92 subpoenas in the period from April to September of 2013<sup>8</sup>—more than double the number of subpoenas it issued in the previous six month period.<sup>9</sup> And with the launch of its new “Civil Fraud Initiative” targeting mortgage origination practices, more subpoenas are expected in 2014. These subpoenas and other inquiries prompt a lot of questions about the OIG and its authority. For example, why does the FHFA-OIG investigate banks, mortgage companies, and other financial institutions? And how can the FHFA-OIG subpoena financial institutions for documents when the FHFA doesn’t regulate these institutions and the OIG is not charged with policing them? This article seeks to shed some light on the FHFA-OIG—what it is, what it can do, and what to expect from it going forward.

## The FHFA and its OIG

The FHFA was established on July 30, 2008, with the enactment of HERA. On Sept. 6, 2008, acting pursuant to the authority granted by HERA, the FHFA placed Fannie Mae and Freddie Mac into conservatorship. As conservator, the FHFA took over the assets and operations of the Enterprises with all the powers of the share-

Content/Files/JPMorgan%20Settlement%20Press%20Release%20v2%2011\_19\_13.pdf.

<sup>3</sup> Press Release, FHFA OIG, A.G. Schneiderman Sues Credit Suisse for Fraudulent Residential Mortgage-Backed Securities (Nov. 20, 2012), <http://fhfaoig.gov/Content/Files/AG%20Schneiderman%20Sues%20Credit%20Suisse.pdf>.

<sup>4</sup> Press Release, U.S. Attorney’s Office, Southern District of N.Y., Manhattan U.S. Attorney Sues Bank of America for Over \$1 Billion for Multi-Year Mortgage Fraud Against Government Sponsored Entities Fannie Mae and Freddie Mac (Oct. 24, 2012), <http://www.justice.gov/usao/nys/pressreleases/October12/BankofAmericanSuit.php>.

<sup>5</sup> Press Release, U.S. Department of Justice, Former Chairman of Taylor, Bean & Whitaker Convicted for \$2.9 Billion Fraud Scheme That Contributed to the Failure of Colonial Bank (Apr. 19, 2011), <http://www.justice.gov/opa/pr/2011/April/11-crm-490.html>.

<sup>6</sup> FHFA-OIG, Audits and Evaluations, <http://fhfaoig.gov/Reports/AuditsAndEvaluations> (last visited Dec. 5, 2013).

<sup>7</sup> FHFA-OIG, Semiannual Report to the Congress: April 1, 2013 through September 30, 2013 (“Sixth Semiannual Report”), at 18, available at <http://origin.www.fhfaoig.gov/Content/Files/SixthSemiannualReport.pdf>.

<sup>8</sup> Sixth Semiannual Report at 108.

<sup>9</sup> Fifth Semiannual Report at 106.

holders, officers, and directors to conduct the business of the Enterprises and to preserve and conserve their assets and property.<sup>10</sup>

HERA also amended the Inspector General Act of 1978 to establish the Office of Inspector General of the FHFA. The FHFA-OIG includes an Office of Audits, an Office of Evaluations, and an Office of Investigations.<sup>11</sup> The OIG had a budget of \$48 million for FY 2013, and a full-time staff of 150 people.<sup>12</sup> The OIG also coordinates with other federal agencies with oversight of federal housing programs, including the Department of Housing and Urban Development, the Department of Veterans Affairs, and the Treasury’s Office of Financial Stability (which manages the Troubled Asset Relief Program).<sup>13</sup> The FHFA-OIG is also an active member of the RMBS Working Group.<sup>14</sup>

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According to the FHFA-OIG, its mission “is to promote the economy, efficiency, and effectiveness of FHFA’s programs; to prevent and detect fraud, waste, and abuse in FHFA’s programs; and to seek sanctions and prosecutions against those who are responsible for such fraud, waste, and abuse.”<sup>15</sup> To those ends, the FHFA-OIG “conducts independent and objective audits, evaluations, investigations, surveys, and risk assessments of FHFA’s programs and operations; keeps the head of FHFA, Congress, and the American people fully and currently informed of problems and deficiencies relating to such programs and operations; and works collaboratively with FHFA staff and program participants to ensure the effectiveness, efficiency, and integrity of FHFA’s programs and operations.”<sup>16</sup>

## The Authority of the FHFA-OIG

The Inspector General of the FHFA basically has the same authority as the IG of any other federal agency; all Inspectors General derive their power from the IG Act. Specifically, the IG Act empowers the FHFA-OIG to “conduct, supervise, and coordinate audits and investigations relating to the programs and operations” of the FHFA.<sup>17</sup> The Act also empowers the FHFA-OIG to (1) “have access to all records, reports, audits, reviews, documents, papers, recommendations, or other material available to the [FHFA] which relate to programs and operations with respect to which that Inspector General has responsibilities” under the Act, and (2) “to require by subpoena the production of all information, documents, reports, answers, records, accounts, papers, and other data in any medium (including elec-

<sup>10</sup> 12 U.S.C. § 4617(b)(2)(A).

<sup>11</sup> Sixth Semiannual Report at 6.

<sup>12</sup> *Id.* at 6.

<sup>13</sup> *Id.* at 36.

<sup>14</sup> *Id.*

<sup>15</sup> FHFA-OIG, Mission, <http://fhfaoig.gov/> (last visited Dec. 5, 2013).

<sup>16</sup> Fifth Semiannual Report at iv.

<sup>17</sup> 5 U.S.C. § 4(a)(1).

tronically stored information as well as any tangible thing) and documentary evidence necessary in the performance of the functions assigned by [the] Act, which subpoena, in the case of contumacy or refusal to obey, shall be enforceable by order of any appropriate United States district court.”<sup>18</sup> Accordingly, the FHFA-OIG has the statutory authority to investigate and audit the FHFA with respect to its “programs and operations”; to access all related records, audits, and reviews available to the FHFA; and to compel by subpoena the production of documents necessary to carry out its responsibilities.

Because the FHFA-OIG derives its subpoena power from the IG Act, case law governing the subpoena authority of other federal OIGs provides useful guidance on the standards a court would apply to any challenge to a subpoena issued by the FHFA-OIG. Such challenges are rare, and the law heavily favors the investigators. Generally, an investigative subpoena will be enforced unless the documents sought are “plainly incompetent or irrelevant to any lawful purpose.”<sup>19</sup> Furthermore, the “court must defer to the agency’s appraisal of relevancy in connection with an investigative subpoena as long as it is not ‘obviously wrong.’”<sup>20</sup> Thus, challenging a subpoena issued by any IG is an uphill battle in most cases.

The authority of the FHFA-OIG is not unlimited, however. While it can ask companies to make witnesses available for interviews, it cannot compel their testimony; its subpoena authority, like that of all other IGs, is limited to seeking documents.<sup>21</sup> And its authority to subpoena documents, while broad, does not extend to documents unrelated to the “programs and operations” of the FHFA or the Enterprises. Nor can an IG require companies to answer written interrogatories. While some federal laws (like the False Claims Act) expressly authorize interrogatories, the IG Act does not.<sup>22</sup> Finally, FHFA-OIG subpoenas (like all administrative subpoenas) may not impose an “unreasonable” burden on the recipient, or seek documents that are already in the possession of the government.<sup>23</sup> Under this latter limitation, an FHFA-OIG subpoena that seeks documents already in the possession of Fannie or Freddie could be vulnerable to a legal challenge, given that the FHFA has a statutory right of access to the documents of the Enterprises, and the OIG generally should not need to subpoena third parties to get them.

<sup>18</sup> *Id.* § 6(a)(1), (4).

<sup>19</sup> *United States v. Aero Mayflower Transit Co., Inc.*, 831 F.2d 1142, 1145 (D.C. Cir. 1987).

<sup>20</sup> *United States v. Hunton & Williams*, 952 F. Supp. 843, 854 (D.D.C. 1997); *United States v. Legal Servs. for N.Y.C.*, 249 F.3d 1077, 1084 (D.C. Cir. 2001).

<sup>21</sup> See *Nat’l Aeronautics & Space Admin. v. Fed. Labor Relations Auth.*, 527 U.S. 229, 242 (1979) (“The [Inspector General Act of 1978] grants Inspectors General the authority to subpoena documents and information, but not witnesses.”).

<sup>22</sup> *United States v. Chevron U.S.A., Inc.*, 186 F.3d 644, 649 (5th Cir. 1999) (observing that False Claims Act CIDs can seek “types of information (such as oral testimony and answers to interrogatories) beyond that permitted an [IG] administrative subpoena”).

<sup>23</sup> See *United States v. Powell*, 379 U.S. 48, 57–58 (1964); *United States v. Morton Salt Co.*, 338 U.S. 632, 652–53 (1950).

## The FHFA-OIG and its Investigations of Mortgage Fraud

While the FHFA-OIG investigates cases involving the internal operations of the FHFA (such as FHFA and GSE employee misconduct), it also claims authority to investigate conduct by companies outside of the FHFA (and even outside Fannie and Freddie), including the authority to investigate mortgage origination fraud, fraud involving residential mortgage-backed securities, and fraud involving mortgage servicing contractors. In fact, its Office of Investigations has opened more than 300 criminal and civil investigations in such wide-ranging areas as “mail, wire, bank, accounting, securities, or mortgage fraud, as well as violations of the tax code, obstruction of justice, and money laundering.”<sup>24</sup> How does the OIG’s authority reach that far, and does it really extend beyond the internal operations of the FHFA?

There are two rationales that arguably support this assertion of authority. First, because the FHFA-OIG is empowered to “recommend policies” designed to promote the “economy, efficiency, and effectiveness” of the FHFA, and because the FHFA is effectively charged with running the Enterprises, the FHFA-OIG may seek information and documents from companies that deal with the Enterprises, such as mortgage originators that sell loans to them, when that information helps the OIG make recommendations for improvements in the operations of the Enterprises. Second, because the FHFA-OIG is charged with the obligation to “prevent and detect fraud and abuse” in the “programs and operations” of the FHFA, the FHFA-OIG may participate in law enforcement investigations into mortgage fraud, at least when that fraud relates to the “programs and operations” of the FHFA (and arguably, by extension, of Fannie and Freddie).

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Neither argument has been tested in court, however. And there are certainly arguments that the OIG’s broad reach exceeds its statutory grasp. For example, while courts have upheld the authority of other federal agency IGs to subpoena third parties, typically those third parties are entities that participated in the programs of the federal agency and received taxpayer money from them, and thus were in a position to have engaged in a fraud in connection with the “programs and operations” of that agency.<sup>25</sup> But when the FHFA-OIG investigates mortgage fraud that occurred in the years leading to the financial crisis, by definition it is investigating companies and individuals that could not

<sup>24</sup> Sixth Semiannual Report at 111.

<sup>25</sup> *Adair v. Rose Law Firm*, 867 F. Supp. 1111, 1115 (D.D.C. 1994).

have participated in the FHFA's programs or take federal money—the FHFA didn't even exist at the time, Fannie and Freddie were not federal agencies, and Fannie and Freddie's money was not taxpayer money. Accordingly, the OIG's authority to investigate pre-2008 mortgage fraud is open to question.

### What to Expect Next From the FHFA-OIG?

In the months and years ahead, expect the FHFA-OIG and its investigators to play an increasingly active role, alongside federal and state prosecutors, in the pursuit of financial fraud cases, in particular in RMBS cases. Although the FHFA's first Inspector General has moved on, his replacement, Acting IG Michael Stephens, recently announced that he had 25 investigators and lawyers conducting interviews, reviewing documents, and serving subpoenas in connection with the work of the RMBS Working Group.<sup>26</sup> Attorney General Eric Holder has said that these investigations are “far from over.”<sup>27</sup>

On the audit and evaluation side, the future is helpfully mapped out by the OIG in an ambitious “Audit and Evaluation Plan,” which lists dozens of areas that the

auditors and evaluators will be exploring in the coming months.<sup>28</sup> Perhaps more significant, in June of 2013 the OIG's Office of Audit launched a “Civil Fraud Initiative,” in which OIG auditors are conducting “civil fraud reviews” to identify fraud and make referrals for civil lawsuits and administrative sanctions against entities and individuals who commit fraud against the FHFA, Fannie, Freddie, or the Federal Home Loan Banks.<sup>29</sup> At the same time, the Office of Audit is working with United States Attorneys' Offices “on reviews of lenders' loan origination practices to determine their compliance with enterprise requirements.”<sup>30</sup> According to the OIG, lenders are selected for these reviews through the use of “data mining techniques” as well as requests from government agencies.<sup>31</sup> Notably, the Office of Audit has issued a dozen subpoenas since April alone, more than three times the number it issued in the previous six months.<sup>32</sup> Expect to see the Office of Audit working closely with the Justice Department on this new Civil Fraud Initiative, and issuing even more subpoenas in 2014.

In short, the FHFA-OIG may have been late to the party, but the party is not nearly over.

<sup>26</sup> Press Release, Department of Justice, Justice Department, Federal and State Partners Secure Record \$13 Billion Global Settlement with JPMorgan for Misleading Investors About Securities Containing Toxic Mortgages (Nov. 19, 2013), <http://www.justice.gov/opa/pr/2013/November/13-ag-1237.html>.

<sup>27</sup> *Id.*

<sup>28</sup> FHFA-OIG, Audit and Evaluation Plan, available at [http://fhfaoig.gov/Content/Files/audit%26evaluation%20plan\\_0.pdf](http://fhfaoig.gov/Content/Files/audit%26evaluation%20plan_0.pdf) (last visited Dec. 5, 2013).

<sup>29</sup> Sixth Semiannual Report at 18.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> Sixth Semiannual Report at 108; Fifth Semiannual Report at 106.