

November 4, 2019

U.S. DEPARTMENT OF JUSTICE AND U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT ISSUE MEMORANDUM ON APPLICATION OF THE FALSE CLAIMS ACT

To Our Clients and Friends:

In a move designed to encourage greater participation by banks and other lending institutions in Federal Housing Administration (“FHA”) programs, on October 28, 2019, the U.S. Department of Justice (“DOJ”) and the U.S. Department of Housing and Urban Development (“HUD”) signed a Memorandum of Understanding (“MOU”) setting forth guidance on the appropriate use of the False Claims Act (“FCA”) to enforce violations of FHA regulatory requirements.^[1]

The guidance—*Inter-Agency Coordination Of Civil Actions Under The False Claims Act Against Participants In FHA Single Family Mortgage Insurance Programs*—is voluntary and creates no legal rights or obligations. Nevertheless, the MOU describes the interagency process for and considerations involved in determining whether certain conduct should be addressed through HUD’s administrative proceedings or similar civil action, or referred to DOJ to pursue action under the FCA. In public remarks proclaiming the MOU’s goal of encouraging banks to participate in FHA lending, HUD Secretary Ben Carson expressed that “the False Claims Act became a monster” that drove banks away in the decade following the financial crisis, “[b]ut now, the monster has been slain.”^[2] Secretary Carson added his “suspicion” that “relatively few things” will warrant referral to DOJ under the MOU, stating that “an obvious case of fraud [is] one thing,” but that “we’re not going to make a big deal of” conduct that “is not a pattern” and is a “mistake that’s correctable.”^[3]

This alert briefly describes the background and key takeaways from the MOU. Gibson Dunn is available to answer any questions you may have about how this guidance applies to your organization, as well as any other topics related to the FCA.

Background

The FHA provides important access to government-backed mortgage loans, particularly for lower income and first time home buyers. Over the past decade, however, banks and other lending institutions have dramatically reduced participation in FHA programs—originating less than 14 percent of FHA-insured mortgages this year, down from nearly 45 percent in 2010. HUD officials have attributed this decline to aggressive FCA enforcement against large FHA lenders following the financial crisis.^[4] DOJ has recovered approximately \$7 billion in FCA actions against mortgage lenders in the last 10 years.

GIBSON DUNN

Against this backdrop, the MOU is specifically “intended to address [the] concerns [regarding] uncertain and unanticipated FCA liability for regulatory defects [that] led many well-capitalized lenders, including many banks and credit unions ... to largely withdraw from FHA lending.”^[5]

The MOU, which pledges to dial back the use of the FCA in enforcing regulatory noncompliance in FHA programs, also marks the latest development in what has become a broader trend of reining in FCA enforcement under the Trump Administration. In recent years, DOJ policy changes have included issuance of the Brand Memo,^[6] which prohibits DOJ attorneys from pursuing enforcement actions predicated on violations of non-binding agency guidance; issuance of the Granston Memo,^[7] which instructed prosecutors to more regularly consider moving to dismiss *qui tam* actions in which DOJ declines to intervene; and revisions to the Yates Memo to provide more opportunities for corporate cooperation credit and inclusion of individuals in corporate settlements, among others.^[8] These policy changes have been incorporated into the Justice Manual, the main internal policy manual for DOJ.^[9]

The MOU

As the MOU makes clear, going forward, HUD will handle enforcement of violations of FHA program requirements “primarily through HUD’s administrative proceedings,” including through the agency’s mortgage review board.

For more serious regulatory violations, the MOU sets forth a framework for the two agencies to follow in “deciding when to pursue False Claims Act cases to remedy material and knowing FHA violations.”^[10] Specifically, the MOU identifies the standards for when HUD may refer a matter to DOJ for pursuit of FCA claims (the “FCA Evaluation Standards”), providing for referral where the following two conditions are met:

- (1) the most serious violations (so-called “Tier 1” violations under HUD regulations) exist either:
 - (i) in at least 15 loans or (ii) in loans with an unpaid principal balance of at least \$2 million; AND
- (2) there are aggravating factors such as evidence that the violations are systemic or widespread.^[11]

Beyond this referral framework, the MOU acknowledges that DOJ will solicit HUD’s views during the investigative, litigation, and settlement phases of any FCA matters predicated in whole or in part on alleged violations of FHA requirements. This includes HUD’s view as to whether the alleged violations “are material or not material to the agency” so that DOJ “can determine whether [the materiality element and other] elements of FCA [liability] can be established.”

It has always been the case that DOJ attorneys would solicit HUD’s views of the allegations under investigation and, as a matter of policy, HUD would have to approve any DOJ action. It is therefore remarkable that the agencies not only highlight this procedure in the guidance but specifically mention materiality—an element which allows an administration to tailor its enforcement agenda by taking the position that an alleged FHA regulatory violation was not important, or at least would not have resulted in non-payment had the government known about it (i.e., was not material).

The MOU also specifically addresses *qui tam* litigation initiated by private relators. Although noting that ultimate dismissal authority remains with DOJ, the MOU nevertheless provides for HUD to recommend dismissal of *qui tam* suits where HUD determines that:

- the alleged conduct would not have warranted referral to DOJ under the FCA Evaluation Standards;
- the alleged conduct does not represent a material violation of FHA requirements; or
- the litigation threatens to interfere with HUD's policies or the administration of its FHA lending program and dismissal would avoid these effects.

Finally, the MOU makes clear that even in cases where HUD declines to refer to DOJ or recommends dismissal, it retains discretion to pursue civil monetary penalties for violations of FHA regulations under other applicable laws, including the Program Fraud Civil Remedies Act.

Conclusion

Citing fears of draconian FCA liability for even minor noncompliance with FHA regulations facing prospective lenders, banks and other lending institutions have shied away from participation in the program in recent years. But particularly if comments from HUD officials are any indication, the new MOU provides a sign that the government has shifted its enforcement priorities in an effort to mitigate these concerns. Organizations that follow the guidance may decrease the likelihood that they will face the prospect of FCA enforcement actions in connection with FHA programs. And particularly noteworthy is that under the MOU DOJ will seek the guidance from HUD as to whether violations alleged by *qui tam* whistleblowers are material or not, such that DOJ may seek to dismiss such claims outright under its recently-flexed authority to dismiss *qui tam* cases even over a whistleblower's objections.

As noted above, the MOU is the latest action taken by the Trump Administration in a broader effort to temper FCA enforcement, promote more practical uses of government resources, and reduce the burden on regulated businesses of defending against cases of low or no merit. This effort has begun to generate real change—for example, since the Granston Memo, DOJ has, in fact, begun moving to dismiss *qui tam* actions at a greater rate than it did in the past. Whether the same can be said of the MOU as to FCA enforcement in connection with FHA lending remains to be seen, but at a minimum, it appears defendants in FCA actions based on alleged FHA program violations will have additional means to pursue declination and dismissal by the government. Gibson Dunn will monitor how this MOU actually works in practice, and will provide updates as they develop.

[1] U.S. Dep't of Justice and U.S. Dep't of Housing and Urban Development, *Inter-Agency Coordination Of Civil Actions Under The False Claims Act Against Participants In FHA Single Family Mortgage Insurance Programs* (Oct. 28, 2019), https://www.hud.gov/sites/dfiles/SFH/documents/sfh_HUD_DOJ_MOU_10_28_19.pdf

[2] Ben Lane, HousingWire, *Exclusive: HUD's Carson on False Claims Act – "The monster has been slayed"* (Oct. 28, 2019), <https://www.housingwire.com/articles/exclusive-huds-carson-on-false-claims-act-the-monster-has-been-slayed/>

[3] *Id.*

[4] Jessica Guerin, HousingWire, *FHA clarifies rules to attract more participants to its mortgage lending program* (May 9, 2019), <https://www.housingwire.com/articles/49011-fha-clarifies-rules-to-attract-more-participants-to-its-mortgage-lending-program/>; MarketWatch, *Trump administration says it will penalize fewer banks who violate FHA regulations* (Oct. 29, 2019), <https://www.marketwatch.com/story/trump-administration-says-it-will-penalize-fewer-banks-who-violate-mortgage-regulations-2019-10-29>

[5] Press Release, Office of Pub. Affairs, U.S. Dep't of Justice, Departments of Justice and Housing and Urban Development Sign Interagency Memorandum on the Application of the False Claims Act (Oct. 28, 2019), <https://www.justice.gov/opa/pr/departments-justice-and-housing-and-urban-development-sign-interagency-memorandum-application>

[6] U.S. Dep't of Justice, Memorandum from Rachel Brand, Associate Attorney General (Nov. 16, 2017), <https://www.justice.gov/opa/press-release/file/1012271/download>

[7] U.S. Dep't of Justice, Memorandum from Michael D. Granston, Director, Commercial Litigation Branch, Fraud Section (Jan. 10, 2018), https://drive.google.com/file/d/1PjNaQyopCs_KDWy8RL0QPAEIPTnv31ph/view

[8] *See* Rod J. Rosenstein, Deputy Attorney General, U.S. Dep't of Justice, Remarks at the American Conference Institute's 35th International Conference on the Foreign Corrupt Practices Act (Nov. 29, 2018), <https://www.justice.gov/opa/speech/deputy-attorney-general-rod-j-rosenstein-delivers-remarks-american-conference-institute-0> [announcing changes]; *see also* U.S. Dep't of Justice, Memorandum from Sally Yates, Deputy Attorney General (Sep. 9, 2015), <https://www.justice.gov/archives/dag/file/769036/download>

[9] U.S. Dep't of Justice, Justice Manual §§ Section 4-4.111 (Granston), 4-4.112 (Yates), Title 1-20.000 et seq. (Brand)

[10] Press Release, Office of Pub. Affairs, U.S. Dep't of Justice, Departments of Justice and Housing and Urban Development Sign Interagency Memorandum on the Application of the False Claims Act (Oct. 28, 2019), <https://www.justice.gov/opa/pr/departments-justice-and-housing-and-urban-development-sign-interagency-memorandum-application>

[11] U.S. Dep't of Housing and Urban Development, Office of Lender Activities & Program Compliance, Loan Review System (LRS): Implementation and Process Changes (Jan. 26, 2017), https://www.hud.gov/sites/documents/LRS_LENDER_PROCESS.PDF, at 24 (Tier 1: Fraud/Misrepresentation; Violations of statutory requirements; Significant eligibility or insurability issues; Inability to determine/support loan approval).

GIBSON DUNN



The following Gibson Dunn lawyers assisted in preparing this client update: Stuart Delery, Jonathan Phillips, James Zelenay, and Sean Twomey.

Gibson Dunn's lawyers have handled hundreds of FCA investigations and have a long track record of litigation success. Our lawyers are available to assist in addressing any questions you may have regarding the above developments. For more information, please feel free to contact the Gibson Dunn lawyer with whom you work, the authors, or any of the following members of the False Claims Act group.

Washington, D.C.

*F. Joseph Warin (+1 202-887-3609, fwarin@gibsondunn.com)
Stuart F. Delery (+1 202-887-3650, sdelery@gibsondunn.com)
Joseph D. West (+1 202-955-8658, jwest@gibsondunn.com)
Andrew S. Tulumello (+1 202-955-8657, atulumello@gibsondunn.com)
Karen L. Manos (+1 202-955-8536, kmanos@gibsondunn.com)
Jonathan M. Phillips (+1 202-887-3546, jphillips@gibsondunn.com)
Geoffrey M. Sigler (+1 202-887-3752, gsigler@gibsondunn.com)*

New York

*Reed Brodsky (+1 212-351-5334, rbrodsky@gibsondunn.com)
Alexander H. Southwell (+1 212-351-3981, asouthwell@gibsondunn.com)*

Denver

*Robert C. Blume (+1 303-298-5758, rblume@gibsondunn.com)
Monica K. Loseman (+1 303-298-5784, mloseman@gibsondunn.com)
John D.W. Partridge (+1 303-298-5931, jpartridge@gibsondunn.com)
Ryan T. Bergsieker (+1 303-298-5774, rbergsieker@gibsondunn.com)*

Dallas

Robert C. Walters (+1 214-698-3114, rwalters@gibsondunn.com)

Los Angeles

*Timothy J. Hatch (+1 213-229-7368, thatch@gibsondunn.com)
James L. Zelenay Jr. (+1 213-229-7449, jzelenay@gibsondunn.com)
Deborah L. Stein (+1 213-229-7164, dstein@gibsondunn.com)*

Palo Alto

Benjamin Wagner (+1 650-849-5395, bwagner@gibsondunn.com)

San Francisco

*Charles J. Stevens (+1 415-393-8391, cstevens@gibsondunn.com)
Winston Y. Chan (+1 415-393-8362, wchan@gibsondunn.com)*

© 2019 Gibson, Dunn & Crutcher LLP

Attorney Advertising: The enclosed materials have been prepared for general informational purposes only and are not intended as legal advice.