S. HRG. 111–191

THE NEED FOR INCREASED FRAUD ENFORCEMENT IN THE WAKE OF THE ECONOMIC DOWNTURN

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

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THE NEED FOR INCREASED FRAUD ENFORCEMENT IN THE WAKE OF THE ECONOMIC DOWNTURN

WEDNESDAY, FEBRUARY 11, 2009

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Committee met, pursuant to notice, at 10:07 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Patrick J. Leahy, Chairman of the Committee, presiding.

Present: Senators Leahy, Whitehouse, Klobuchar, Kaufman, and Grassley.

OPENING STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM THE STATE OF VERMONT

Chairman LEAHY. As we all know, we are in the middle of trying to put together the stimulus package. We have everybody being pulled five different ways.

Senator Grassley is the Ranking Member of the Finance Committee, and the Finance Committee, of course, is an integral part of this. I am one of the senior members of the Appropriations Committee and may have to go, but I know you have to go to a meeting with the Majority Leader, Chuck. Why don't I yield to you so you can give your opening statement. You are going to be acting as Ranking on this thing, anyway. You are one of the cosponsors of the bill. Why don't you go ahead and then come back whenever you can.

STATEMENT OF HON. CHUCK GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator GRASSLEY. It is my intention coming back, although I do not have any idea ahead of time how much Senator Reid wants of our time. But I should give him all the time he wants. So thank you very much, Mr. Chairman, for that courtesy. Thank you very much for holding this important hearing. It is very timely, particularly given the economic downturn, particularly the unprecedented amount of money from the Treasury that is going to be expended to shore up the banking system, retail lending institutions, and efforts to stabilize housing. In these times of Federal financial intervention in the marketplace, we need heightened awareness about how taxpayer dollars are being spent and what controls are in place to ensure that they are effectively used.

Today's hearing is an opportunity to discuss the important work done by auditors, Federal agents, prosecutors, and others in their

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efforts to investigate and prosecute particularly mortgage fraud. The economic crisis that the country is experiencing began with problems that were related to the overleveraged, overpriced, and unsustainable housing bubble. Simply put, the housing market got too big, too fast, and there were not enough controls.

With so much money in the housing market, unscrupulous individuals found a marketplace that was lax in regulation and enforcement, making it easy to commit fraud. I refer to a chart here that my staff will put up that is based upon information collected by FinCEN, the Financial Crimes Enforcement Network, in Treasury. This chart shows the number of "suspicious activity reports" filed by banks related to mortgage transactions.

As you can see, the number of these SARs increased very dramatically between 1996 to 2007, with over 52,000 reports filed in 2007. While suspicious activity reports do not in themselves represent criminal wrongdoing, they are an indicator of potential criminal acts such as mortgage fraud, money laundering, identity theft, or even tax evasion.

This hearing is not limited to mortgage fraud, and we have an opportunity to examine the impact that fraud and abuse are having on our entire economy. As I stated earlier, the problems in our housing market are the root. Each and every American has been impacted whether they have lost a job, whether they owe more on their home than it is worth, or even if they try to purchase a new car. The financial markets have experienced the most dramatic decline, and so have manufacturers, consumers, and small businesses.

When Congress passed the TARP legislation, I pushed to ensure that we had a strong, independent Inspector General, and that led to the creation of the Special Inspector General for TARP. So I am pleased that that person is here, getting that office up and running, and helping us account for the taxpayers' money.

Today I am interested in examining the prevention and recovery side of the TARP program and all efforts to stabilize the economy. Mainly, I want to know what we can do with our criminal laws to deter and prevent wrongdoing. I also want to focus on how our civil fraud laws can be used to recover taxpayers' money if it is fraudulently gotten.

I think today's panel will help shed some light on potential criminal activity that has occurred in the housing market and things involved with the TARP program if it not used appropriately. They will also be able to discuss the danger that unscrupulous individuals pose to a successful recovery.

Finally, this hearing provides an opportunity to discuss the important legislation that you, Chairman, and I have introduced under your leadership to provide important fraud-fighting resources, and particularly an area I am interested in, strengthening the Federal False Claims Act. So I thank you for that and the courtesy in cooperating with me in that effort.

Thank you very much, Mr. Chairman. I did not read my whole statement. I would like to put the whole statement in the record.

Chairman LEAHY. Of course, we will, and I appreciate your being here, and I know you are going to come back as soon as you can. I joined with you and Senator Kaufman to put this legislation. I

think on the question of increased fraud enforcement, this is not a partisan issue. This is something that Republicans and Democrats should certainly agree on. More importantly, the American people agree on it.

Senator GRASSLEY. Absolutely.

Chairman LEAHY. We have to find out how you protect the money that is being spent on the road to recovery in this economy.

We have already spent hundreds of billions of dollars to stabilize our banking system. We are going to spend hundreds of billions of dollars more. Staggering amounts of money. We toss the figures around, but it is a staggering, staggering amount of money. We finally approved the American Recovery and Reinvestment Act in the Senate to boost the economy and create jobs.

I do not think we have paid enough attention to the mortgage and financial fraud that has so dramatically contributed to the economic downturn. I was here a couple decades ago when we had the savings and loan crisis. Just like then, we have to rebuild and strengthen the Justice Department's ability to enforce Federal fraud laws, partly to recover the billions of dollars lost in real estate and securities schemes, but also to set a deterrent factor so it does not happen again. We have to ensure against the diversion of money, especially the huge amounts of money that are going to be necessary to rebuild our economy and provide jobs.

So many Americans have lost their jobs and subsequently lost their homes. They expect us to at least find out what happened. And we know that there have been unscrupulous mortgage brokers and some Wall Street financiers who contributed to this.

As the crisis worsened last fall, I called upon Federal law enforcement to track down and punish those responsible for the financial and mortgage frauds. So we are going to learn more about what tools we actually need to do that and more about what the Justice Department might be able to do.

As I said, this is not a partisan issue. Senator Grassley, who just spoke; Senator Kaufman is here; the three of us introduced the Fraud Enforcement and Recovery Act. We want to strengthen fraud enforcement at the Justice Department, the FBI, the Office of Inspector General at the Department of Housing and Urban Development, and even the Postal Inspection Service.

One thing I learned as a prosecutor in an earlier career, you can all have the laws in the world on the books, but if you are unable to enforce them, if you do not have the resource to enforce the laws and actually go after people who have broken the laws, they are meaningless. Our bill would actually give new tools for prosecutors to use in their fight against fraud. Senators Schumer and Shelby introduced a complementary bill calling for additional FBI agents, Assistant U.S. Attorneys, and staff at the Securities and Exchange Commission.

We do know that banks and mortgage companies relaxed their standards for loans, approving ever riskier mortgages with less and less due diligence. It is almost like opening the door and saying, "Hey, come on in. Fraud is welcome." Private mortgage brokers and lending businesses came to dominate the home housing market. These companies did not have the same kind of banking oversight and internal regulations that had always been in place to help pre-

vent fraud. Now we see what happened with this lax supervision, and we have problems that are rippling not only through our country but around the world.

In the last 2 weeks, the Justice Department has announced prosecutions involving more than $100 million lost to mortgage and real estate frauds. The FBI estimates there may be as much as $2 billion lost to these frauds each year. In my own State of Vermont, we saw a crooked mortgage broker who was convicted of defrauding homeowners and banks of over $1 million in deals related to more than 200 homes in Vermont and rural upstate New York. A million dollars does not seem like a lot with all the things we are talking about. In a small area like mine, it is a huge amount of money, and 200 homes, it is a huge amount.

It is not just mortgage fraud. We had home mortgages packaged together, and they were turned into securities that were bought and sold in largely unregulated markets on Wall Street. Of course, as the value of the mortgages started to decline with falling housing prices, these securities unraveled. Some on Wall Street were not honest about these securities; that led to more fraud and victimizing investors nationwide—I might say, in some instances worldwide.

So we have an unprecedented collapse in the mortgage- backed securities market. In the past year, banks and financial institutions in the United States alone have suffered more than $500 billion in losses associated with the subprime mortgage industry. Some of our Nation's largest financial institutions collapsed as a result. And that is not even going to things like the Madoff scandal, a $50 billion Ponzi scheme. If you were writing a book about something like this, everybody would say it would be too far-fetched to be real.

So let us give our law enforcement agencies the tools and resources they need. After all, ordinary Americans who have suffered the brunt of this want to know that we are doing everything possible to find those who committed the fraud.

Our witnesses this morning are Deputy FBI Director John Pistole, and Rita Glavin, the Acting Head of the Justice Department's Criminal Division. Neil Barofsky is the new Special Inspector General for the Troubled Assets Relief Program. You are going to be a busy person.

Senator Kaufman, did you want to add anything to this before we start?

Senator KAUFMAN. Yes, I just have a longer statement I will ask to be put in the record, but——

Chairman LEAHY. And I will put my full statement in the record, too.

[The prepared statement of Senator Leahy appears as a submission for the record.]

STATEMENT OF HON. EDWARD E. KAUFMAN, A U.S. SENATOR FROM THE STATE OF DELAWARE

Senator KAUFMAN. Mr. Chairman, the behavior of Wall Street executives, investment bankers, the credit agencies, mortgage brokers, and other players in the recent financial meltdown was complicated, tangled, a confluence of many factors—and in the end,

devastating to the financial and economic well-being of millions of Americans.

For the purpose of the hearing, I just have really one overriding question, and that is, was any of this behavior illegal? The question itself has a complicated answer, so I think one of the things we really want to work on is to ensure that the Justice Department, the FBI, and the regulatory agencies have all the resources and tools they need.

As Attorney General Holder said at his swearing-in, "Only by drilling down can Federal law enforcement understand the various transactions that took place, investigate the actions and behaviors of persons and firms who engaged in suspected illegal activity, and prosecute those whom the Justice Department or regulatory agents believe to have engaged in criminal activity."

I hope this hearing and I am convinced this hearing will help move the ball forward in trying to answer the question, and that is, during this time was any of this behavior illegal?

Thank you. I am looking forward to your testimony.

[The prepared statement of Senator Kaufman appears as a submission for the record.]

Chairman LEAHY. Thank you.

Our first witness will be John Pistole, who began working with the FBI as a Special Agent in 1983. He served in Minneapolis, New York, and FBI hearing before becoming a Field Supervisor of the White-Collar Crime and Civil Rights Squad in Indianapolis, Indiana. There he created a Health Care Fraud Task Force and a Public Corruption Task Force. He then served as Assistant Special Agent in Charge in Boston where he had oversight of all white-collar crime investigations in Massachusetts, Maine, New Hampshire, and Rhode Island. He also helped lead the Information Security Working Group following the Robert Hannsen espionage case, something that I recall being fully briefed both in open aspects of it and the classified aspects of an intriguing case. After 9/11, he served in various leadership capacities in the FBI's Counterterrorism Division, including Executive Assistant Director. He was promoted to be Deputy Director of the FBI in October 2004. He got his undergraduate degree from Anderson University, his J.D. from the Indiana University School of Law in Indianapolis.

Please go ahead, Mr. Pistole.

STATEMENT OF JOHN S. PISTOLE, DEPUTY DIRECTOR, FEDERAL BUREAU OF INVESTIGATION, WASHINGTON, D.C.

Mr. PISTOLE. Thank you, Chairman Leahy, Senator Kaufman, other members of the Committee that may be here. I appreciate the invitation to be here today to talk on these critical issues of mortgage fraud and other economic crimes. Today, what I would like to do is just give a very brief overview of the law enforcement challenge facing us and describe the FBI's current efforts in this regard.

Since 2005, we have addressed a significant increase in mortgage fraud and related cases. In fact, we had 721 investigations in that year, and now we have over 1,800 investigations currently. Of course, we expect an upward trend to continue.

Our work in mortgage fraud and related crimes generally appear in two distinct areas, the first being fraud for profit, of course, which Senator Kaufman and, Chairman, you were referring to. These are individuals who false inflate the value of the property or issue loans relating to fictitious properties. These schemes rely, of course, on "industry insiders," those appraisers, accountants, mortgage brokers, and other professionals who override lender controls designed to prevent this type of crime from happening.

The second area we refer to is fraud for housing, which an individual borrower, typically with the assistance of a real estate professionals, acquires a house under false pretenses. This usually involves a borrower who misrepresented his or her income or employment history to qualify for a loan, which they would not normally obtain. Obviously, many of these loans end up in default, and there is a resulting financial loss, sometimes substantial, to the institutions involved and, as we have seen, ultimately the taxpayer.

The FBI is currently working to address this environment in several ways. First, we have shifted resources such that over 240 FBI agents are currently assigned to mortgage fraud and related investigations, and another 100-plus agents working corporate fraud matters. We sponsor 55 mortgage task forces or working groups to further leverage available resources in our communities. We established an FBI headquarters-based National Mortgage Fraud Team to coordinate and prioritize the FBI efforts across the country, and to provide tools to identify the most egregious fraud perpetrators, and to work even more effectively with our counterparts in law enforcement, regulatory, and industry leaders. Even before the creation of this national initiative, we received results from our increased focus in this area.

For example, last June, completed the initial phases of what we called "Operation Malicious Mortgage" involving the arrest of more than 400 defendants nationwide believed to be responsible for over $1 billion in estimated losses. This initiative has focused on three types of mortgage fraud: lending, of course; mortgage rescue schemes; and mortgage-related bankruptcy schemes. To date, there have been 164 convictions and forfeitures or seizures of more than $60 million in assets. Our work in that initiative, and others, continues.

In closing, it is clear to Director Mueller and me and our law enforcement partners that more must be done to protect our country and our economy from those who try to enrich themselves through illegal financial transactions. We are committed to doing so, and thank you for your support.

[The prepared statement of Mr. Pistole appears as a submission for the record.]

Chairman LEAHY. Thank you very much, Deputy Director.

Neil Barofsky is the Special Inspector General for the Troubled Assets Relief Program at the Treasury Department. He was confirmed by the Senate at the beginning of last December, I believe unanimously. Prior to his position as Special Inspector General, he worked as a Federal prosecutor in the United States Attorney's Office for the Southern District of New York. While in New York, Mr. Barofsky was a senior trial counsel heading the office's Mortgage Fraud Group. He had extensive experience as a line prosecutor in

the office's Securities and Commodities Fraud Unit where his successful prosecution of the president and CEO of Refco earned him the Attorney General's John Marshall Award. He graduated magna cum laude from New York University School of Law.

Mr. Barofsky, we are glad to have you here. Please go ahead, sir.

STATEMENT OF NEIL M. BAROFSKY, SPECIAL INSPECTOR GENERAL, OFFICE OF THE SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSETS RELIEF PROGRAM, WASHINGTON, D.C.

Mr. BAROFSKY. Thank you, Chairman, and thank you for that kind introduction. Chairman Leahy, Senator Kaufman, it is an honor to appear before you today.

My office, the Office of the Special Inspector General for the Troubled Asset Relief Program—or, as we call it, "SIGTARP"—began operations on December 15, 2008, the day I was sworn into office. And as we indicated in our initial report, which we delivered to each of you and each Member of Congress earlier this week, nearly $300 billion has already gone out the door on TARP. And yesterday, Secretary Geithner outlined Treasury's plans for the remaining balance of the $700 billion in TARP funds. The total amount of Government money at risk in this program, as well as the other programs operated by the Federal Reserve, will total in the trillions. These huge investments of taxpayer money, made over a relatively short period of time, will require close oversight and will invariably provide an incentive to those seeking to criminally profit.

Responding to these challenges has been and will continue to be a focus of my office. Of the four primary oversight bodies born from the Economic Recovery Act, we stand alone as the sole TARP oversight body charged with criminal law enforcement authority—the cop on the beat—and this is one of our most important functions.

As we expand our Investigations Division, we have focused on building essential relationships with law enforcement and prosecutorial agencies. For example, I have joined the President's Corporate Fraud Task Force, and we have initiated relationships and cases with the FBI, the IRS, the Criminal Division of the Department of Justice, the New York State Attorney General's Office, and numerous U.S. Attorney's Offices around the country. Through the TARP-IG Council which I have formed and chair, we coordinate with the other Inspectors General whose responsibilities include oversight of TARP-related matters. We have already opened several criminal investigations, and we have teamed up with the SEC, recently helping them to shut down a securities fraud scam in Tennessee, where someone was illegally trading on the TARP name and reaped millions of dollars of ill-gotten profits.

We have begun outreach to potential whistleblowers and those who may have tips about ongoing fraud, waste, and abuse. Our hotline and website are up and running, and plans are being formulated to help develop a "fraud awareness program" to let potential whistleblowers know who we are, how they can reach us, and how we can protect them. This proactive cooperation and coordination that is the heart of our investigative strategy is resource intensive,

and we cannot shoulder this burden alone. We must work closely with our law enforcement partners.

Based on my experience as an Assistant United States Attorney in the Southern District of New York from 2000 to 2008, where I prosecuted securities fraud cases and founded and built our district's Mortgage Fraud Group, I saw firsthand the understandable shift, since September 11, 2001, in law enforcement resources away from white-collar crimes to terrorism. We saw areas of coverage shrink and prosecutorial thresholds rise. The Department of Justice's recent shift of focus to resource-intensive mortgage fraud investigation has further left other white-collar investigative efforts underfunded and underprosecuted.

Now, with trillions of dollars going out the door under TARP, associated Federal Reserve facilities, and potentially more through the proposed stimulus bill, we stand on the precipice of the largest infusion of Government funds over the shortest period of time in our Nation's history. And, unfortunately, our history teaches us that spending so much money in such a short period of time will inevitably draw those who seek to profit criminally. One need not look any further than the recent outlay for Hurricane relief, Iraq reconstruction, or the savings and loan meltdown to learn important lessons. To fully address this potential criminal vulnerability, it is essential that the appropriate resources be dedicated to meet the challenges of both deterring and prosecuting fraud. As a taxpayer who is heavily invested in these programs, as a former Federal prosecutor who got a firsthand look at corporate greed, and in my current position, I applaud the efforts of this Committee to introduce bipartisan legislation, such as the Chairman and Senator Kaufman's Fraud Enforcement Recovery Act and Senator Schumer and Senator Shelby's Safe Markets Act. These will help ensure that law enforcement has the necessary resources to meet the daunting challenges that lay ahead. Such measures will greatly assist us and our partners as we engage in this historic effort to deter and prosecute those who would seek to criminally profit from a national crisis.

Chairman Leahy, members of the Committee, this concludes my statement, and I would be happy and look forward to answering any questions that you may have.

[The prepared statement of Mr. Barofsky appears as a submission for the record.]

Chairman LEAHY. Well, thank you very much.

Our next witness will be Rita Glavin, who is currently the Acting Assistant Attorney General for the Criminal Division at the Department of Justice. She joined the Criminal Division as Acting Principal Deputy Assistant Attorney General in June of last year. She began her tenure with the Department in 1998 as a trial attorney in the Public Integrity Section, where she prosecuted public corruption cases for 5 years. She then became an Assistant United States Attorney in the Southern District of New York where she conducted complex white-collar investigations, trials, and appeals. Ms. Glavin received her Bachelor of Arts degree from Middlebury College, which, of course, is in Middlebury, Vermont, one of our finest institutions—my daughter-in-law graduated from there, too—

and her J.D. from Fordham University School of Law, where she served as editor in chief of the Fordham Law Review.

Ms. Glavin, glad to have you here. Please go ahead.

STATEMENT OF RITA M. GLAVIN, ACTING ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, U.S. DEPARTMENT OF JUSTICE, WASHINGTON, D.C.

Ms. GLAVIN. Good morning, Mr. Chairman, Senator Kaufman, and other members of the Committee. Thank you for your invitation to address the Committee today. The Justice Department welcomes this opportunity to testify on fraud enforcement and in support of the Fraud Enforcement and Recovery Act of 2009, which I will be referring to as "FERA" or "the Act." It is also a pleasure for me to be here testifying with FBI Deputy Director John Pistole and alongside my good friend and former colleague from New York, Neil Barofsky.

This Nation's economic crisis, as you know, has had devastating effects on mortgage markets, credit markets, commodities and securities markets, and the banking system. The financial crisis demands an aggressive and comprehensive law enforcement response, including vigorous fraud investigations and prosecutions of any entities and individuals that have defrauded their customers and the American taxpayer or otherwise placed billions of dollars of private and public money at risk. Furthermore, a strategic and proactive approach for detecting and preventing fraud is needed.

The Department, through its Criminal Division, the FBI, the U.S. Attorney community, and other components, has been investigating and prosecuting financial crimes aggressively. As the Attorney General has stated, we still must reinvigorate the traditional missions of the Department, and we must embrace the Department's historic role in fighting crime and ensuring fairness in the marketplace.

This proposed FERA legislation gives us some of the tools we need to aggressively fight fraud in the current economic climate, and the Department thanks this Committee and Senators Leahy and Grassley for their leadership on this bill. The proposed legislation will provide key statutory enhancements that will assist in ensuring that those who have committed fraud are held accountable. FERA will also provide needed resources to investigate and prosecute those responsible for such misdeeds.

It is clear that, along with widespread mortgage delinquencies and foreclosures, lender failures, massive losses by investors in mortgage-backed securities, and turbulence in the credit markets, there has been an alarming increase in mortgage fraud. Yet even before this current crisis, the Department was responding to such fraud. For years, we have been waging an aggressive campaign against mortgage fraudsters through vigorous investigation and prosecution, and we have deployed a broad array of enforcement strategies that ensured optimal use of our investigative and prosecutorial resources to maximize deterrence. We have conducted nationwide sweeps in mortgage fraud cases, formed local and regional task forces and working groups, and engaged in major undercover operations. We are also working to uncover rescue scams that target desperate homeowners trying to avoid foreclosure.

As just one example, which Deputy Director Pistole just mentioned, in partnership with the FBI and numerous other law enforcement agencies, last year the Department conducted a nationwide sweep, "Operation Malicious Mortgage," that resulted in charges against more than 400 defendants across the country, and it was brought by many of the more than 45 local and regional task forces and working groups currently targeting mortgage fraud. By fully utilizing these task forces and working groups, we have leveraged our limited resources by joining forces with Federal, State, and local law enforcement and regulatory partners, and we have ensured a coordinated and comprehensive response.

Because of the complexity and creativity of these criminal schemes, the Department has embraced a collaborative approach. We work closely with many different law enforcement agencies to bring these prosecutions. For example, in a case investigated by the Secret Service and the FBI and prosecuted by the U.S. Attorney's Office for the Northern District of Georgia, a defendant agreed to purchase properties from true owners, assumed their identities, obtained further mortgages on the properties, used the identities of the homeowners and others to purchase vehicles, open bank accounts, and obtain passports which he then used to travel to Jamaica, Italy, and Greece while a Federal fugitive. His crimes resulted in clouded property titles in several States, a trail of over 100 victims, and millions of dollars in losses. That defendant was sentenced to 26 years in prison, ordered to pay restitution of almost $6 million, and the Government obtained a forfeiture judgment of $6 million, access to the defendant's book and movie rights, and the right to sell the defendant's paintings on eBay in order to restore money to the victims.

In a very recent example of the Department's collaborative efforts, just last week my colleagues in the Southern District of New York, working with the FBI, the New York City Police Department, and the U.S. Department of Homeland Security's Office of Immigration and Customs Enforcement, obtained a conviction of an attorney involved in a multi-million-dollar mortgage fraud scam that used the kind of fraudulent property-flipping practices that have become common with mortgage fraud. Twenty-five other people have pleaded guilty in connection with that same massive mortgage fraud scheme.

But not just the criminal prosecutions did the Justice Department focus on. The Department is also addressing fraud through vigorous civil enforcement, including under the False Claims Act. The Department's recoveries under the FCA, with the assistance of private whistleblowers, have reached record levels. In 8 of the last 9 years, the Department's recoveries have exceeded $1 billion. Moreover, since 1986, the Department, working with Government agencies and private citizens, has returned more than $21 billion in public monies to Government programs and the Treasury.

The Department has always been committed to fighting fraud, and as we suffer through the current economic crisis, we are committed to redoubling our efforts. This Act is an important and timely step in the process, and we applaud the initiative of this Committee in proposing this Act.

I would be happy to answer any questions from the Committee.

[The prepared statement of Ms. Glavin appears as a submission for the record.]

Chairman LEAHY. Thank you. I found interesting the idea of selling the paintings of the defendant on eBay.

Ms. GLAVIN. We get creative.

Chairman LEAHY. Well, we did not have such things back when I was prosecuting cases. I may want to talk to you privately more about that.

Deputy Director Pistole, we have seen, obviously, this wave of mortgage and securities fraud. It makes the whole method of recovery that much more difficult. I understand the number of suspicious activity reports filed by banks alleging mortgage and other fraud has climbed considerably. The notes I have is that in 2002 there were fewer than 6,000 reports alleging mortgage fraud; in 2008, there were 60,000 such reports—a tenfold increase; and since the collapse of some of the large Wall Street investment banks, a spike in securities fraud as well.

You were involved in investigating the savings and loan crisis of the 1980s. How serious is the crisis today to put that in perspective?

Mr. PISTOLE. Thank you, Mr. Chairman. The savings and loan crisis obviously went on for a number of years, from roughly 1986 to 1995, depending on who you talk to, and obviously involved hundreds of millions of dollars of losses in a number of institutions. This obviously dwarfs that in terms of potential fraud, and that is what we are trying to identify in the stages we are right now.

What we have seen is that the potential that has been referenced to in terms of the billions, the tens of billions, the hundreds of billions of dollars that is already out there under TARP, the $300 billion and additional money that is being made available, makes it a significant challenge.

To give you some kind of context, during the height of the S&L crisis, the FBI had approximately 1,000 agents and analysts, financial analysts and others, working on the S&L crisis through a series of 27 strike forces around the country, as you are familiar with. Today, as I mentioned, we have about 240 agents, and then there is another equivalent number of task force officers from other agencies, such as the others have mentioned, so probably around 500. But in terms of the FBI, around 240-plus agents just on the mortgage fraud-related matters.

When we add in the additional financial analysts, the intelligence analysts, and things, it is a higher number, but you can see the challenge that we have.

Chairman LEAHY. It is only a fraction of what you had before.

Mr. PISTOLE. It is a fraction. That is right.

Chairman LEAHY. What do you think is being lost to mortgage and security fraud annually?

Mr. PISTOLE. In terms of a dollar amount?

Chairman LEAHY. Yes.

Mr. PISTOLE. It is really impossible for us to say. The SARs that you mentioned obviously only represent a small portion of the overall potential fraud out there. It is just those institutions, financial institutions, that have depository requirements and obligations that are required to file the SARs. So there is a number of other

institutions that are not required to file, and, of course, when they file, many times they do not know either the exact amount of fraud or the potential fraud involved.

So it is very difficult to give you any type of number in terms of potential, other than to say the larger the dollar amount that is being funneled in through, for example, the $300 billion, the higher the potential there.

Chairman LEAHY. It certainly dwarfs the savings and loan.

Mr. PISTOLE. It certainly does.

Chairman LEAHY. In fact, Inspector General Barofsky, you work on these mortgage fraud cases. Did the fraud itself contribute to the instability and near collapse of some of our markets and banking system?

Mr. BAROFSKY. I think that is a difficult question to answer. Certainly a lot of the——

Chairman LEAHY. That is why I asked it.

[Laughter.]

Mr. BAROFSKY. I am getting used to difficult questions. But I think that if you look at the collapse of mortgage-backed securities, obviously the collateral underlying those securities are mortgages. And the extent of mortgage fraud, I think it is difficult to put a number on it, but then you have to take that number and multiply it, because whatever the actual dollar amount of pure fraud, the bigger impact that it has on communities and surrounding areas, dealing with victims when I was head of the Southern District Mortgage Fraud Group, you would see that when a fraud hit a neighborhood, if it took out eight or nine properties that ended up getting foreclosed because of a foreclosure rescue scam where they steal the houses out from under homeowners, the ripple effect it has on the community is tremendous. It is a cyclical effect. It is a chain reaction of foreclosures because properties get overvalued in the community, then they are abandoned and foreclosed, and you have abandoned houses, squatters, neighborhoods deteriorate. All of this contributed to the financial crisis and a reduction in the value of those securities and ultimately the housing crisis.

So, Mr. Chairman, I am not an economist and just really do not have the scope and breadth that my colleagues do here. But, yes, I think it has contributed.

Chairman LEAHY. Well, last—my time is up—I do want to ask this one question of Ms. Glavin. We are talking about the legislation that Senator Grassley, Senator Kaufman, and I have introduced, and I realize the Justice Department is still studying it. It does authorize additional resources for Justice and the FBI and the Inspector General at the Department of Housing and Urban Development, Postal Inspection Service, and so on. Do you have any preliminary views on it? And I will at least ask you this part, I do not want to get you ahead of your own Department, but do we need these additional resources? Senator Schumer and Senator Shelby have also proposed additional resources.

Ms. GLAVIN. Senator, we are going to see the demands on law enforcement over the next few years really increase when you see $700 billion outlaid through the TARP program and you see the economic stimulus package. The demands are going to increase, and with the demands that are going to increase on law enforce-

ment and the Justice Department to follow up and investigate, we are going to need resources.

And so, to the extent this Committee is wanting to give resources to law enforcement, we are always appreciative of those efforts and welcome those efforts and support those efforts.

Chairman LEAHY. I am going to be discussing the legislation with Attorney General Holder, also, but I just—most people are honest. The ones who are not honest in this field are creating economic havoc. And I want to make sure that we are able to go after them, and I want to make sure that, one, we can recover whatever assets we can; but I want to see people prosecuted, and I want to see people who have committed such fraud and the havoc it has caused to this country—frankly, I want to see them go to jail.

Senator Kaufman.

Senator KAUFMAN. Mr. Pistole, clearly you do not have enough FBI agents. Can you tell me a little bit about the fact that this is a very different kind of a crime than what most of the FBI is? What is your capability and how do you see ramping up to get the FBI to have sufficient knowledge of financial markets and these kinds of things?

Mr. PISTOLE. Thank you, Senator. I think I would respond in two ways.

One is we have had a long history, obviously, of financial institution frauds, bank frauds, and things like that. The Enron type investigations also helped hone and refine our investigative abilities, along with our partner agencies and, obviously, the U.S. Attorney's Offices, in terms of investigating and prosecuting complex financial frauds, a number of other corporate frauds involved also. So I think our cadre of people are well prepared in dealing with some of these complex investigations. It is really a scope and breadth of really trying to manage expectations of the American people of what we can do with what we are currently addressing.

Now, we have done a scrub of all our criminal investigative resources, and as you know, after 9/11, we moved almost 2,000 criminal investigative resources over to national security matters, particularly counterterrorism. We have been gradually moving those back and have done that in terms of priority areas such as this mortgage fraud and the corporate fraud area, which is potential as significant in terms of the long-term complex investigations.

We are taking a slightly different approach than we did, for example, on Enron, which involved trying to decipher every potential illegal transaction, and looking at it more, for example, like a traditional organized crime or even a drug investigation. We were trying to identify people in different levels and eliciting their cooperation and then moving along, as opposed to trying to prove every single transaction that may be illegal.

Senator KAUFMAN. Great.

Mr. Barofsky, let me go back and not in your present position but kind of when you were a prosecutor. It seems to me you believe that there was fraud that went on. If you were starting to prosecute cases, what is kind of the low-hanging fruit, what do you think are the most obvious cases that you would move on quickly to try to get the most number of prosecutions and put most of the bad people away?

Mr. BAROFSKY. Well, when I started up the Mortgage Fraud Group in the Southern District, we focused to have—what I believe would have the greatest and quickest impact not only on putting people in jail but, as importantly, creating deterrence was going after the licensed professionals. For most of your fraud-for-profit schemes, which because of limited resources we focused on exclusively, the gatekeepers—the lawyers, the appraisers, the licensed mortgage brokers—the trial conviction that Ms. Glavin just referred to was a case that came out of our group, and the person who was convicted was an attorney. And making examples of those and letting their colleagues know that criminal behavior in these types of mortgage frauds is unacceptable, because they have the most to lose. Your run-of-the-mill fraudster will go from fraud to fraud. We see securities fraud defendants who are convicted and did their time, they are all over the mortgage fraud markets, and especially the unregulated side.

But where you could have, I think, the biggest impact is focusing on those licensed professionals. They have the most to lose, they are the most likely to flip, and they make the best examples.

Senator KAUFMAN. Thank you.

Ms. Glavin, there are people that say—I have talked to a number of people that say, look, this is very complex, and, you know, really we should leave it to the regulatory agencies; you know, the criminal justice is kind of a blunt instrument to use in these kinds of cases. There are going to be opportunities that people are going to get hurt and the rest of that.

Would you comment on that kind of a thought in terms of how we should be proceeding and dealing with this whole area?

Ms. GLAVIN. The criminal justice system has been out in the forefront on white-collar crimes and financial fraud since the early part of this decade. In 2002, you had the Corporate Fraud Task Force. In 2003, we had the Enron Fraud Task Force. We have the prosecutions coming out of the WorldCom collapse, accounting fraud, corporate fraud. We saw it in Refco, which my colleague Mr. Barofsky prosecuted.

Regulation works to one extent, but criminal law enforcement sends a very, very powerful message, and it also has tools that regulatory agents do not have. And I want to refer back to what Chairman Leahy said a few moments ago. One of the big deterrent effects is people go to jail, and in the criminal justice system, when you steal and when you leave people penniless and there are thousands of victims from a crime that you committed with criminal intent, prosecutors are in the best place to handle that. And we have been equipped to do that and have been doing that for the last 10 years when we have seen some of these major frauds happen.

I also want to point out we were there at the forefront with Hurricane Katrina. We had our task force ready to go because we knew the fraud that was going to happen. The National Procurement Fraud Task Force was also ready to go. When we saw Government money going out, we were ready to prosecute the people that were going to misuse it.

Senator KAUFMAN. Thank you. I totally agree with you.

Chairman LEAHY. Senator Klobuchar.

Senator KLOBUCHAR. Thank you very much, Mr. Chairman.

Thank you to all of you. As I was getting ready for this hearing, I pulled out testimony that I had given to our State legislature many years ago when I was a local prosecutor and we were seeing some increase in white-collar crime. I used this John Kenneth Galbraith quote that I think is so—from the book "The Great Crash of 1929," which is so applicable. He said, "In good times, people are relaxed, trusting, and money is plentiful. But even though money is plentiful, there are always many people who need more. Under these circumstances, the rate of embezzlement grows, and the rate of discovery falls off. In depression, all this is reversed. Money is watched with a narrow, suspicious eye. The man who handles it is assumed to be dishonest until he proves himself otherwise. Audits are penetrating and meticulous. Commercial morality is enormously improved."

So you have a big job, to improve all of commercial morality.

My question, first, I was reading your testimony, Mr. Barofsky, and you talked about—which I experienced after September 11th—this great shift which was necessary to the U.S. Attorney's Office working on terrorism, and it actually shifted down to the local units. Our Hennepin County Attorney's Office doubled our white-collar group, and it was actually a great experience, and we did a good job. But as the cases got more complicated, as we got into the mortgage fraud areas and some of these complicated computer crimes and frauds, I found that we did not have the resources in law enforcement on the local level to really do a good job of investigating those.

So I thought maybe you could talk about this as you look at these partnerships. We never really got the Federal resources we needed for the computer analysis and the kinds of things as local prosecutors to handle those cases. How are we going to fix that?

Mr. BAROFSKY. Resources, resources, resources. I mean, it is a real problem. And we saw in our district—and we are fortunate. The New York field office is, I assume, one of the largest field offices for the FBI. We have two districts in New York City, Southern and Eastern District, and we had, comparatively speaking, an abundance of resources compared to a lot of my colleagues I worked with in other districts. But even then, once the—you know, before the mortgage fraud focus, after 9/11, you just saw a drop-off of the number of cases that we were able to do across the board on white-collar fraud. And the focus on mortgage fraud—and we had, I think, 20—when I left, there were 20-something agents who were working with us in the Eastern District on our Mortgage Fraud Group and their Mortgage Fraud Task Force. But that necessarily drew down on other types of white-collar criminal activity—types of bank fraud, computer crime, intellectual property crime. And that is just on the Federal level.

I am not really an expert on the local level, but from our task force and working group relationships, there is a need for these types of combined and leveraging of resources to address these problems because they are severe.

Senator KLOBUCHAR. And maybe, Mr. Pistole and Ms. Glavin, you want to comment. But one of these ideas was to have these computer centers where we could use the expertise of the FBI and forensic analysis that we did not have on the local level, because

as your threshold levels went up, we were handling more and more complicated cases.

Mr. PISTOLE. Yes, Senator. And, obviously, in the FBI we look at the State and local task forces as that force multiplier, not just for the Federal Government but for State and local task forces and law enforcement across the board. For example, in Minnesota, there are some Indian reservations, so we have Safe Trails Task Forces to deal with some of the crimes on Indian reservations, and Safe Streets Task Forces in Minneapolis and St. Paul.

In the same fashion, these mortgage fraud task forces and working groups are designed to leverage the collaborative efforts of everybody in a way that brings more than the sum of the individual parts.

In terms of the computer forensic lab, we have 16 of those across the U.S. and try to really use those in a fashion that does enhance the greatest needs across the country, not just the Federal or State or local, but looking collectively. And it is our goal to have many more of those as we progress and get funding.

Senator KLOBUCHAR. Very good. How about international crimes, which we started to see a lot of when I was leaving, and are there plans to address that in a better way, where we have these schemes that go across internationally and it is very hard to track those people?

Mr. PISTOLE. Yes, many of our investigations, both on the criminal side but also in cyber, of course, involve international partners because many of the crimes are committed by people overseas. There is recent publicity about a $10 million fraud being committed by a group of individuals in Russia against a particular bank, where people are just using the ATM as their personal wallet, just going up and getting money out and just draining them there, $10 million across the world.

So we have 61 offices around the world, plus 15 sub-offices, 76 offices that act as that liaison with a host of law enforcement and intelligence services to make sure that we have quick exchange of information, chain of custody issues, if we are trying to prosecute back here, to work with the host governments to try to prosecute there if that is appropriate. So we have really had an expanded international focus, particularly since 9/11.

Senator KLOBUCHAR. Thank you.

Senator WHITEHOUSE. A couple of different questions. John, good to see you again. Pleased to be with you, sir.

Mr. PISTOLE. Good to see you, sir.

Senator WHITEHOUSE. You referenced that the FBI has around 1,600 mortgage fraud investigations that are currently open. I would like you to—obviously, you are not going to be able to be very specific about it, but characterize those to some degree, because you can have everything from the one-off fraudster who comes in and files his disclosure sheet improperly in order to get a mortgage, to somebody who is kind of a repeat offender and is a known fraudster and is going to do this over and over again to somebody who is involved in an organized criminal effort to defraud. And a number like this can look good, but if it is 1,600 ordinary folks who do not lead professional lives of crime but did violate the law on their application by filling out the form fraudu-

lently, that is a very different response than 1,600 investigations that are really targeting people who are systemic wrongdoers.

How would you characterize those 1,600 prosecutions along that spectrum?

Mr. PISTOLE. Thank you, Senator. And good to see you again, sir. Actually, the updated figures are over 1,800 investigations now, and they are largely based on the systemic fraud that we have seen at the professional level that Neil made reference to. There is a small number of those who the individual who was trying to obtain housing and commit fraud to obtain that, that is very small because we just do not have the resources to address that.

But, for example, in Rhode Island, it is a matter of looking at those professionals, whether lawyers or mortgage brokers or real estate professionals, appraisers and others, that are systemically trying to defraud the system and getting up not only in the millions, but the tens of millions, perhaps hundreds of millions of fraud. So the majority of our 1,800-plus current investigations are focused on that, to look at that systemic fraud and try to take out those rings, if you will.

We do see some limited involvement, if you want to call organized crime—there is almost any ethnic group, of course, you can put that name in front of it, whether it is Italian or Sicilian or Russian or Albanian or whatever. And we have seen some instances of that in terms of an enterprise, if you want to look at it for purposes of the RICO statute, a group of individuals associated, in fact, who are perpetrated these types of frauds. That is where we are trying to focus our resources right now as we try to leverage those resources through the various task forces and working groups we have. The key is using some fairly sophisticated software tools and working with HUD and others to try to use—to be an intelligence-based and an intelligence-driven approach rather than just reacting to SARs coming in and saying, OK, here is a fraud, potential fraud.

So we are really trying to leverage that information that FinCEN puts out through the SARs, taking that, crunching the numbers, doing the analysis to say what is going on. And going back to Minneapolis, there has actually been a very focused effort in that regard looking at a small group of individuals, really, who have purchased hundreds of properties and used fraudulent documentation and a number of individuals involved in that to perpetrate a significant fraud. And so the same thing we are trying to do across the country to work smarter, more efficiently with what resources we have.

Senator WHITEHOUSE. And you mentioned 38 matters that are open directly related to the current financial crisis. That sounds like a number that would be small even for the Southern District of New York alone by the time this all shakes itself out. Where do you expect that number to go in the next year or two? And where would you like to see it? And what resources are needed to meet that demand? I mean, I would assume that number will be in the hundreds before very long.

Mr. PISTOLE. It very likely could, Senator. And the numbers can be misleading, and, of course, as—who was it, Disraeli who said, the thing with numbers you have to watch out, "There's lies, damn lies, and statistics." In terms of context, those 38 are significant.

These are companies, businesses that everybody knows about. I just cannot comment on them publicly, but these are significantly large, complex investigations, not dissimilar to the Enron investigation. We just use a different approach.

But to specifically answer your question, we see that number potentially rising into the hundreds, and as the number of bank failures—there have been nine thus far this year—as those increase, the potential for fraud involved in some of those increases. So it is an exponential potential there.

Senator WHITEHOUSE. Mr. Barofsky, you have to deal with an awful lot of agencies. Coordinating with the Inspector General might not be their highest priority. Do you feel you have all the authorities that you need by statute in order to generate the cooperation, the support, and the information that you need to do your job?

Mr. BAROFSKY. Yes, Senator. I think we do have the appropriate authorities, and the response and reaction has been very positive and favorable, from other Inspectors General, from—the FBI has been tremendously supportive, and we thank them especially as we are building up. I want to thank all of you for supporting the Special Inspector General Act for the TARP of 2009, which passed the Senate unanimously. And I look forward to the House also approving that bill, which will help us meet some of our immediate hiring needs and apply some of our authorities. But so far the reaction has been tremendous from other law enforcement agencies.

Senator WHITEHOUSE. Good. Mr. Chairman, my time has expired. If we are going to do a second round, I do have one more question.

Chairman LEAHY. Go ahead and ask the question.

Senator WHITEHOUSE. Ms. Glavin, I just wanted to ask how the Department is structuring itself to meet this need. Is there a task force model, a working group? Are there any—from a structure point of view, are you setting anything up to meet this anticipated bulge of effort?

Ms. GLAVIN. There are a couple of things that we are doing right now. I think one of the most important things that we are doing is that the Department has been actively engaged in discussions with Mr. Barofsky about the best ways that we can help in terms of getting referrals from Mr. Barofsky through the investigations and what he is uncovering and then how we go about prosecuting. So the first thing we are doing is we are talking with the SIGTARP.

The second thing is that within the last year or so, we have had—the Fraud Section of the Criminal Division has led a Mortgage Fraud Working Group which is a collection of representatives from various investigative agencies. They speak with U.S. Attorney's Offices. They find out what is going on in those offices. They talk about best practices. They look at mortgage fraud takedowns. They see what can we learn from that, what can we do better the next time.

I know that there has been some discussion about whether to create a national mortgage fraud task force, and what I can say about that is that the Department is studying it. No decisions have been made with respect to that. And it is just something that is

still under discussion in the Department as to what we want to do and the best way to coordinate.

Senator WHITEHOUSE. And the same with respect to corporate fraud?

Ms. GLAVIN. Yes. In fact, we still have the standing Corporate Fraud Task Force, which met most recently with our newest member, Mr. Barofsky.

Senator WHITEHOUSE. Thank you.

Chairman LEAHY. Thank you.

Senator Grassley is back, and before I turn to him, I just want to note we have written testimony of the Inspector General for the Department of Housing and Urban Development, Kenneth Donohue. Inspector General Donohue warns also that key Federal programs such as the Housing and Economic Recovery Act, passed last year to help homebuyers to avoid foreclosure, are also at risk of being exploited by fraud. Ten years ago, his office had more than 130 investigators dedicated to housing fraud. The last administration made cuts, and now there are none dedicated to housing fraud. Again, I think most people are honest, but we know some people are not. And with the amount of money we are pouring out, we have got to have people who can investigate fraud and then prosecute people for fraud and try to recover assets.

I will put, without objection, Inspector General Donohue's whole statement in the record.

[The prepared statement of Mr. Donohue appears as a submission for the record.]

Chairman LEAHY. Senator Grassley, again, is a cosponsor of this legislation. We are glad to have you back. Please go ahead.

Senator GRASSLEY. Thank you, and once again thank you for allowing me to work with you on that bill, and particularly the part that you put in about the False Claims Act.

I am going to ask some questions to each of you, the first question at least for each of you. I have worked with whistleblowers a lot in my life in Congress. I consider them very courageous people. They bring forth a lot of valuable information. I think Enron in the private sector would be an example of it. This latest Madoff case of Wall Street would be another example.

Usually, whistleblowers have a rough time, whether it is in the private sector or in the public sector. They are about as welcome in an organization as skunks are at a picnic. So I believe that as more Government money is pumped into the system, be it housing, financial institutions, any private business, we are going to have more whistleblowers come forth with information of fraud and abuse. So I want to ask both questions and have you answer each of them.

How do you envision working with whistleblowers that come forward with good-faith allegations of fraud and abuse of taxpayers' money? And will you work cooperatively with whistleblowers and their counsel, if they have it, to ensure that they are protected from retaliation consistent with Federal law? Whoever wants to start out, I would like to have each of you give short answers, because I have two more questions I want to ask.

Mr. PISTOLE. I will start off, Senator. Obviously, anybody who has credible information that can help either predicate or enhance

an investigation, we look forward to working with, and their counsel, so no issues there from our perspective.

Mr. BAROFSKY. Senator Grassley, first of all, I just want to thank you for your continued support of our office. Its creation and continued support have been invaluable. And whistleblowers are obviously one of the most important things we have for finding cases in the TARP. Our website is up and running. It has a link for whistleblowers to lodge complaints. We have a telephone number, toll-free, 877–SIG–2009. We are going to promote that with training and awareness programs to encourage whistleblowers to reach out to us with any information they have on any TARP program, whether they are within Government or without. And we are 100 percent committed to protecting whistleblowers. The IG Act makes it very clear that any whistleblower's information will remain confidential, but there are other certain circumstances where—there may be some circumstances where it has to be disclosed. But we will work vigilantly to protect the identity of whistleblowers to the extent they seek that protection. And we will make sure that they are not retaliated against.

Ms. GLAVIN. Senator, as you know, the Department has enjoyed tremendous success in working with whistleblowers under the False Claims Act. We have obtained approximately $10 billion in the past 8 years under the qui tam statute, and we have paid whistleblowers, who are also called relaters, a substantial amount of those recoveries—$1.6 billion in rewards under the statute for their laudable efforts.

The Department believes that whistleblowers, often insiders, can serve a vital function in our law enforcement efforts in exposing potential fraud in connection with Government programs, and we expect that we are going to see some of that with the TARP, and whistleblowers will be treated the same way for their laudable efforts that the Department has historically treated them and have had a successful relationship.

Senator GRASSLEY. OK. Thank you.

Now, Mr. Barofsky, as you know, the bailouts of Bear Stearns and AIG took place outside of the TARP. In fact, they were orchestrated through special purpose vehicles, which in these cases were limited to liability companies Maiden Lane, Maiden Lane II, and Maiden Lane III. Secretary Geithner announced yesterday that the revised approach for dissemination of TARP funds includes the use of Financial Stability Trusts as well as Public-Private Investment Funds. That may sound like Bear Stearns. I have this concern about the use of such vehicles because they seem to result in less transparency. Enron used an SPV to hide many of its assets. While my Finance Committee staff still has some documents to review from the AIG and Bear Stearns bailouts, much of the information is not public. I think it makes sense to fold oversight of the Bear Stearns and AIG bailouts into your office.

Do you have any thoughts or concerns about taking on that responsibility? Do you believe that all special purpose vehicles, including those that the Treasury Secretary may implement, should be subject to the same filing and disclosure requirements of SEC companies? And, last, what other ways do you propose to bring

transparency to Maiden Lane SPVs and similar things that taxpayers' money simply is not part?

Mr. BAROFSKY. We will, of course, follow the lead of Congress in our jurisdiction of the coverage of areas. Obviously, right now under the existing statute, we are limited to TARP-related—tracing basically TARP-related funds. If this Congress wants us to look into and have jurisdiction over other areas, we will follow this Congress' lead, of course.

With regard to the special purpose vehicles and transparency, I think that is a very serious concern. We addressed it just yesterday. We have initiated discussions with both the Federal Reserve and with Treasury to get a handle on what their plans are for transparency on the SPV with the TALF program, which are announced now may be as large as a $1 trillion program. And we look forward to having those discussions, and we are going to make recommendations based on once we have a better sense of exactly what their plans are.

A lot of these programs are still works under construction, and we plan on having a role in giving recommendations in their formation, as we have to date.

Senator GRASSLEY. Could I put the rest of my questions——

Chairman LEAHY. You can continue if you want. If the Senator from Iowa needs additional time, feel free.

Senator GRASSLEY. Then I might ask one more question. But by unanimous consent may I have exhibits put in?

Chairman LEAHY. Without objection.

[The exhibits appears as a submission for the record.]

Senator GRASSLEY. Okay. Then this will be my last question.

To Mr. Pistole, resources at the FBI have been reallocated as a core mission of FBI shifting its focus to counterterrorism. At the same time, we have had a dramatic increase in the amount of Federal Government resources into the private sector to shore up financial institutions, private businesses, and other Government-sponsored enterprises. Given these significant outlays of Federal taxpayer dollars, it would seem wise to make sure that adequate resources are available to investigate fraud. However, the FBI cannot simply let up on counterterrorism.

Now, I am not known around here to be one to simply, you know, hand out money, but it seems to me that if we do not address this head on, we will have a hard time chasing taxpayers' money.

Two questions, and then answer both of them at the same time. If Congress decides that the FBI needs more resources and agrees to fund them, what sort of controls can we expect to prevent the FBI from simply retasking those agents to different areas once they get the money? Would you adhere to any restrictions on the use of funding by Congress? I guess that is two questions, so then one more. If Congress does provide additional funding, will you pledge to comply with any reporting requirements that we include with those resources?

Mr. PISTOLE. Senator, we currently have in place similar situations, for example, on our health care fraud investigators and in our Organized Crime and Drug Enforcement Task Force, OCDETF investigators, reimbursable positions that have much greater accountability and oversight than the other positions. But in response

to your two-part first question, absolutely if we are given additional resources to apply to the mortgage fraud problem, that is what we would put them on. We need the bodies there. It is a huge problem that we look forward to addressing as robustly and as aggressively as we can. The 240 agents working now are working very hard, and we have actually looked at our national security resources to see can we incrementally move some of those over without jeopardizing national security.

So we are doing a complete scrub of all available resources to make sure that we are putting those resources where they are needed.

Senator GRASSLEY. Thank you, Mr. Chairman, for your kindness.

Chairman LEAHY. Thank you very much, and, of course——

Senator GRASSLEY. And also a letter, we have something that Senator Specter asked us to put in, too.

Chairman LEAHY. And I will keep the record open for anything that any member wishes to add to the record.

[The letter appears as a submission for the record.]

Chairman LEAHY. Senator Kaufman.

Senator KAUFMAN. Ms. Glavin, in those areas of finance that have gone unregulated, like derivatives and hedge funds, can you talk about how that makes trying to prosecute fraud cases more difficult?

Ms. GLAVIN. Well, one of the—it does and it does not. In the areas that have gone unregulated, we still have at our disposal the same tools we have always had in fraud cases—mail fraud, wire fraud. You tell a lie to get money and you use the mails or the wires to do it, we can prosecute you.

So, to the extent that some areas of the financial industry have gone unregulated, it does not mean that we cannot prosecute them, and it does not mean that we do not, you know, have the same tools at our disposal. We are still going to use, you know, the basics—you know, we can use wiretaps. We can use grand jury subpoenas. We still have all of our investigative tools at our disposal.

And so I do not think that we are particularly hindered just because it is unregulated. I think the unregulated aspect to it could make it more ripe for fraud and heavier use of our statutes. But I think we can still go after those sectors.

Senator KAUFMAN. All right. Mr. Barofsky, what are some of the telltale signs on Wall Street—now we are talking about financial fraud here—that fraud has been committed? In your old days a prosecutor now, what kind of things do you look at that just scream out that something has gone wrong here?

Mr. BAROFSKY. Restatements are always good to see, any type of audit qualified opinions, you know, relying on auditors. Jumps and shifts that are unexplained or do not make sense. You know, for insider trading, there is a whole bunch of tell tales that we look for.

The list is a long one, and we are going to be looking at those very closely, especially with respect to potential frauds in procuring TARP funds from financial institutions.

Senator KAUFMAN. Mr. Pistole, can you kind of go through—clearly, there is going to have to be some training done here for FBI agents. Can you talk a little bit about how that is going to

happen—you are talking about a rather massive scale up—how that would happen and what kind of funds are going to be required for that?

Mr. PISTOLE. Yes, Senator. There are two aspects to that: the training of our current employees who are both the agents and financial and intelligence analysts who are investigating those. Again, many of those have the experience from the Enron type, or other investigations, in terms of the complex corporate fraud. And it is as much a practical issue that my colleagues Neil and Rita know about in terms of trying to take a very complex financial fraud and then making it presentable to a jury in a way that it makes sense. So that is just one of the practical challenges.

The other aspect is the training of new agents and analysts who we are hiring. We actually have a fairly targeted recruiting effort trying to identify those people with the financial skills backgrounds that could be beneficial. Obviously, that is a longer-term proposal, but we look forward, believing this is going to be a long-term process for us, to having those people on board, whether 6 months, 9 months, a year from now, to complement those with the current experience. So it is really that twofold process.

Senator KAUFMAN. Ms. Glavin, you start—at least I am starting to hear the old story, look, there are a few bad apples on Wall Street that did this, and, you know, they are just bad people, and, you know, why go to criminal investigations because it really is not a deterrent for these kind of folks. Could you just talk about that a little bit, how you see criminal investigations and criminal prosecutions as deterrent to the kind of folks that behaved in the bad behavior in the recent financial crisis?

Ms. GLAVIN. I think that you can see historically through some of the prosecutions that have happened in corporate fraud over the last 10 years. Adelphia, you saw the people running the company were convicted after embezzling money from the company. It makes your corporate heads aware that they are responsible and that they cannot use money for their personal use. I think you saw with the Bernie Ebbers/WorldCom prosecution, that had an incredible deterrent effect on what CEOs do with money, what they are supposed to know about what they do with their money. And so criminal law enforcement, it is—a few bad apples, I cannot really speak to that. What I can say is historically when corporate leaders have been prosecuted, such as you saw with Skilling and Lay in Enron, it makes a difference and you see the way corporations operate, how they structure themselves, and how the boards want to pay more attention to what is going on in the company. It is effective because when you have a corporate head who is stealing or lying to the stockholders or participating in falsification of accounting records or reports to the SEC, the stockholders get victimized. And when it is prosecuted criminally, that is what makes a real difference, and that is what can make changes. And I think changes were already made because of some of those prosecutions.

Senator KAUFMAN. Thank you. You three have a real challenge in front of you. I am glad you are doing this. Thanks.

Chairman LEAHY. Thank you.

Senator Klobuchar.

Senator KLOBUCHAR. Thank you, Mr. Chairman.

Do you say your name "Gla-vin" or "Glay-vin"? Sheldon and I were having a senatorial debate over this fact.

Ms. GLAVIN. It is "Glay-vin."

Senator KLOBUCHAR. Okay, good. I completely agree with what you have been saying. I saw it in our own cases. We once prosecuted nine pilots for not paying their taxes, and the Minnesota Revenue Department got millions of extra dollars in because people saw it in the news and they got very worried. And I think it has a positive effect going forward, but a deterrent effect. And one of the things that I am concerned about is that there has not been enough of this, some legitimately because of the transfer of resources over, and some because some of the regulatory agencies having basically been asleep at the wheel. And what comes to, I think, everyone's mind when they think about this is the Madoff case and how this could have happened when a whistleblower came forward. And while I do not expect you to go into the details of that, if you could just give some of your impressions of how that could have gone wrong, why that happened, and how we could not have that happen again?

Ms. GLAVIN. I cannot really speak to all the particulars of the Madoff case because I am not in the weeds on that. What I can say is that I think what we may be starting to see is that as the economy went south, you see these sort of Ponzi schemes that were able to go along for a little while, and then all of a sudden, you know, there is a rush by the victims of the schemes who do not know they are victims yet. And then the money is not there when they go to get the money out.

Just last week, our Fraud Section in the District of Minnesota——

Senator KLOBUCHAR. That was so nice how you brought that up. Very, very smooth.

[Laughter.]

Senator KLOBUCHAR. Go on.

Ms. GLAVIN. It took down a Ponzi scheme involving commodities that were supposed to be pooled into a trading account, and the charges in that case alleged that they were not really pooled at all, they just ran off with the money.

So I think that for some of the frauds that we are going to see is that people are going to be exposed because they are going to need their money more now than when they invested, and then all of a sudden, that is going to expose that maybe some lies were told to them to get the money in the first place or that the money just is not there and was misused.

Senator KLOBUCHAR. That is why I used that quote at the beginning. They discover it when the times are bad.

Mr. Barofsky, any thoughts on the Madoff case, and just your impressions of it and, I am sure, your frustrations when you found out what happened.

Mr. BAROFSKY. Well, I am certainly proud of my former district for prosecuting the case. But I think the lesson is that—you know, we just started our hotline, and we are dealing with whistleblowers. But I think everyone is going to pay very, very careful attention to whistleblowers and tips, and I think that will be the one positive result of everything that happened with Madoff, is I think

everyone will necessarily take a very careful—pay careful attention. And we are considering—as we are designing our hotline program, one of the things that I have done is I have hired a lawyer to be in charge of all things related to the hotline and review every single case, and we are going to have senior executive review, because we do not want to miss the next——

Senator KLOBUCHAR. Sometimes don't people get overwhelmed with these tips? I mean, we saw that after 9/11. There were, you know, many sightings of Osama bin Laden at the Mall of America in Minnesota and things like that. Sometimes you get overwhelmed with these tips, and how are you going to handle that?

Mr. BAROFSKY. We are dedicating a significant portion of our modest resources to dealing with the hotline because we do think it is so important and it is such a potential area for significant investigations. But I think that really is the answer, that we are going to have to take some of our precious resources, which we have already done, and address this, because even if there is—you know, if there are 99 that are not necessarily valid tips, we do not want to miss that one.

Senator KLOBUCHAR. And one last thing. I think both of you referenced the experience after the hurricanes and some of the prosecutions, that you were ready to go and did that. Are there things you learned from that that will be helpful with this big influx for the TARP funds and the stimulus funds?

Mr. BAROFSKY. I think what we are trying to do is get out in front as much as we can. One of the areas of our focus as an office in our oversight function is trying to make the right recommendations for funds before they go out the door, because I think that is going to make fraud prevention easier. It is going to raise deterrent levels. Obviously, we did not come into existence until most of the first tranche was committed or out the door, but we have had an impact on how the money since we have been there has gone out and some of the more significant programs, the Citigroup and Bank of America and the auto industry, and I look forward to working with Treasury to put the right conditions and fraud prevention into these programs before the money goes out the door.

Senator KLOBUCHAR. Thank you.

Ms. Glavin, do you want to add anything?

Ms. GLAVIN. The best response is what we want to do is coordination, coordination, coordination. You have got to have the law enforcement bodies working together and sharing information, and that is going to make the biggest impact. We have been doing that, and we are going to continue to do that.

Senator KLOBUCHAR. OK. Well, I just want to thank you as well, and I think these resources are going to be well spent. The public is crying out for accountability. This is a lot of money, and as Senator Kaufman said, you have a big job. But I know you are up to it, and we just have to be there to help you.

Thank you.

Chairman LEAHY. Thank you. Whatever other questions I have, I am going to place in the record, and we will leave the record open, as I mentioned, to all of you. We are trying to learn as much as possible, especially with this new legislation. If after you see the transcript of your testimony you think, "I should have added. . .,"

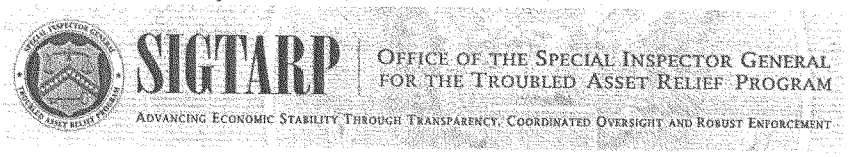
please feel free to do so. Or if you find any numbers in there that, as you look at it, on reflection you feel they are wrong, just note that so that it can be corrected. This is not a "gotcha" hearing. This is a hearing where we are trying to move a significant piece of legislation backed by Democrats and Republicans—a trend the Congress should return to. You do not have to respond to that. That is my own feeling.

So I thank you all very much, and we stand in recess.

[Whereupon, at 11:27 a.m., the Committee was adjourned.]

[Questions and answers and submissions follow.]

QUESTIONS AND ANSWERS



SENATE COMMITTTEE ON THE JUDICIARY

HEARING ON THE NEED FOR INCREASED FRAUD ENFORCEMENT IN THE WAKE OF THE ECONOMIC DOWNTURN

QUESTIONS FOR THE RECORD

NEIL BAROFSKY

SPECIAL INSPECTOR GENERAL
TROUBLED ASSET RELIEF PROGRAM

March 11, 2009

Questions for the Record from Senator Grassley

(1) Qui Tam Whistleblower Coordination:

The proactive law enforcement agency cooperation and coordination that is at the heart of our investigative strategy, is part of our efforts to establish an effective framework that will permit us to meet our oversight obligations with respect to the nearly $3 trillion at risk in the TARP programs. In this regard, we have begun our outreach to potential whistleblowers and those who may have tips about ongoing fraud, waste and abuse. As previously reported, the SIGTARP Hotline is operational and can be accessed through the SIGTARP website at www.SIGTARP.gov, and by telephone at (877) SIG-2009. Plans are being formulated to develop a fraud awareness program with the objective of informing potential whistleblowers of the many ways available to them to provide key information to SIGTARP.

Q: Have you spoken to the Department of Justice to establish a channel to discuss qui tam complaints that are filed and under review by the Department pending a decision to intervene?

A: Yes. My Investigations Division has met with the Director, Commercial Litigations, Department of Justice, the DOJ directorate responsible for handling qui tam matters, to establish a process for coordinating TARP related qui tam complaints, including complaints currently before DOJ as well as those received by my office or DOJ in the future. Discussions and coordination are ongoing.

Q: Have you discussed how you will cooperate with the FBI on investigating any major frauds that [have been] brought forth by qui tam relators?

A: As indicated above, we have aggressively reached out to several other law enforcement agencies, the FBI most notably, to ensure that where existing and future investigative interests intersect, that coordination occurs at the earliest possible time—this includes qui tam complaints and other potential major criminal and civil fraud allegations. In this regard, we have led the development of joint efforts with the FBI, U.S. Attorneys Offices, the Securities and Exchange Commission and several Inspector General Offices. This includes initiating the Assistant Inspectors General for Investigations TARP Working Group, under the TARP Inspector General Council (TARP-IGC), which I founded and chair. As I have previously reported, the TARP-IGC was created in order to facilitate SIGTARP's coordination role while creating a forum amongst those IGs with a potential oversight role, to meet and discuss issues of common interest, exchange ideas with respect to robust TARP oversight, and to coordinate joint oversight efforts. Additionally, my Deputy Special Inspector General for Investigations participates in the Department of Justice's Mortgage Fraud, Bank Fraud and Securities Fraud Working Groups, where areas of mutual investigative interest are shared and developed.

Q: How do you plan to coordinate with DOJ and FBI on investigations initiated by whistleblower complaints?

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A: In addition to the activities described above, SIGTARP has been afforded responsibilities and authorities under the Inspector General Act of 1978, as amended. As such, the SIGTARP Investigations Division is subject to requirements set forth in the current Attorney General Guidelines for Offices of Inspector General with Statutory Law Enforcement Authority, dated December 2003. These guidelines require Offices of Inspector General and the FBI to notify one another of the opening of mutual-interest fraud investigations within 30 days; this includes those initiated from qui tam relators. SIGTARP Investigations Division policies and procedures embrace these requirements. Along the lines of efficient coordination between DOJ, FBI and SIGTARP on whistleblower and other fraud complaints, SIGTARP has welcomed an FBI special agent on detail to its Investigations Division, working side-by-side with SIGTARP special agents on matters of mutual investigative interest. Open and current ongoing communications between SIGATRP Investigations Division staff and DOJ are designed to ensure that qui tam relator complaints are shared in a timely fashion.

(2) Asset Management Issues at Treasury:

Q: The first report you issued earlier this month highlighted several concerns at the Treasury Department. One of the areas of concerns was the fact that Treasury had not fully developed programs to address asset management. Specifically, the report stated:

"To date, Treasury has not fully developed significant policies or controls with respect to asset management issues. Although this is understandable—in light of the urgency associated with standing up TARP, the fact that no asset managers have yet been retained, and given that Treasury's focus has been on the purchase of preferred stock and warrants rather than on specific troubled assets—Treasury needs, in the near term, to begin developing a more complete strategy on what to do with the very substantial portfolio that it now manages on behalf of the American people."

- Given the lack of a clear baseline or starting point for purchased assets, do you believe the lack of asset management controls at Treasury will hinder your current or future investigative efforts to determine waste, fraud and abuse of TARP dollars?
- Do you see a role for SIGTARP in the development of the Treasury's asset management program? Do you think direct oversight of the Treasury's asset management program is necessary at this time? If so, why?

A: The more baseline data that is available, the better able we will be to monitor and track changes that occur over time. Over the long term, a failure by Treasury to address asset management and valuation issues would hamper SIGTARP's oversight mission because it would make it more difficult to assess whether Treasury is effectively managing the taxpayers' investments. As the assets purchased thus far are intended to be held for a considerable time, this situation has not caused significant problems for SIGTARP's oversight mission to date. For the moment, being able to comment on and influence the oversight provisions in program

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documentation is probably of greater importance, and provisions giving access to SIGTARP and other oversight bodies have been included in recent agreements at our suggestion. We will continue to monitor the asset management and valuation issues and will report if Treasury does not make steady progress on this front.

SIGTARP's independence is essential to our being able to perform our role effectively. Accordingly, we must avoid being a part of program management decision-making. However, we do believe that we have an important role to play in observing program development, making recommendations to Treasury regarding the implementation of programs concerning fraud, waste and abuse, and as well as subsequently reviewing and testing the effectiveness of program implementation. To the extent we are fully briefed on programs as they are being developed and have access to program officials, that certainly facilitates our ability to provide timely and objective insights into certain steps that might be beneficial to prevent fraud, waste, and abuse.

(3) Term Asset-backed Securities Loan Facility (TALF)

Q: Your report also identified serious problems after an initial review of the proposed Term Asset-backed Securities Loan Facility (TALF) program which allows participants to receive loans upon posting of certain asset-backed securities (ABS) as collateral. Under the proposed guidelines, TALF participants can abruptly end their relationship with the Treasury by forfeiting the collateral to the government. As you pointed out, this is a real problem when private-sector parties overstate or over-promise asset values to the government. In this scenario, the government (and taxpayers) would be left with tons of worthless collateral assets without recourse.

> Your office has made some recommendations to Treasury regarding the TARP program, including a recommendation to follow certain minimum underwriting standards. However, I am concerned that these changes may not be implemented in a timely manner.
>
> - How receptive were Treasury and the Federal Reserve to your recommendations regarding TALF? Will Treasury coordinate with SIGTARP on the implementation for this program?
> - The Federal Reserve has indicated that it does not have the resources to follow-up on TALF compliance. The TARP funds could easily find their way to TALF participants potentially exposing taxpayer dollars to significant liability. Do you see a way that SIGTARP could go about monitoring compliance in TALF participants?

A: As your question notes, we have made a number of recommendations to Treasury regarding the TALF program—with an emphasis on measures that might be taken to reduce fraud vulnerabilities. Those recommendations were outlined in our February 6, 2009, report to the Congress. Following issuance of that report, we were contacted by senior officials of the Federal

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Reserve Bank of New York, whose office is primarily responsible for operating this program, and we have had a number of discussions with them regarding the establishment of anti-fraud provisions into the TALF. The program, as was announced in more detail last week, includes enhanced anti-fraud provisions and represents a significant improvement from the program as originally announced, including collateral and lender screening.

Nonetheless, oversight of this program will be important to assess how those measures are implemented and how effective they are in guarding against vulnerabilities to fraud, waste, and abuse. SIGTARP and the Inspector General for the Federal Reserve have already discussed a number of aspects of such oversight, and SIGTARP has established a TALF Task Force comprised of members of various agencies who will combine a shared expertise in securities fraud investigations and that will maximize member agencies' resources to identify and cut off potential fraud schemes before they can fully develop, deter would be criminals, and bring to justice those who seek to commit fraud through the TALF. We have been assured by Federal Reserve officials that they will work with us, upon request, to gain needed access to the program to carry out effective oversight.

(4) Major Fraud Statute Amendments:

Q: As the Inspector General overseeing the TARP and other recovery programs do you think an express statement in the criminal law would be helpful in both prosecuting those who defraud the Government and in deterrent impact? Why of why not?

Q: Do you feel that any other changes are necessary to the criminal law to help protect the TARP funds?

A: I believe that the current federal fraud laws give us the necessary tools to investigate and prosecute frauds related to the TARP programs. The current federal statutes pertaining to securities fraud, wire fraud, mail fraud, false statements, theft of government funds, public corruption and others all appear to encompass fully the range of TARP-related crimes. Regarding other legislation that would change the criminal laws, at this time I have not identified such a need. However, I have been only on the job for approximately 90 days, and I will not hesitate to let you know if we discover a gap in the criminal laws.

(5) Loan Modification Programs

Q: According to recent press reports and Secretary Geithner's announcement yesterday, the Treasury plans to implement a robust loan modification program in hopes of stemming the tide of foreclosures across the country. From all accounts, the Treasury will be employing an off-the-shelf computer program that can evaluate and write some 500,000 mortgages per month.

> My staff has spoken with mortgage fraud experts across the industry, and the only consensus is that fraud is pervasive—some estimate fraud in up to 50% of mortgage

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loans. I am extremely concerned that fraudsters and other opportunities don't benefit from government's taxpayer-funded recovery efforts.

- What input have you had, to date, regarding Treasury's loan modification plans?
- What provisions must a loan modification program include in order to sufficiently prevent and detect fraud?
- In order to fully diagnose fraud, you and your team must have access to third-party documents, including originating loan documents and the servicing documents. Will you push to ensure such access is included as part of a borrower's participating in the program?

A: Based on my own background as a mortgage fraud prosecutor and upon my discussions with the subject matter experts at the FBI, I have had made several recommendations to Treasury regarding its loan modification plans, and Treasury has informed us that it intends to continue to solicit our input as the anti-fraud and compliance terms for the program are developed. Among the suggestions I have made: (1) requiring specific steps to verify through third parties the income and employment of applicants; (2) ensuring independent third-party verification that an applicant is in fact occupying the mortgaged residence; (3) ensuring a well-documented process that would include (a) closing warning sheets that require signature/notary/thumbprint of each participant, (b) collecting and retaining identification documents, and (c) warnings regarding incentive payments/fees to make sure that servicers are not charging hidden fees. We have also made recommendations concerning the incentive payments to servicers (such as their timing), public outreach to educate homeowners about the risks of fraud, and document retention.

We anticipate that we will be given full access to available third-party documents in conducting oversight of this program.

SIGTARP is in discussions with HUD-OIG, the FBI and other relevant law enforcement entities to explore how best to respond to the significant law enforcement challenges that the mortgage modification program poses.

(6) FDIC Loan Modification Programs:

Q: Do you agree to work with FDIC Inspector General Rymer to minimize the potential for opportunities and fraudsters from benefiting from such a taxpayer-funded program?

A: Yes. FDIC Inspector General Rymer is an active member of the TARP-IG Council and we have been and will continue to work with one another to protect taxpayers in all TARP-related programs.

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Question for the Record from Senator Kaufman

Q: Mr. Barofsky, what role if any should a robust "third party" forensic audit function play to prevent fraud and verify with specificity the accuracy of the information that TARP recipients are required to provide?

A: As a former prosecutor, I have great appreciation for the importance of giving independent and focused "forensic" audit attention to areas most vulnerable to fraud, waste, and abuse so as to assess the accuracy and completeness of information being provided to meet specific legal requirements of TARP agreements. In the context of our coordination with other civil and criminal law enforcement agencies, forensic auditing will likely play a significant role in our investigations. Further, the Federal Reserve has included a requirement in the TALF program to require third party testing of assets by independent accountants and is requiring those accountants to report any fraud that is discovered to the Federal Reserve and to SIGTARP. Through our hotline and other outreach efforts, we are also encouraging auditors and others that detect fraud in TARP related programs to notify us so that we may investigate any and all allegations of fraud, waste or abuse.

SIGTARP Hotline

If you are aware of fraud, waste, abuse, mismanagement or misrepresentations affiliated with the Troubled Asset Relief Program, please contact the SIGTARP Hotline.

By Online Form: *www.SIGTARP.gov*

By Phone: Call toll free: (877) SIG-2009

By Fax: (202) 622-4559

By Mail:

Hotline
Office of the Special Inspector General
For The Troubled Asset Relief Program
1500 Pennsylvania Ave., NW, Suite 1064
Washington, D.C. 20220

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U.S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

March 13, 2009

The Honorable Patrick J. Leahy
Chairman
Committee on the Judiciary
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

Please find enclosed a response to questions arising from the appearance of Acting Assistant Attorney General Rita Glavin before the Committee on February 11, 2009, at a hearing entitled "The Need for Increased Fraud Enforcement in the Wake of the Economic Downturn".

We hope that this information is of assistance to the Committee. Please do not hesitate to call upon us if we may be of additional assistance. The Office of Management and Budget has advised us that from the perspective of the Administration's program, there is no objection to submission of this letter.

Sincerely,

M. Faith Burton

M. Faith Burton
Acting Assistant Attorney General

cc: The Honorable Arlen Specter
Ranking Minority Member

"The Need for Increased Fraud Enforcement in the Wake of the Economic Downturn"

February 11, 2009

Questions for the Hearing Record
for
Rita Glavin
Acting Assistant Attorney General
Criminal Division
United States Department of Justice

QUESTIONS FOR THE RECORD FROM SENATOR GRASSLEY

1. Financial Crimes Enforcement and Prosecution:

Enforcement of financial crimes can often be lengthy and difficult because of the complex subject matter, complex nature of financial transactions, and sophisticated individuals conducting the fraud. These investigations also have a significant cost in resources that are required to conduct these investigations and prosecutions.

- **Does the Department of Justice need additional resources to conduct prosecutions of financial crimes? If so, what sort of resources are necessary? Would that include both Civil and Criminal Divisions?**

RESPONSE:

As I said during my testimony, our nation faces an unprecedented financial crisis, which requires a strategic response to prosecute those responsible for abusing the financial markets, to deter similar conduct in the future, and to prevent fraud and abuse relating to funds that have been and will be disbursed to help improve the current situation. The Department has a critical role to play. Federal prosecutors, including those in the United States Attorneys' Offices, and in the Criminal, Civil and Tax Divisions of the Department, will face an unprecedented demand on their prosecutorial resources. To meet these demands and to effectively prosecute the crimes that have come to light as a result of the financial crisis, the Department requires a concomitant increase in resources.

Additionally, the Department anticipates an increase in False Claims Act cases relating to financial fraud. The Department has recently obtained recoveries in a number of cases involving participants in the mortgage industry. These cases include a $10.7 million settlement with RBC Mortgage Company to resolve allegations that it sought FHA insurance for hundreds of ineligible loans, and judgments in two cases, totaling $7.2 million, against a California real estate investor and a Chicago-based mortgage company for defrauding HUD's direct endorsement program. Additionally, Congress has made available $50 million to the Special Inspector General for Troubled Assets Relief

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Program (SIGTARP) to audit and investigate disbursements under the TARP program. It has been the Department's experience that when IG resources are augmented it translates into additional referrals to the Department. An increase in financial fraud cases will place additional resource demands on the Civil and Criminal Division's attorneys and support personnel and the United States Attorney's offices.

We commend Chairman Leahy and Ranking Member Grassley on the introduction of the "Fraud Enforcement and Recovery Act" and support its provisions. If Congress appropriates additional resources for the purposes of prosecuting financial crimes, we will continue to utilize the appropriated resources as efficiently and effectively as possible to hold criminals accountable for their actions and to recover funds that otherwise may be lost.

- **If Congress decides to provide additional funds, will you pledge to adhere to any constraints placed upon the funding to ensure that they are used for the intended purpose?**

RESPONSE:

As noted above, we are committed to making the best use of whatever resources are provided. If the allocations are designed to investigate and prosecute financial frauds, then we will ensure that the funds are dedicated for that purpose. We are committed to being good stewards of the taxpayers' money.

- **Has the Department determined if it will use a financial crimes taskforces similar to the Enron task force for enforcing potential violations of law by TARP recipients? Why or why not?**

RESPONSE:

The Department is reviewing a number of options on how best to fight financial frauds and crimes, with an eye toward ensuring that we use our limited resources in the most efficient manner to prosecute violations of law by TARP recipients. Task forces are among the options under consideration.

2. False Claims Act:

On November 17, 2008, I wrote a letter to then-Attorney General Mukasey and then-Treasury Secretary Paulson discussing the impact the False Claims Act may have on recovering any Government money expended by the TARP. Mr. Chairman, I'd like unanimous consent to make this letter part of the record.

In this letter, I pointed out the various types of FCA liability courts have found for fraud against the Government that could be applicable to any cases brought to recover TARP Funds. I just received a response to my letter last

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evening, but I want to make sure that DOJ is aware of potential applications of the FCA to TARP funds and other recovery programs.

- **Has the Justice Department considered civil actions under the False Claims Act as a possible avenue to recovery any TARP or other recovery dollars lost to fraud or abuse?**

RESPONSE:

The Department is committed to using the False Claims Act to pursue all efforts to defraud the United States, including the submission of false claims by the recipients of TARP funds. It is important that these funds be used for their intended purposes, and the False Claims Act is an important tool for holding accountable those who would misuse these funds.

The Department is coordinating with the Special Inspector General for TARP (SIGTARP) to ensure the referral of potential False Claims Act cases, and to provide appropriate advice and training with respect to such cases. The Department also believes that whistleblowers have an important role to play in identifying TARP related fraud, and fully supports the use of the False Claims Act's *qui tam* provisions to help root out fraud on the TARP program.

- **In your written testimony, you noted that the Department supported some of the changes to the False Claims Act included in S.386—the Fraud Enforcement and Recovery Act. Specifically, your testimony noted that the Department supported eliminating the "presentment" requirement that exists in the current version of the law. Additionally, you stated that the Committee should consider addressing the decision in *Allison Engine*. It is my understanding that this section includes a redrafting of the provisions that led to the decision in *Allison Engine*. What additional changes does the Department believe are necessary to fully address the problem caused by *Allison Engine*? What are the Department's additional concerns with the False Claims Act section as drafted in S.386?**

RESPONSE:

In our February 24, 2009 views letter and accompanying appendix, the Department provided certain additional suggestions for redressing the Supreme Court's decision in *Allison Engine*. Specifically, the Department proposed removing from paragraphs 3729(a)(2) and (a)(3) of the False Claims Act the "to get" language that the Supreme Court relied upon to read an intent requirement into these provisions. Additionally, the Department proposed revising paragraphs 3729(a)(2) and (a)(7) to require only a "material" connection between the defendant's use of a false statement or record, and the submission of an affirmative or reverse false claim, and also proposed adding a definition of the term "material". Finally, the Department recommended adding a separate provision at the end of section 3729(a) clarifying that liability does not require proof of the defendant's intent or purpose in submitting an affirmative or reverse false

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claim. We appreciate the Committee's willingness to incorporate some of these suggestions.

3. Money Laundering Proceeds

Last year, a plurality of the Supreme Court held in *United States v. Santos*, that the term "proceeds" in the anti-money laundering laws should be construed as "net profits" and not "gross receipts" of the criminal act. As a result, the Government must prove that any criminal, drug, or terrorist enterprise actually turned a profit to be convicted of a money laundering offense.

The Fraud Enforcement and Recovery Act that Senator Leahy and I introduced would correct this by carefully defining "proceeds" so that the Government isn't required to prove that a criminal enterprise was profitable to obtain a conviction.

- **Do you believe that the *Santos* decision hindered the effective prosecution of money laundering, and, could lead to preposterous results—as Justice Alito said in his dissent?**

RESPONSE:

We believe that the *Santos* decision has made it more difficult to bring money laundering cases. For example, in light of *Santos*, one court has held that a criminal's use of the proceeds of sex trafficking to pay expenses of a prostitution scheme does not constitute money laundering. In another case, the *Santos* decision compelled a court to conclude that the use of Medicare fraud proceeds to pay the expenses of a corrupt dentist's practice did not constitute money laundering. Such decisions have had a significant effect on the Department's ability to bring money laundering prosecutions.

We support the enactment of FERA so the Department will be able to target all those who launder money.

4. TARP Funds and Criminal Prosecution:

It appears that the early $300 billion in TARP funds was distributed quickly and without safeguards so that the Treasury could address the volatility in the financial markets. According to the first SIGTARP report, the Treasury's valuation methodology may have exposed the government to be over-charged for certain preferred shares or warrants.

- **Do you anticipate that the Justice Department will have difficulty in enforcing criminal or civil penalties if it is determined that there was intent on the part of an individual or financial institution to defraud**

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the Government based upon weaknesses in the TARP? Why or why not?

RESPONSE:

We have been working closely with the SIGTARP to determine whether there has been any wrongdoing committed by recipients of TARP funding. My staff and I have met with the SIGTARP and will continue to closely coordinate with the SIGTARP, as well as with the Federal Bureau of Investigation and all of our other law enforcement partners.

The False Claims Act imposes liability on any person who submits a false or fraudulent claim for payment to the United States. The Act has been interpreted to include attempts fraudulently to induce the United States to pay money to which the claimant is not entitled. Accordingly, although the Department would need carefully to consider the facts of each case, if a TARP recipient obtained funds by misstating certain assets, or otherwise deceiving the United States about the recipient's entitlement to those funds, then the recipient potentially would be liable under the False Claims Act.

In addition, we will review and evaluate all referrals for potential criminal prosecution carefully, in order to determine whether there was any wrongdoing and whether a particular case merits prosecution based upon the facts and circumstances. I do not anticipate any obstacles or difficulties with respect to enforcement efforts where intent to defraud can be demonstrated by the evidence.

5. False Statements and Appraisals:

According to the FinCEN reports, false statements are the second most likely type of suspicious activity reported with SARs for mortgage fraud. These statements include those designed to mask actual income and those made by false appraisals. Currently, the federal law that makes it a crime to make a false statement on loan and credit applications, does not apply to private mortgage lending businesses, even if they are issuing a federally backed loan. This creates a loophole where federally backed mortgages could be fraudulently obtained, without federal recourse against the criminal fraud.

- **Do you believe that amending the statute to include federally backed mortgages would help federal authorities prosecute future frauds against federally backed mortgages obtained by false statements or appraisals?**

RESPONSE:

Yes. The proposed modifications to Section 1014 of Title 18, U.S. Code, provided in the "Fraud Enforcement and Recovery Act" (sponsored by Chairman Leahy, Ranking Member Grassley, and other Senators) would enhance the Department's ability to prosecute those who make misrepresentations and defraud "mortgage lending

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businesses" and federally-related mortgage lenders. We therefore strongly support the modifications that have been proposed.

6. Mortgage Fraud Investigations by Secret Service:

At the hearing, you mentioned a recent case example of a mortgage fraud investigation that was jointly run by the FBI and Secret Service in Georgia. Based upon what we've heard in the past about agencies not cooperating, I was interested to learn of the coordination between the Secret Service and the FBI in investigating a major mortgage fraud. How did this case originate? Could you describe how the Secret Service and FBI jointly investigated this case? Did the FBI contact the Secret Service for assistance? What was the role of the FBI in this investigation? What was the Secret Service's role in the investigation? What is the current status of this case?

RESPONSE:

The case to which I referred in my testimony, *United States v. Cox*, began when the defendant was convicted in 2002 in the Middle District of Florida as a result of a mortgage fraud investigation by the FBI. The defendant subsequently violated the terms of his probation and in December 2003, an arrest warrant was issued for him.

About the same time, the United States Secret Service (USSS) had begun an investigation of the same defendant for additional mortgage fraud in Georgia, Florida, South Carolina, North Carolina, Alabama, Texas, and Tennessee, which the defendant was able to commit through his creative use of over 50 stolen identities. The defendant was indicted in the Northern District of Georgia for his mortgage fraud activities in Georgia, Florida and South Carolina. Thereafter, the USSS traced Cox through seven states and abroad until they arrested him in Nashville, Tennessee. A criminal information was filed in the Middle District of Tennessee. Following his re-arrest by the USSS, another criminal information was filed in the Middle District of Florida based on Florida mortgage frauds committed by the defendant after his first conviction.

Eventually, both the Middle District of Tennessee and Middle District of Florida cases were transferred to the Northern District of Georgia, where Cox entered guilty pleas to the charges from all three districts. The defendant was sentenced to over 26 years in prison on charges of mortgage fraud, identity theft, passport fraud, and violating terms of his probation in the original FBI case in the Middle District of Florida. In addition, his funds and properties are subject to forfeiture and restitution orders.

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U.S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

March 13, 2009

The Honorable Patrick J. Leahy
Chairman
Committee on the Judiciary
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

Please find enclosed a response to questions arising from the appearance of Federal Bureau of Investigation Deputy Director John Pistole before the Committee on February 11, 2009, at a hearing entitled "The Need for Increased Fraud Enforcement in the Wake of the Economic Downturn".

We hope that this information is of assistance to the Committee. Please do not hesitate to call upon us if we may be of additional assistance. The Office of Management and Budget has advised us that from the perspective of the Administration's program, there is no objection to submission of this letter.

Sincerely,

M. Faith Burton

M. Faith Burton
Acting Assistant Attorney General

cc: The Honorable Arlen Specter
Ranking Minority Member

"The Need for Increased Fraud Enforcement in the Wake of the Economic Downturn"

February 11, 2009

Questions for the Hearing Record
for
John Pistole
Deputy Director
Federal Bureau of Investigation
United States Department of Justice

QUESTIONS FOR THE RECORD FROM SENATOR GRASSLEY

1. Investigative Coordination with other Agencies:

I'm always concerned with "mission creep" at agencies and at the FBI I've often referred to it as a "Pac Man" mentality because the FBI has a way of gobbling up other agencies jurisdiction. Financial crimes have such a wide reach and can involve other agencies jurisdictions, be it narcotics smuggling, money laundering, tax evasion, or other federal crimes that fall into other agencies jurisdictions. These investigations could involve the Drug Enforcement Administration, Immigration and Customs Enforcement, or even the Internal Revenue Service.

- **Deputy Director Pistole, what efforts will the FBI make to ensure that investigations are coordinated among the various partner federal law enforcement agencies that share overlapping investigative jurisdiction with the FBI on financial crimes?**

RESPONSE:

The FBI strongly emphasizes and relies upon joint investigations in all of its substantive investigative programs. We coordinate and work closely with our Federal, state, local, and international partners to ensure the protection of our national security and to bring to justice those who violate our laws. In order to accomplish its mission of protecting the United States, the FBI is authorized to carry out a wide array of investigative and enforcement activities. Though the FBI's jurisdiction sometimes overlaps with that of other investigative agencies, there is no "Pac Man" mentality within the FBI, and "mission creep" is unlikely because the FBI investigates violations of only those laws we have been appropriately directed to enforce.

Soon after the attacks of 9/11/01, the FBI Director established the FBI's top 10 priorities, and there are articulated priorities within each of those 10 categories. Among the top 10 priorities is combating major white-collar crime, and the highest priority financial crime sub-program within that priority is corporate fraud. The FBI coordinates its corporate fraud investigations with the Securities and Exchange Commission and

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Department of Justice (DOJ). Money laundering violations are investigated by the FBI in conjunction with other Federal crimes, and these investigations are coordinated with the relevant United States Attorney's office. The FBI does not regard "narcotics smuggling" as a financial crime, and tax evasion is addressed by the Internal Revenue Service.

- **Do you believe that the current level of coordination is adequate to address the mission?**

RESPONSE:

The current level of coordination is adequate to address the mission.

- **Do you believe that special task forces should be created to address mortgage fraud and other sophisticated financial crimes the way that the Enron task force was created?**

RESPONSE:

The FBI currently hosts or participates in approximately 16 mortgage fraud task forces and 39 working groups addressing mortgage fraud schemes. In addition, the FBI is represented on the President's Corporate Fraud Task Force, one focus of which is mortgage fraud and securitization fraud.

- **What about using the Health Care Fraud and Abuse Task force model for financial crimes, would that be a viable option? Why or why not.**

RESPONSE:

The Health Care Fraud Strike Force has enjoyed great success and uses an intelligence-driven model to concentrate limited law enforcement resources on the most culpable perpetrators. It is currently used by the FBI, the Health and Human Services Office of the Inspector General, and DOJ's Criminal Division. This model draws upon real-time data and intelligence to permit the government to quickly focus on and target the most egregious criminal wrongdoers, thus yielding the greatest possible impact.

As noted above, the FBI currently hosts or participates in approximately 16 mortgage fraud task forces and 39 working groups addressing mortgage fraud schemes. Although these groups do not follow the exact model of the Health Care Strike Force, they have been very helpful to our enforcement efforts. The FBI will continue to work with DOJ's Criminal Division to ensure we are employing the most effective and efficient means of addressing mortgage fraud.

2. Financial Crime Investigations:

I showed this chart during my opening statement which outlines suspicious activity reports (SARs) filed by banks with FinCEN. According to FinCEN,

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many of these SARs include not only mortgage fraud, but also include other suspicious activity, such as identity theft, consumer loan fraud, commercial loan fraud, and money laundering. The list goes on and on.

These elaborate schemes appear to target not only lenders, but also future purchasers through flipping and other scams. I think what is often forgotten is that a lot of the fraud that occurs, hurts small businesses and the average homeowner too. It's not just all multi-national banks and large corporations that are hurt, but average Americans.

- **How does the FBI determine what priority is assigned to a specific financial crime investigations? For instance, does the FBI prioritize only the largest frauds, or is there an effort to send the message to low level criminals as well?**

RESPONSE:

While the FBI targets large-scale fraud schemes to have the maximum impact, the victims of these frauds are often small businesses and individual homeowners as you point out. The FBI currently seeks to address the most serious white-collar criminal offenders, disrupting and dismantling large-scale corporate frauds, mortgage frauds, and other financial frauds through intelligence-based targeting of the most damaging frauds, whether committed by individuals or by organized groups. Along with our Federal, state, and local partners, the FBI works to actively address the most serious white-collar criminal subjects threatening our citizens and financial institutions, and we participate in numerous task forces in furtherance of this goal. Through these task forces, and through numerous other less formal partnerships between the FBI and state and local law enforcement, the FBI and other Federal agencies are able to pass along information and to assist in coordinating cases appropriate for state level investigation and prosecution.

- **Is there any coordination between the FBI and state and local law enforcement to go after smaller crimes that may not rise up to the level of the FBI investigating? If not, do you think such cooperation is warranted?**

RESPONSE:

The FBI currently hosts or participates in approximately 16 mortgage fraud task forces and 39 working groups related to mortgage fraud. With representation from Federal, state, and local law enforcement organizations, these task forces are strategically placed in areas identified as high threat areas for mortgage fraud. The compositions of these task forces and working groups vary by location, but typically include representatives of the Department of Housing and Urban Development, the U.S. Postal Inspection Service, the Internal Revenue Service, the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN), and the Federal Deposit Insurance Corporation, as well as numerous state and local law enforcement officers. As discussed above, through these task forces, and through numerous other less formal partnerships between the FBI and state and local law enforcement, the FBI and other Federal agencies

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are able to pass along information and to assist in coordinating cases appropriate for state level investigation and prosecution. These partnerships also provide platforms for state and local law enforcement to pass along information appropriate for Federal investigation. Whether or not a particular case is ultimately worked jointly or separately, the proper communication channels are open and the appropriate information sharing is occurring on a routine basis.

3. Money Laundering and SUAs:

I'm a firm believer that one sure fire way to stop criminals, drug traffickers, and terrorists is to hit them where it hurts, their pocketbooks. To that end, I've been working to reform our federal money laundering laws for a number of years. I think that reform is necessary because what started as a statute that included only a relatively small number of predicate offenses known as "specified unlawful activities" has turned into a laundry list of statutes that every now and again is updated to add new offenses when we in Congress realize we forgot to add one.

Instead, I think a better approach is to simply make all federal felonies a predicate, because, after all, any criminal activity to hide proceeds is in fact money laundering. Further, there are a number of other fixes that are necessary.

- **Deputy Director Pistole, do you agree that a simplified approach to the definition of Specified Unlawful Activities is a good idea?**

RESPONSE:

The FBI supports simplifying the statutes that address "specified unlawful activities" (SUAs). Currently, money laundering charges can be predicated on over 170 listed SUAs, and that list is steadily growing as Congress adds new violations. The FBI would be pleased to work with the Department of Justice to provide the Administration's views of proposed legislation in this area.

- **What about you Assistant Director Glavin?**

RESPONSE:
FROM ACTING AAG RITA GLAVIN:

Although we believe that there is merit to your proposal to simplify the money laundering statutes by making all federal felonies money laundering predicates -- and we appreciate your strong support of the Department's efforts to bring prosecutions under the money laundering statutes -- we are concerned that adding this new provision could delay passage of this important bill. We look forward to continuing to work with you and your staff in the coming months regarding additional possible amendments to the money laundering statutes.

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SUBMISSIONS FOR THE RECORD

STATEMENT OF NEIL BAROFSKY

SPECIAL INSPECTOR GENERAL

TROUBLED ASSET RELIEF PROGRAM

BEFORE THE

UNITED STATES SENATE

COMMITTEE ON THE JUDICIARY

February 11, 2009

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Chairman Leahy, Ranking Member Specter, and Members of the Committee, it is an honor to appear before you today.

The Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") was created under the Emergency Economic Stabilization Act of 2008 ("EESA"). As was indicated in our initial report to Congress, which was delivered to each member of Congress earlier this week, nearly $300 billion has already been expended under TARP, and, yesterday, Secretary Geithner outlined his plans for how Treasury will spend the balance of the $700 billion approved by Congress. In addition to the six programs previously announced, Treasury has announced several new programs that will be implemented in the coming weeks, including aggressive efforts to deal with foreclosure mitigation, additional infusions of capital, and addressing the toxic assets that remain on many financial institutions' books. The total amount of Government money at risk in these programs as well as programs operated by the Federal Reserve, will total in the trillions. These huge investments of taxpayers money, made over a relatively short time period, will require close oversight and will invariably provide an incentive to those seeking to profit criminally.

As described in my report, responding to these challenges has been and will continue to be a focus of my Office. Of the four primary oversight bodies set forth in EESA, SIGTARP stands alone as the sole TARP oversight body charged with criminal law enforcement authority – as the cop on the beat. This is one of our most important functions.

Criminal cases will be housed in our Investigative Division, which currently includes a Deputy Special Inspector General, a Chief Attorney Investigator, and four special agents who have been detailed by the IRS and the FBI. We have additional agents in the pipeline and we look forward to staffing up aggressively in the coming weeks and months. Our Investigations Division will be built around teams of financial and corporate fraud investigators that include not only special agents, but also forensic

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analysts and attorney advisors, affording it a broad array of expertise and perspective in developing focused complex investigations.

As we expand we have focused on building essential relationships with other law enforcement and prosecutorial agencies. For example, I have joined the President's Corporate Fraud Task Force and have initiated coordinated planning efforts with the FBI, the Department of Justice, the Internal Revenue Service, and several U.S. Attorney's offices throughout the country to best utilize our collective investigative resources. Through the TARP-IG Council which I have formed and chair, we are also coordinating our efforts with the other Inspectors General who operate in areas relating to the TARP, including the Federal Reserve, FDIC, FHFA, SEC, HUD, Treasury and TIGTA. We have already opened several criminal investigations involving multiple jurisdictions, and we have teamed up with the SEC, providing assistance to them in shutting down a securities fraud scam in Tennessee that had reaped millions in ill gotten gains by illegally trading on the TARP name. We are also closely coordinating our executive compensation oversight efforts with the New York State Attorney General.

We have begun our outreach to potential whistleblowers and those who may have tips about ongoing waste, fraud and abuse. The SIGTARP Hotline is operational and can be accessed through the SIGTARP website at www.SIGTARP.gov, by telephone at (877) SIG-2009, as well as through email. Plans are being formulated to develop a "fraud awareness program" with the objective of informing potential whistleblowers of the many ways available to them to provide key information to SIGTARP on fraud, waste and abuse involving TARP operations and funds, and explaining how they will be protected. Training is being developed to instruct law enforcement at a variety of agencies to assist in the oversight of the TARP.

Among other initiatives in the works, we plan on the following:

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- Detailing SIGTARP investigators to existing and future multi-agency task force activities at select locations in order to maximize efficiency and achieve timely and substantial investigative results;

- Supporting joint criminal intelligence initiatives with the objective of proactively identifying potential areas of exploitation by those who would commit fraud against the TARP;

- Utilizing a flexible investigative model in order to achieve the most significant results, by employing a multidisciplinary team of experienced special agents, attorney advisors and analysts; and,

- Providing the necessary tools to the investigative team so that it can achieve program objectives in the most efficient and effective manner possible.

The proactive cooperation and coordination that is at the heart of our investigative strategy is resource intensive. Given the dollar amounts at stake, the increasing number of programs and recipients involved, and other large government programs coming on line simultaneously, there is no question that SIGTARP and its sister law enforcement agencies will face analytical and resource allocation challenges going forward. We cannot shoulder this burden alone. We must work closely with our law enforcement partners, particularly the FBI, the SEC and the federal prosecutors that will be prosecuting our cases. Based on my experience as an Assistant United States Attorney in the Southern District of New York from 2000 to 2008, where I prosecuted securities fraud cases and then founded SDNY's Mortgage Fraud Group, I saw, first hand, the understandable shift, since September 11, 2001, in law enforcement resources away from white collar criminal investigation to terrorism. We saw areas of coverage shrink and prosecutorial thresholds rise. The Department of Justice's recent shift of focus to mortgage fraud has left other areas of white collar crime underfunded and under prosecuted.

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Now, with $700 billion going out the door under TARP, additional hundreds of billions (if not trillions) of credit being provided through the Federal Reserve, and additional hundreds of billions through the proposed stimulus bill, we stand on the precipice of the largest infusion of Government funds over the shortest period of time in our Nation's history. Unfortunately, history teaches us that an outlay of so much money in such a short period of time will inevitably draw those seeking to profit criminally. One need not look further than the recent outlay for Hurricane relief, Iraq reconstruction, or the not-so-distant efforts of the RTC as important lessons. To fully address this potential criminal vulnerability, it is essential that the appropriate resources be dedicated to meet the challenges of deterring and prosecuting fraud in connection with these programs. As a taxpayer who is invested in these programs, as a former prosecutor who has a close up view of corporate greed, and, of course, in my current position, I applaud the efforts of this committee to introduce bipartisan legislation, such as the Chairman, Senator Grassley and Senator Kaufman's Fraud Enforcement Recovery Act and Senator Schumer and Senator Shelby's Safe Markets Act, that will help ensure that law enforcement has the necessary resources to meet the daunting challenges that lay ahead. Such measures will greatly assist us and our partners as we engage in this historic effort to deter and prosecute those who seek to criminally profit from a national crisis.

Chairman Leahy, Ranking Member Specter, and Members of the Committee, this concludes my statement and I would be happy to answer any questions you may have.

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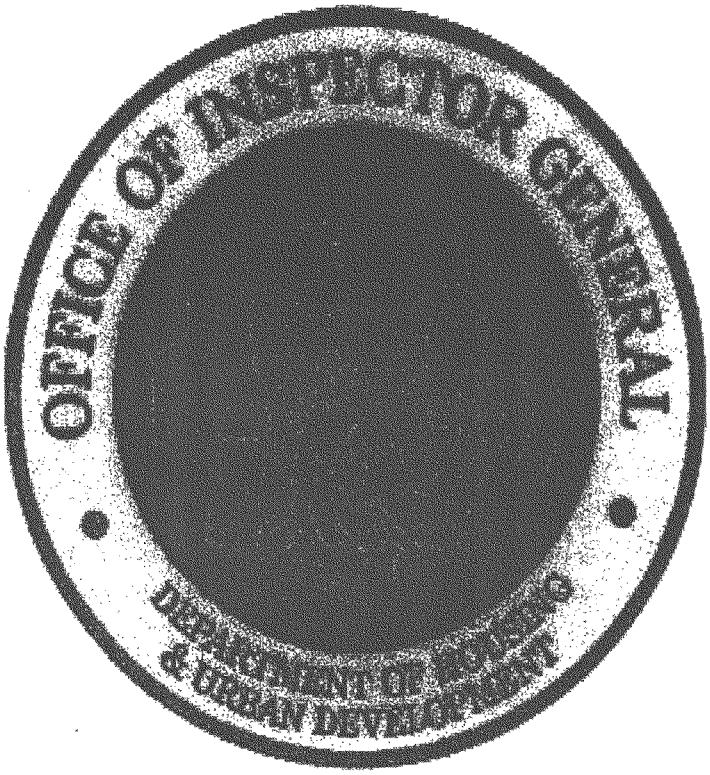

WRITTEN STATEMENT OF KENNETH M. DONOHUE

INSPECTOR GENERAL DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

BEFORE THE COMMITTEE ON JUDICIARY UNITED STATES SENATE FEBRUARY 11, 2009

SUBMITTED FOR THE RECORD

Chairman Leahy, Ranking Member Specter, and members of the Committee, thank you for inviting me to submit written testimony today. I very much appreciate the opportunity to make statements on the important issue of the need for increased fraud enforcement during this economic downturn.

Background

The U.S. Department of Housing and Urban Development (HUD) Inspector General is one of the original 12 Inspectors General authorized under the Inspector General Act of 1978. The OIG strives to make a difference in HUD's performance and accountability. The OIG is committed to its statutory mission of detecting and preventing fraud, waste, and abuse, and promoting the effectiveness and efficiency of government operations. While organizationally located within the Department, the OIG operates independently with separate budget authority. This independence allows for clear and objective reporting to the Secretary and to the Congress.

The Department's primary challenge is to find ways to improve housing and to expand opportunities for families seeking to improve their quality of life. HUD does this through a variety of housing and community development programs aimed at helping Americans nationwide obtain affordable housing. These programs, which include Federal Housing Administration (FHA) mortgage insurance for Single-Family and Multifamily properties, are funded through a $30+ billion annual budget and, in the case of FHA, through mortgage insurance premiums.

The last two years have seen enormous and damaging developments in the mortgage market: the dissolution of the subprime and Alt-A loan markets; dramatic drops in housing prices in most areas of the country; a concomitant rise in default and foreclosures; financial insecurity in the mortgage-backed securities markets represented by the government takeover of Fannie Mae and Freddie Mac; the collapse of credit markets; and, as a primary vehicle to address these issues, an urgent reliance on the FHA to bolster the mortgage market.

While there are other programs at HUD that are being utilized in a significant way to help stimulate the economy (i.e., billions of dollars in new funding to Community Development Block Grants, to increased Public Housing assistance, etc.) which are also vulnerable to fraudulent and abusive activities, I will focus this testimony on the salient issues facing the OIG from the FHA program due to the mortgage crisis and to an increased reliance on our Department to resolve foreclosure matters at this critical juncture. *The current degree of FHA predominance in the market is unparalleled.*

First off, to put the FHA issues into perspective, we have recently stated in testimony to the Congress that, through the multitude of our work in auditing and investigating many facets of the FHA programs over the course of many years, we have had, and continue to have, concerns regarding FHA's systems and infrastructure to adequately perform its current requirements and

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services. This was expressed by the OIG to the FHA through audits and reports regarding a spectrum of areas prior to the current influx of loans coming into the program and prior to the consideration of the numerous proposals that expanded its reach. We continue to remain concerned regarding FHA's ability and capacity to oversee the newly generated business.

The Evolving Landscape

The past year and a half have certainly produced a lot of changes and initiatives. In response to increasing delinquencies and foreclosures brought about by the collapsing subprime mortgage market, in September 2007, HUD acted administratively to provide mortgage assistance through the FHA Secure program to refinance existing subprime mortgages. The program was expanded in May 2008 to provide lenders the added flexibility to refinance and insure more mortgages, including those for borrowers who were late on a few payments and/or received a voluntary mortgage principal write-down from their lenders. This program served a fraction of its anticipated scope. The FHA recently issued a formal letter terminating the program stating that "maintaining the program past the original termination date would have a negative financial impact on the MMI Fund."

The Housing and Economic Recovery Act (HERA) passed last summer, created a new Hope for Homeowners program to enable FHA to refinance the mortgages of at-risk borrowers. While activity to date has been limited, the FHA was authorized to guarantee $300 billion in new loans to help prevent an estimated 400,000 homeowners from foreclosure. The House just last week worked on legislation to revise this program so as to increase participation. These proposals, and others, to remedy a dysfunctional mortgage market are likely to increase the challenges to the OIG. While the goal to help homeowners in distress is important, a redraft to relax qualification requirements for borrowers and lenders may create a situation that could be exploited by fraud perpetrators to take advantage of desperate homeowners, at risk-lenders, and the FHA insurance fund. The HERA legislation also authorized changes to the FHA's Home Equity Conversion Mortgage (HECM) program that will enable more seniors to tap into their home's equity and raises new oversight concerns for this agency.

As we turn to today's environment, *the volume of Single-Family FHA-insured loans has enlarged in Fiscal Year 2008 by tripling from $59 billion in Fiscal Year 2007 to over $180 billion in Fiscal Year 2008. The latest figures from Single-Family market comparisons from October 2008, show that FHA's total endorsements have increased from 21% of the market the year before to 76% of the market which includes both home sales and refinances. FHA's home sales' market share (excluding refinances) has increased from 6.4% to 23% during this time period.* Many potential homeowner loans may not have come to the agency yet as some of the new initiatives are still taking hold and the industry is flushing out its options and possibly posturing for more favorable terms. FHA may not be able to handle its expanded workload or new programs that require the agency to take on riskier loans then it historically has had in its

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portfolio. This surge in FHA loans is likely to overtax the oversight resources of the FHA, making careful and comprehensive lender oversight difficult. In addition, our experience in prior high FHA volume periods (such as from 1997-2001) shows that the program was beset by fraud schemes, most notoriously flipping activities, that severely undercut the integrity of the program.

Departmental Issues

It is our understanding from the Department that funding for 22 staff positions and approximately $20 million for system improvements have been made available for the Hope for Homeowners program. FHA tells us that they are reprogramming other funds to try to address modernization requirements. Yet, it remains very tight particularly as it relates to departmental oversight. For example, the mortgage licensing provisions contained in the new legislation set minimum standards for nationwide licensing and a registration system for mortgage broker and loan officers. We have recently been told that there is one FHA person in the RESPA (Real Estate Settlements Procedure Act) unit who is assigned to work with the States in complying with this new regulatory requirement.

We continue to believe there is a critical need for more resources for FHA: 1) to enhance its IT systems; 2) to increase its personnel to meet the escalation in processing requirements; 3) to increase its training of personnel to maintain a workforce with the necessary skills to deal with the responsibility of this new portfolio; 4) to oversee the numerous contractors it maintains; and 5) to increase its oversight in all critical front end issues including such important areas as the appraisal and underwriting processes.

We are also concerned that increases in demand to the FHA program *are having collateral implications for the integrity of the* ***Government National Mortgage Association (Ginnie Mae)*** *mortgage-backed securities (MBS)* program including the potential for increases in fraud in that program. HUD too needs to consider the downstream risks to investors and financial institutions of Ginnie Mae's eventual securitization of a large proportion of the Hope for Homeowners and Home Equity Conversion Mortgage (HECM) Single-Family loans. Ginnie Mae securities are the only MBS to carry the full faith and credit guaranty of the United States. If an issuer fails to make the required pass-through payment of principal and interest to MBS investors, Ginnie Mae is required to assume responsibility for it. Typically, Ginnie Mae defaults the issuers and assumes control of the issuer's MBS pools. Like FHA, Ginnie Mae has seen an augmentation in its market share (it had a 39% market share for the month of October 2008 surpassing both Fannie Mae and Freddie Mac and increased $150 billion in outstanding mortgage-backed securities and commitments during a one year period from FY 2007 to FY 2008) and it too has stretched and limited resources to adequately address this increase.

The OIG has initiated investigations of possible Ginnie Mae MBS fraud. In one recent case, the two former corporate officers of a Michigan financial company were charged with conspiring to

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defraud Ginnie Mae by allegedly retaining the funds obtained from terminated and/or paid off loans. The defendants failed to disclose to Ginnie Mae that the loans were terminated, while one of the defendants utilized the funds from the paid off loans to invest in the stock market and to make fraudulent monthly payments to Ginnie Mae on the loans that were previously paid-off in order to conceal the fraud. The fraud began during July of 1998 and continued until October of 2007, resulting in a loss of approximately $20,000,000.

Despite all these enumerated issues, we are gratified that a new penalty provision was inserted into the Housing and Economic Recovery Act. When we corresponded during consideration of that legislation, we stated our belief that a new penalty enunciated specifically for the FHA program would be beneficial from an oversight and enforcement perspective. We assisted in its development and were very pleased that it was included in the final passage. The statute now creates a penalty of up to $1 million and 30 years in prison for committing fraud against FHA programs, similar to the predicates established in the Financial Institutions Reform, Recovery and Enforcement Act legislation, and will be a useful tool for prosecutors and the law enforcement community to employ in order to address those who would seek to harm the program.

OIG Observations

The results of the latest actuarial study show that HUD has sustained significant losses in its Single-Family program making a once fairly robust program's reserves smaller. The study shows that FHA's fund to cover losses on the mortgages it insures are contracting. *As of September 30, the fund's economic value was an estimated $12.9 billion, an almost 40 percent drop from over $21 billion a year ago.* The current $12.9 billion economic value represents 3 percent of the mortgages insured by the FHA. Although above the 2 percent ratio required by law, it is well below the 6.4 percent ratio from the same time last year. If more pessimistic assumptions are factored in, the ratio could dip below 2 percent in succeeding years requiring an increase in premiums or Congressional appropriation intervention to make up the shortfall. Since its inception in 1934, FHA has been self-sustaining and premiums paid to the fund have covered the losses due to fluctuating defaults and foreclosures.

A significant problem facing FHA, and the lenders it works with, is the fallout from decreasing home values. This increases the risk of default, abandonment and foreclosure, and makes it correspondingly difficult for FHA to resell the properties. About 6.5 percent of FHA loans are currently in default. A major cause for concern is that even as FHA endorsement levels meet or exceed previous peaks in its program history, FHA defaults have already exceeded previous years. Foreclosure and default levels on FHA loans are above those for prime conventional loans as evidenced below:

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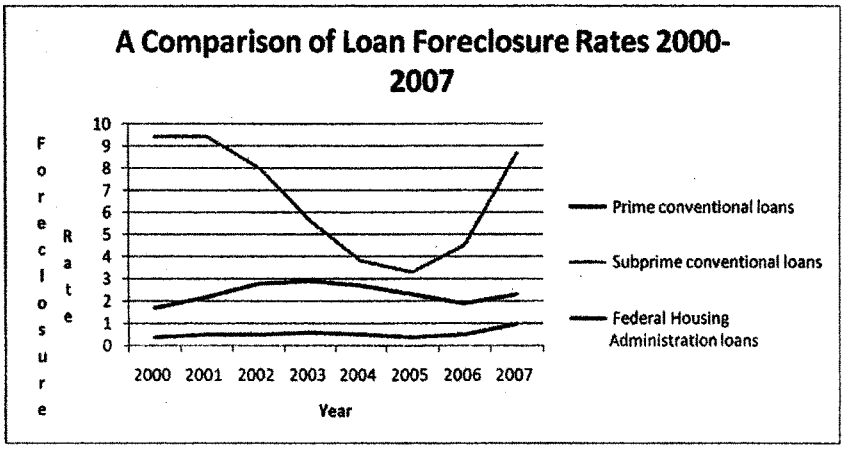

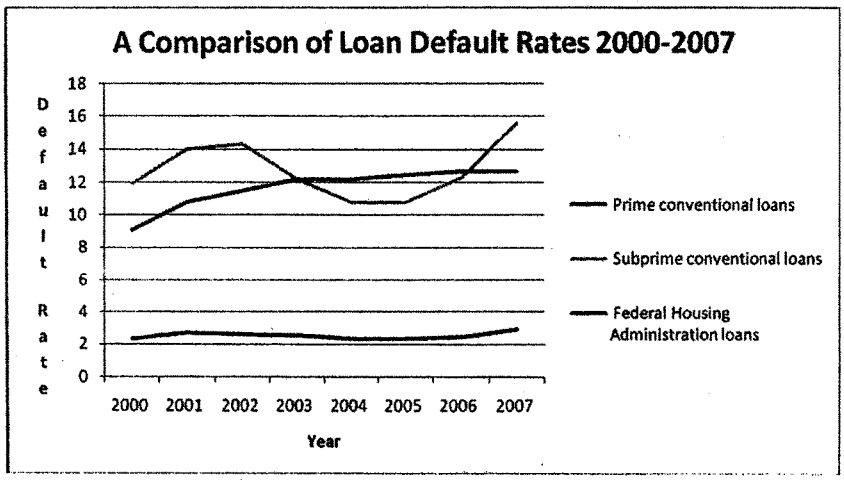

This reinforces the importance for FHA approved lenders to maintain solid underwriting standards and quality control processes in order to withstand severe adverse economic conditions. Another extensive problem confronting FHA has been its inability to upgrade and replace legacy (developed in the 1970s and 1980s) application systems that had been previously

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scheduled to be integrated. The FHA systems environment remains at risk and must evolve to keep up with its new demands. Add to that an escalation in the properties owned and managed by FHA and the overall picture becomes more complicated.

Increased Risks to FHA

Until recently, FHA's market share remained quite low as conventional subprime loans were heavily marketed by lenders. The tightening credit market has increased FHA's position as a loan insurer and, with that, is coming an increase in lender/brokers seeking to do business with the federal program and an overall concern regarding some of these loan originators. For example, we currently have under investigation for alleged inappropriate activities several FHA lenders who were also lenders in the subprime market. The movement towards HUD is already underway as reflected in recent statistics. FHA approval of new lenders increased 525% in a two year period. For example, *as of the end of Fiscal Year 2008, FHA had over 3300 approved lenders as compared to 997 at the end of Fiscal Year 2007 for* ***an increase of 330%.*** *If you compare the FY 2008 totals (over 3300) to the FY 2006 totals (692)* ***it is a 525% increase.*** *Open applications received so far for FY 2009 total 1007 of which 827 have already been approved.* The integrity and reliability of this crop of program loan originators, in our view, is unproven and, in light of the aggressive recent history of this industry, may pose a risk to the program.

We have seen lenders reacquiring FHA approval despite past abuses. A previous investigation on an FHA lender in New York led to the debarment of its owner for a period of five years from originating FHA insured loans. After the debarment was served, the lender, under the same owner, resumed operations using the same fraudulent practices. We again reviewed some of the loans and determined that the originations were fraudulent similar to the loans investigated in the first case. The OIG, in conjunction with the U.S. Attorney's Office, sought and received an injunction against them in order to stop the business from operating. Following the injunction, FHA withdrew their lender approval.

Our audit work also highlights how problem lenders may regain admission into the FHA program even when previous transgressions were apparent. For example, we reviewed an Arizona corporation that was approved as an FHA mortgage lender by HUD in 1996. This particular lender had 13 active branch offices and sponsored close to 2,000 FHA-approved loan correspondents nationwide. As highlighted in our audit, this lender had a number of serious issues related to RESPA violations such as paying marketing fees, non-competition fees and quality incentives to real estate companies in exchange for more than $57 million in FHA mortgage business. The corporation's license was suspended by the State and it filed for bankruptcy. One of the principal owners and principal managers reconstituted under a different name but operates from the same location. In 2008, HUD approved the new entity to originate and process FHA loans despite its principals' prior citations for RESPA violations.

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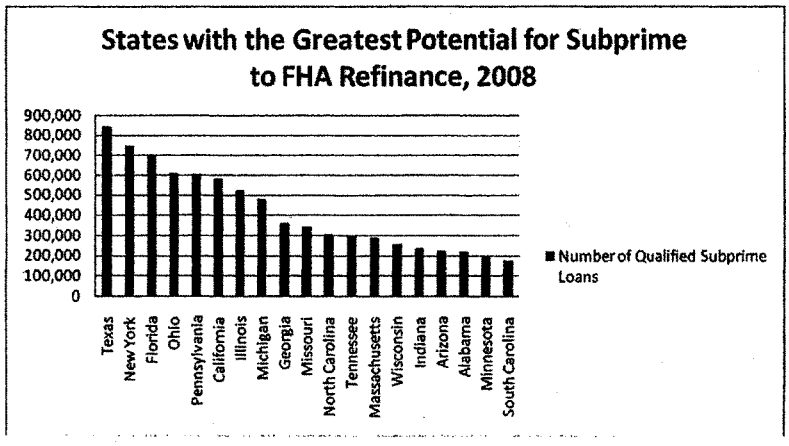
Adding to the risk, FHA is now, due to loan limit increases, serving new metropolitan areas with which it previously has had little interaction. Recent legislation increased maximum FHA loan limits to $729,750. With such entry, come new players and unknown hazards. The effects of this significantly increased loan limit are potentially much greater losses sustained by FHA on defaulted loans and that the loans may be much more attractive to perpetrators of fraud who will be able to extract greater payouts in fraudulent loans schemes. Simultaneous to this confluence of events, is an increase in the reported incidents of mortgage fraud. Mortgage fraud incidents reports, as compiled by the Mortgage Asset Research Institute in the overall marketplace, have increased by 45 percent in the second quarter compared to a year-ago period.

The chart below is an OIG analysis of some areas of the nation and of the projected potential impact of subprime loans refinanced to the FHA:



Our long-term investigative exposure in the area of mortgage fraud schemes impacting both FHA and conventional loans (since most fraud schemes cross loan programs) has given us vast experience and extensive knowledge. Many "traditional" fraud schemes continue to affect FHA and are described below:

- **Appraisal Fraud** – typically central to every loan origination fraud and includes deliberately fraudulent appraisals (substantially misrepresented properties, fictitious

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properties, bogus comparables) and/or inflated appraisals (designed to "hit the numbers"); appraiser kickbacks; and appraiser coercion.

- **Identity Theft** – often includes use of bogus, invalid or misused Social Security numbers and may include involvement of illegal aliens, false ownership documents or certifications.

- **Loan Origination Fraud** - including false, fraudulent and substantially inaccurate income, assets and employment information; false loan applications, false credit letters and reports; false gift letters; seller-funded down payments; concealed cash transactions; straw buyers; flipping; kickbacks; cash-out schemes; fraud rings; and inadequate or fraudulent underwriting activities.

While these types of mortgage fraud schemes continue to operate, changing market conditions have generated new, or variant, schemes:

- **Rescue or Foreclosure Fraud** - recent trends show that certain individuals in the industry are preying on desperate and vulnerable homeowners who are facing foreclosure. Some improper activities include **equity skimming** [whereby the homeowner is approached and offered an opportunity to get out of financial trouble by the promise to pay off the mortgage or to receive a sum of money when the property is sold -- the property is then deeded to the unscrupulous individual who may charge the homeowner rent and then fails to make the mortgage payment thereby causing the property to go into foreclosure] and **lease/buy-back plans** [wherein the homeowner is deceived into signing over title with the belief that they can remain in the house as a renter and eventually buy back -- the terms are so unrealistic that buy-back is impossible and the homeowner loses possession with the new title holder walking away with most or all of the equity].

- **Bankruptcy Fraud** – typically Chapter 7 bankruptcy petitions are filed in lieu of Chapter 13 petitions on behalf of debtors; however, property sales information is fraudulently withheld from the bankruptcy court and the properties are leased back to the debtors at inflated rents. The debtors' property ownership and equity are stripped from them.

- **Home Equity Conversion Mortgage (reverse mortgage) Fraud** – FHA reverse mortgages are a new and potentially vulnerable area for fraud perpetrators. We are aware that the larger loan limits can be attractive to exploiters of the elderly, whether it is by third parties or by family members, who seek to strip equity from senior homeowners. Due to the vulnerability of the population this program serves, we are also concerned about evasions of statutory counseling requirements or fraud by counseling entities. We are working with the Chairman and members (Senator McCaskill, in particular) of the

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Senate Committee on Aging and the Chairman of the House Committee on Financial Services to address some of their concerns regarding these issues. We have also been partnering with the AARP and other groups to foster consumer protection education awareness. The following represent some of the types of schemes that we are encountering:

- **Flipping** - the perpetrator creates a fake mortgage company and 'lends' funds to the borrower (no money changes hands, no loan is given, but a mortgage is filed). The subject refinances the borrower into a HECM. At closing the title company pays all outstanding debt including the fraud perpetrators' fake mortgage and the perpetrator walks away with the payoff.
- **Recruitment** - Some HECM-related fraud activities involve an investor who sells the property to an elderly straw buyer and enters into a quit claim deed with the straw buyer. The buyer applies for the HECM loan within a short time frame and the appraisal used to originate the HECM loan is then fraudulently inflated. This allows the investor to illegally divert the proceeds of the loan. Straw buyers are "recruited" in residential areas with a high rate of renters. The buyers are often unaware that they must pay property taxes and some are unaware that the cash due to them at closing has been diverted. A current investigation involves recruiting elderly homeless to live in properties victimizing these seniors who often have desperate needs.
- **Annuity** - Another activity that we currently have under investigation involves financial professionals convincing HECM borrowers to invest HECM proceeds in a financial product such as an annuity. The financial professionals receive increased fees and, in the case of annuities, the victims are unable to get access to their savings for many years or even past their projected life expectancy.
- **Unauthorized Recipient** – Individual, often family members, may keep HECM payments after the authorized recipient dies or permanently leaves the residence.

HECM loans represent a significant investment by FHA, with considerable recent increases. The chart below shows a 253% increase in the dollar amount of HECM loans from 2004 through 2008.

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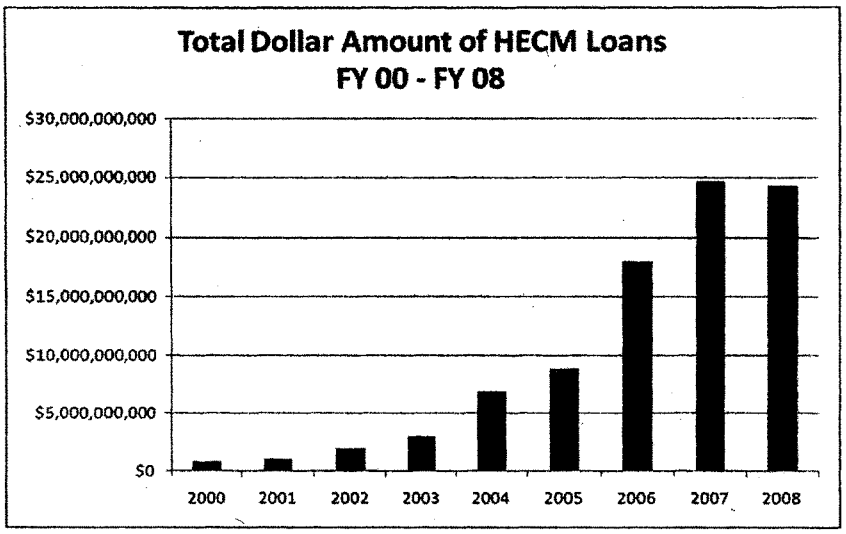

In addition to the schemes described previously, the following case histories also illustrate some of the types of mortgage fraud that the OIG typically encounters:

- In January, 2009, in Philadelphia, Pennsylvania, an appraiser and two settlement agents, were collectively sentenced to 45 months incarceration and 9 years probation and ordered to pay HUD $235,802 in restitution for their earlier guilty pleas to making false statements to HUD and committing a conspiracy and wire and identity fraud. The defendants and others provided fraudulent appraisals and other documents used by unqualified borrowers to obtain FHA-insured mortgages. HUD realized losses of $4,460,588 after 183 mortgages defaulted. HUD OIG and the FBI conducted the investigation.

- In September, 2008, two defendants in South Florida were charged in a 21 count indictment for their participation in a mortgage fraud scheme that resulted in the approval and disbursement of six mortgage loans totaling $980,000. According to the indictment, one of the defendants, through his company, sold six properties in Miami-Dade County to unqualified buyers using FHA loans. In all six sales, the same defendant, through straw donors, fraudulently financed the down payments and closing costs of the buyers. The second defendant, one of the false donors, was also a silent investor in the scheme. Both

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defendants allegedly received sizable payments once the properties were sold. When the loans were closed, four of the six properties went into foreclosure.

- An investigation was initiated against a southwest mortgage company. The investigation revealed that the defendant, a real estate broker and owner of an investment company, fraudulently sold 17 properties to undocumented aliens in the Fort Worth, Texas area. The fraudulent FHA loans totaled $1,060,600. The defendant placed false Social Security numbers on the loan applications, inflated loan application figures, made side payment agreements with the borrowers for down payments that, in some cases, were never made and conducted other fraudulent activities. Subsequently, 12 of the 17 loans defaulted and HUD sustained a loss of $445,862. On December 31, 2008, the defendant was sentenced to 37 months in prison, 36 months probation and ordered to pay restitution of $445,862.

- In Rockford, Illinois, in a joint HUD OIG-FBI investigation, a loan officer, realtor, loan processor, and company employers were charged with conspiracy, making false statements to HUD, and mail fraud, in a 35 count indictment. Specifically, the defendants were alleged to have engaged in a complex scheme to defraud HUD through a litany of false and fraudulent statements on FHA loan applications. These included, but were not limited to, the following: verifications of employment, pay stubs, W-2's, credit letters, cashier's checks, Social Security numbers, Social Security cards, and letters containing Social Security Administration letterhead. Overall, 50 FHA loans were in question, with losses totaling in excess of $2 million.

Continuing OIG Concerns

We continue to focus resources on the Single-Family program and point out where weaknesses or deficiencies need to be addressed. Our work of the FHA appraiser roster identified weaknesses in the quality control review and monitoring of the roster. *The roster contained unreliable data including the listing of 3,480 appraisers with expired licenses and 199 appraisers that had been state sanctioned.* In a further review, we found that HUD's appraiser review process was not adequate to reliably and consistently identify and remedy deficiencies associated with appraisers. Moreover, results from a number of other key audits have noted significant lender underwriting deficiencies, inadequate quality controls, and other operational irregularities.

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Additionally, we note that FHA's lender approval process is largely manual. FHA will be challenged within current resource constraints to keep up with the increasing volume of entities doing business. FHA controls currently rely upon random, and again, manual processes by contractors to select for review about 1 in every 20 loans or approximately 5 percent. FHA then relies upon post-endorsement automated lender or service performance information, such as high delinquency or early default rates, to target these entities for examining a limited number of loans for quality assurance reviews. We believe FHA needs the resources to take advantage of commercial off-the-shelf pre-screening loan software or to require at least the larger lenders use such tools as part of their underwriting process.

Further, *we have recently initiated a review, at the request of Senator Grassley, of the Mortgagee Review Board (MRB) enforcement actions* and its efficiency, effectiveness and impact in resolving cases of serious non-compliance with FHA regulations particularly during this period of significant changes in the housing market. The MRB is a statutorily created board within the Department that has responsibility to sanction FHA-approved lending institutions that violate applicable housing laws and HUD regulations and policies.

Specifically, our review will determine the timeliness of decisions; evaluate controls over the mortgagee referral and enforcement processes; summarize data gathered on settlement agreements and collections; and provide an objective basis to comment on the effectiveness of the MRB as a regulatory body. We are looking into issues such as the types of penalties assessed; whether the penalties were mitigated to administrative payments; the sizes of the mortgagees brought before the board; the elapsed time from referral to board action; whether indemnification was required; and whether the mortgagees were repeat offenders or their principals were under limited denial of participations or debarred. We anticipate completion of this review in a few months.

ISSUES FACING THE OIG

The Committee asked that we describe our staffing situation as it relates to joint operations and endeavors. During a previous peak period of FHA loan activity (1999-2003), the OIG conducted Housing Fraud Initiatives ('HFI's,') in which OIG and FBI agents, with a designated federal prosecutor, worked closely together in investigating and prosecuting cases of fraud. This strategy was very successful due to sufficient resources and personnel. The charts below represent the dedicated OIG case percentage and specific investigative levels assigned to FHA fraud.

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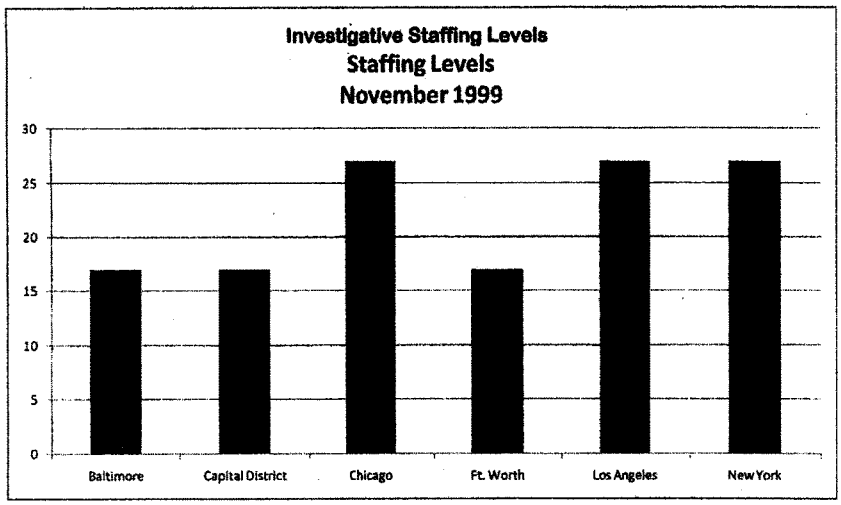

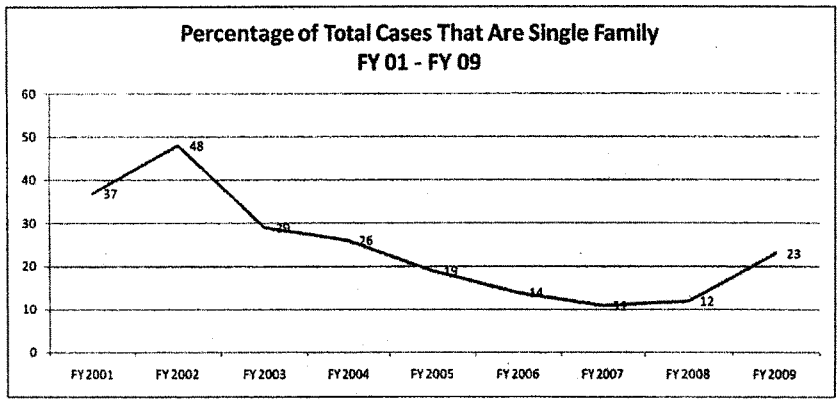

The HFI's were discontinued after 2003 due to decreasing FHA loans and limited funding. Although the OIG currently assigns agents to conduct mortgage fraud investigations, we are unable to operate mortgage fraud task forces on an exclusive basis.

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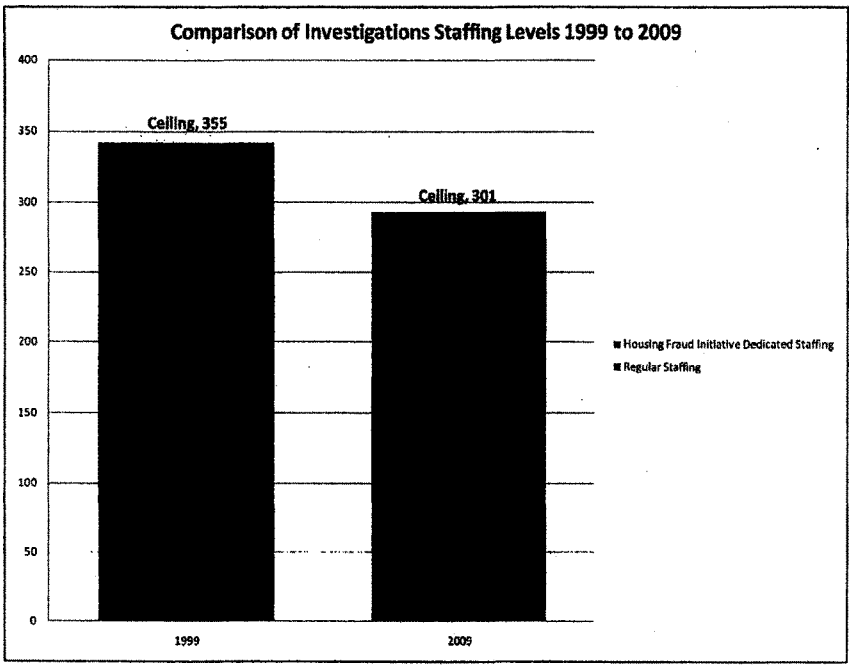

The 2009 figure above shows how dedicated staffing to FHA fraud has decreased since 1999. Agents today are also tasked with conducting investigations related to HUD's designated major management challenges, which include corruption in the administration of Community Planning and Development grant programs; corruption in the administration of public housing authorities; multifamily projects; rental fraud by landlords and tenants; and disaster fraud. Of our limited numbers, 23 Office of Investigation FTE's are dedicated to investigation of disaster relief fraud, mostly in the Gulf Coast region. These multiple challenges are supported by less investigative staff than were available in 1999. The above figures do not include decreases in other critical OIG staff (i.e., audit, counsel, administrative, etc.) which simultaneously occurred with the decrease in our investigative staff.

The task before the HUD OIG is a daunting one: addressing the elements of fraud that were involved in the collapse of the mortgage market; monitoring the roll-out of new FHA loan products in order to reduce exploitation of program vulnerabilities; and, combating perpetrators of fraud, including those who have migrated from the subprime markets, who would exploit FHA loan programs. The consequences of the current mortgage crisis, its worldwide economic

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implications, and the subsequent pressures placed on the Department and OIG could not have come at a more inopportune time. The Department, as a whole, has had significant new leadership responsibilities over the last seven years in rebuilding communities devastated by disasters (i.e., lower Manhattan post-September 11th; the Gulf Coast region after hurricanes Katrina, Rita and Wilma; the Galveston area after recent hurricanes; California fires; and Midwest flooding) that have added tens of billions of dollars in new program funds that require quick distribution and keen oversight.

While there have been some monies appropriated for salaries and expenses needed for administering all these new programs, the Department has not received analogous increases needed to deal with this new influx of requirements. They are quite stretched in their ability to keep up with the pace of new, critical needs and the changing dynamics of essential demands placed on the Department. While, for example examining our own situation which the Committee requested we provide, we were grateful to receive supplemental funds a number of years ago for Gulf Coast activities, these funds will be exhausted this year and we still have many years of activities that will have to be absorbed by regular funding. In addition to our responsibility to oversee more than $20 billion in HUD disaster relief in the Gulf States, we currently must report every six months on post-September 11th reconstruction in lower Manhattan.

We are currently operating, as is most of the government, in a continuing resolution environment. We are working diligently to address the range of audits and investigations needed to oversee all of HUD's current programs and operations. In 2001, HUD OIG held a level of 705 FTEs. Our funding at the current rate will support only 610 FTEs. We recognize that our ability to keep pace is one component to the overall health of our national programs. If the efforts to salvage mortgage markets are jeopardized by widespread and unchecked Single-Family loan fraud, there may be deeper repercussions on the national economy, potentially requiring further bailouts and infusion of funds.

We have had a long history of leading and participating in joint task forces and initiatives intended to combat particularly complicated and intractable problems affecting HUD programs. At the request of the Special Inspector General of the Troubled Asset Relief Program (SIG TARP), we are a critical player on the SIG TARP Council and I regularly attend their meetings. In addition to the HFI's described above, we have been key participants in the Department of Justice Procurement Task Force, Gulf Coast Recovery Task Force, High Intensity Drug Trafficking Area Task Force, and the Federal Bureau of Investigation (FBI) National Mortgage Fraud Team which includes the detailing of OIG personnel, coordinating of investigative activities, performing of public and industry outreach and liaison, and conducting of training. We have a long, established relationship with the FBI in working cases and cooperating in many different areas. For example, when another Inspector General was under scrutiny by the President's Council on Integrity and Efficiency for allegations of improprieties, the then head of

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the FBI Criminal Division specifically sought us out to conduct the sensitive and lengthy investigation due to our high quality work for them in the past.

Though the challenges and tribulations are increasing, the Office of the Inspector General stands ready to assist in whatever way is deemed necessary and will be vigilant in its efforts to protect the funds of the American taxpayer. We thank you for the opportunity to relay our thoughts on these important issues based on the body of our work and of our experience, and greatly appreciate the activities of the Congress to protect the Department's funds from predatory and improper practices and to ensure an effective response on oversight at this critical time.

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UNITED STATES
POSTAL SERVICE

February 19, 2009

The Honorable Patrick Leahy, Chairman
The Honorable Arlen Specter, Ranking Member
United States Senate
Committee on the Judiciary
224 Dirksen Office Building
Washington, DC 20510-0001

Dear Chairman Leahy and Ranking Member Specter:

The United States Postal Inspection Service, the law enforcement and security arm of the United States Postal Service, is respectfully submitting a letter for the record in connection with the Senate Judiciary Committee's February 9 hearing, "The Need for Increased Fraud Enforcement in the Wake of the Economic Downturn." When Rita Glavin, acting assistant attorney general in the Justice Department's criminal division, testified during the hearing that additional staff would allow her office to recover more funds and initiate new prosecutions, she cited two cases—Adelphia in New York and a Minnesota man accused of operating a Ponzi scheme involving commodity pools—as examples of the high-profile work the Department of Justice could deliver. The Postal Inspection Service was the sole investigative agency or led the criminal investigation in each case.

The Postal Service delivers more than 200 billion pieces of mail a year to 149 million addresses. Postal Inspectors are mandated to safeguard the mail, including the people who move it and the business and residential customers who use it. The Postal Inspection Service is uniformly recognized both domestically and internationally as a model practitioner among law enforcement agencies. This is not because it is federal in nature, but because it is effective in action. Few agencies of any size can compare to the Postal Inspection Service in terms of investigative efficiency as measured by successful court action. Among federal law enforcement agencies, the Postal Inspection Service has one of the highest conviction rates for cases brought to trial.

The reputation and respect Postal Inspectors have earned over the years have caused them to be used in all types of sensitive investigations on behalf of the United States government. The Department of Justice requested the services of Postal Inspectors to lead the investigations into the incidents at Ruby Ridge, Waco, and the Martin Luther King, Jr., assassination. The independence of the Postal Inspection Service (not being a part of either the Justice or Treasury Department) has proven to be a valuable asset. From consumer fraud to child exploitation to physical security of postal property and the mail, the Postal Inspection Service has been an effective agent for ensuring that the will of Congress and the American people is reflected in the conduct of the nation's mail.

475 L'Enfant Plaza SW
Washington DC 20260
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The Mail Fraud Statute, enacted in 1872, is one of the most effective fraud enforcement weapons, and Postal Inspectors have been using it for over 100 years. In 1920, it was used when Charles Ponzi was arrested following an investigation by Post Office Inspectors. By the late 1960s, the Mail Fraud Statute became a key weapon in the war against organized crime. Through the Organized Crime Control Act of 1970, mail fraud was considered a racketeering activity and a RICO predicate. The last years of the 20th century and the beginning of the 21st century have affirmed the Mail Fraud Statute as a premier fraud-fighting tool.

The Civil Asset Forfeiture Reform Act (CAFRA) of 2000 further boosted Postal Inspectors' ability to resolve fraud cases. Prior to CAFRA, when the best or the only way to seize proceeds of a fraud was forfeiture, the requirements of forfeiture were such that it was very difficult to provide victim restitution. Moreover, it was only possible to pursue forfeiture in mail fraud cases when money laundering could be proven. CAFRA changed all of that. Now forfeiture of assets in mail fraud cases can be accomplished by showing the property is a proceed of the crime. Restitution to identified victims is through a much more efficient and simplified process.

To increase efficiency in investigating suspected mail fraud, Postal Inspectors have led or participated in law enforcement and mass-marketing fraud initiatives aimed at protecting consumers and safeguarding the public's confidence in the U.S. Mail.

Criminal prosecution is an important element in our fraud program, but not the only tool. The Postal Inspection Service works to protect consumers by educating them about current fraud schemes. We have led numerous fraud prevention initiatives since 1999, beginning with the "Know FRAUD" campaign. In 2007, we launched an extensive consumer awareness campaign in cooperation with the Department of Justice, international law enforcement authorities, financial institutions, and consumer advocacy groups.

The proposed Fraud Enforcement and Recovery Act of 2009 provides additional tools we need to fight fraud. Postal Inspectors currently make maximum use of the Money Laundering Statute and have recovered substantial sums under the False Claims Act. The statutory enhancements provided by the Act will improve our ability to address fraud through vigorous civil enforcement.

Even before 2008, the Postal Inspection Service responded to an alarming increase in mortgage fraud. We actively participate in local and regional task forces and working groups. We are also investigating rescue scams that target desperate homeowners trying to avoid foreclosure. We have joined forces with the financial regulatory community, including the Securities and Exchange Commission, to identify fraud associated with mortgage-backed securities, and with the Office of Inspector General for HUD and the FBI to investigate other types of mortgage fraud. We work with many different law enforcement agencies in a collaborative approach to treat complex and creative criminal schemes.

The Postal Inspection Service has a long and successful track record in leading groundbreaking investigations into fraudulent activities. Its experience in this area reveals that an investment in its resources will ensure that frauds, especially those against the government, will be thoroughly investigated and the government's ability to recover funds increased. We support the Fraud Enforcement and Recovery Act's allocation of resources for the Postal Inspection Service.

Sincerely,

William R. Gilligan Jr.

William R. Gilligan, Jr.
Acting Chief Postal Inspector

Department of Justice

STATEMENT OF

RITA GLAVIN
ACTING ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION
UNITED STATES DEPARTMENT OF JUSTICE

BEFORE THE

UNITED STATES SENATE
COMMITTEE ON THE JUDICIARY

HEARING ENTITLED

"THE NEED FOR INCREASED FRAUD ENFORCEMENT IN THE WAKE OF THE ECONOMIC DOWNTURN"

PRESENTED

FEBRUARY 11, 2009

Good morning, Mr. Chairman, Senator Specter, and members of the Committee. Thank you for your invitation to address the Committee. The Department of Justice (Department or DOJ) welcomes this opportunity to testify on fraud enforcement in the wake of the economic downturn and in support of the Fraud Enforcement and Recovery Act of 2009 (FERA or the Act).

Introduction

I am privileged to be serving the Department of Justice as the Acting Assistant Attorney General for the Criminal Division. Although I am new to this position, I am not new to the Department. I have been a prosecutor with the Department for more than 10 years, and have served the Department in many different capacities, including as Acting Principal Deputy Assistant Attorney General of the Criminal Division, Assistant United States Attorney in the Southern District of New York, and trial attorney with the Public Integrity Section of the Criminal Division. During my long tenure with the Department, I have personally prosecuted and have supervised complex, financial crime cases. As a result, I am well-versed in the tools the Department has at its disposal to address the Nation's current economic crisis.

The Nation's current economic crisis has had devastating effects on mortgage markets, credit markets, commodities and securities markets, and the banking system. The financial crisis demands an aggressive and comprehensive law enforcement response, including vigorous fraud investigations and prosecutions of securities and commodities firms, banks, and individuals that have defrauded their customers and the American taxpayer and otherwise placed billions of

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dollars of private and public money at risk. Furthermore, a strategic and proactive approach for detecting and preventing fraud is needed to detect and deter fraud in the future.

The Department, through its Criminal Division, the Federal Bureau of Investigation (FBI), the U.S. Attorney community, and other components, has been investigating and prosecuting financial crimes aggressively. But, we believe more can and should be done. As the Attorney General has stated, we must reinvigorate the traditional missions of the Department and we must embrace the Department's historic role in fighting crime and ensuring fairness in the marketplace.

The proposed FERA legislation gives us some of the tools we need to aggressively fight fraud in the current economic climate. The legislation will provide key statutory enhancements that will assist in ensuring that those who have committed fraud are held accountable. FERA will also provide needed resources to investigate and prosecute those responsible for such misdeeds.

Mortgage Fraud

Along with widespread mortgage delinquencies and foreclosures, lender failures, massive losses by investors in mortgage-backed securities, and turbulence in the credit markets, there has been an alarming increase in mortgage fraud. Whether measured by Suspicious Activity Report (SAR) data, or by the rapid expansion of the FBI's nationwide inventory of mortgage fraud cases, fraud has infected a significant segment of mortgage lending over the past five or more

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years. During that period, for example, the FBI's inventory of mortgage fraud cases has more than tripled, and SARs of mortgage fraud have increased almost four-fold.

Even before this current crisis, the Department responded to these alarming numbers. For years, we have been waging an aggressive campaign against mortgage fraudsters through vigorous investigation and prosecution. We deployed a broad array of enforcement strategies that ensured optimal use of our investigative and prosecutorial resources to maximize deterrence and remediation. We have conducted nationwide sweeps in mortgage fraud cases, formed local and regional task forces and working groups, and engaged in major undercover operations. We are also working to uncover rescue scams that target desperate homeowners trying to avoid foreclosure.

For example, in partnership with the FBI, the Department has conducted three nationwide mortgage fraud and other banking crime sweeps. Operation "Malicious Mortgage", conducted last year, resulted in charges against more than 400 defendants across the nation brought by many of the local and regional task forces and working groups currently targeting mortgage fraud. By fully utilizing these task forces and working groups, we have leveraged our limited resources by joining forces with federal, State, and local law enforcement and regulatory partners and have ensured a coordinated and comprehensive response to mortgage fraud and related crimes. Operation "Malicious Mortgage" was the most recent coordinated sweep in an ongoing law enforcement effort to combat mortgage fraud, which also included Operation "Quick Flip" in 2005 and Operation "Continued Action" in 2004.

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On another front, the FBI has established a National Mortgage Fraud Team at FBI Headquarters. This unit, working closely with the DOJ Criminal Division, U.S. Attorneys' Offices and other law enforcement partners, encourages proactive investigations of mortgage fraud and related crimes and employs an intelligence-driven case targeting system to promote real-time enforcement operations. The Deputy Director of the FBI will describe this program in further detail.

Another example of our ongoing efforts to prosecute mortgage fraud is Operation "Homewrecker," a case brought last year by the United States Attorney's Office for the Eastern District of California and investigated by the FBI and the Internal Revenue Service Criminal Investigation Division, which resulted in the indictment of 19 individuals on mortgage fraud-related charges stemming from a scheme that targeted homeowners in dire financial straits, fraudulently obtaining title to more than 100 homes and stealing millions of dollars through fraudulently obtained loans and mortgages. *See United States v. Charles Head et al.*, 08-cr-116 (E.D. Cal. Feb. 2, 2008); *United States v. Charles Head et al.*, 08-cr-116 (E.D. Cal. Mar. 13, 2008).

The Department, joining forces with the financial regulatory community, including the Securities and Exchange Commission, has also successfully identified and prosecuted fraud associated with securitization of mortgage-backed securities. For example, as part of Operation "Malicious Mortgage," the United States Attorney's Office for the Eastern District of New York charged a securitization fraud scheme in which investors were victimized when risky subprime mortgage-backed securities were substituted for safer and more conservative investments.

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Because of the complexity and creativity of these criminal schemes, the Department has embraced a collaborative approach – working closely with many different law enforcement agencies – to bring these prosecutions. For example, in a case investigated by the Secret Service and the FBI and prosecuted by the U.S. Attorney's Office for the Northern District of Georgia, a defendant agreed to purchase properties from true owners, assumed their identities, obtained multiple further mortgages on the properties, then used the identities of the homeowners and others to purchase vehicles, open bank accounts and obtain passports which he then used to travel to Jamaica, Italy, Greece while a federal fugitive. His crimes resulted in clouded property titles in several states, a trail of more than 100 victims, and millions of dollars in losses. The defendant was sentenced to 26 years in prison and ordered to pay restitution of almost $6 million. The government also obtained a forfeiture judgment of $6 million, access to the defendant's book and movie rights, and the right to sell the defendant's paintings on eBay in order to restore money to victims.

At the same time, the Department has addressed mortgage fraud through vigorous civil enforcement, including under the False Claims Act (FCA). The Department's recoveries under the FCA, with the assistance of private whistleblowers, have reached record levels. In eight of the last nine years, the Department's recoveries have exceeded $1 billion. Moreover, since 1986, the Department, working with government agencies, and private citizens, has returned more than $21 billion in public monies to Government programs and the Treasury. During the past year, the Department also recovered funds on its own behalf, as well as on behalf of the Departments of Defense, Homeland Security, and Education, and the General Services Administration, to name just a few of the agencies.

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The Department has used the FCA to protect a broad range of government programs and contracts. Health care fraud cases are currently the largest source of the Department's recoveries, but the Department has also relied on the FCA to combat mortgage and other fraud on the Department of Housing and Urban Development (HUD). The Department's recent recoveries include a $10.7 million settlement with RBC Mortgage Company to resolve allegations that it sought FHA insurance for hundreds of ineligible loans. Additionally, the Department obtained two recent judgments, totaling $7.2 million, against a California real estate investor and a Chicago-based mortgage company, for defrauding HUD's direct endorsement program. The Department will continue to vigorously utilize the FCA to hold accountable those who engage in all types of housing related fraud.

Financial Fraud

In addition to mortgage fraud, the Department has had tremendous success in identifying, investigating, and prosecuting massive financial fraud schemes, including securities and commodities market manipulation and Ponzi schemes. Just last week, the Criminal Division and U.S. Attorney's Office in Minnesota charged and arrested an individual who is alleged to have engaged in a large Ponzi scheme operation involving commodities. *See United States v. Charles Hays*, 09-mj-36 (D. Minn. Feb. 4, 2009). The defendant allegedly told investors that their money had been invested in a pooled commodities trading account, but his company had no such account; instead, he used this investor money for his own personal expenses, including a $3 million yacht. This criminal case was brought in parallel with a civil enforcement action and

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restraining order freezing assets by the Commodity Futures Trading Commission (CFTC). The case was also worked jointly with U.S. Postal Inspection Service.

In addition, last year, the Department secured the convictions of five former executives, including the owner and president of National Century Financial Enterprises, one of the largest health care finance companies in the United States until its 2002 bankruptcy, on charges stemming from an investment fraud scheme resulting in $2.3 billion in investor losses. In addition, in a case investigated by the United States Postal Inspection Service, the U.S. Attorneys' Offices in Connecticut and the Eastern District of Virginia, working with the Criminal Division's Fraud Section, obtained convictions of four executives who engaged in corporate fraud by executing two false reinsurance transactions to conceal a $59 million decrease in the loss reserves of AIG. The Court found that the transactions caused a loss to AIG shareholders of between $544 and $597 million. Just two weeks ago, an AIG vice president was sentenced to serve four years in federal prison.

Oversight of Economic Stimulus Funding

In addition to continuing our efforts to prosecute the types of fraudulent conduct described above, we must ensure that the funds that Congress authorizes to rejuvenate and stimulate the economy are used as intended. Where these taxpayer funds are not used appropriately or where misrepresentations are made in order to obtain such funds, we are committed to investigating and prosecuting the wrongdoers.

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The Department has always been committed to fighting fraud and, as the nation suffers through the current economic crisis, we are committed to redoubling our efforts. We are determined to move decisively to uncover abuses involving financial fraud schemes, mortgage lending and securitization frauds, foreclosure rescue scams, government program fraud, bankruptcy schemes, and securities and commodities fraud. Much remains to be done and this bill is an important and timely step in the process. It arises at a critical juncture to provide enhanced tools and critically-needed resources that will advance our work in protecting the public, our markets and institutions from fraud and related abuses.

Criminal Statutory Revisions

Let me now turn to specific comments on the legislation. First, I would like to address the proposed changes in various provisions of Title 18 of the United States Code. These changes would enhance our ability to investigate and prosecute mortgage fraud and other types of investment fraud. We support these changes, and would like to take a moment to explain why:

Expanding the scope of financial institution frauds.

First, section 2(a) of the bill would amend the definition of "financial institution" in section 20 of Title 18, United States Code, to include both mortgage lending businesses and any person or entity that makes in whole or in part a federally-related mortgage loan. Subsection 2(b) would introduce a definition of "mortgage lending business" as a new section 27 of Title 18 and would define that term to mean any organization that finances or refinances any debt secured

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by an interest in real estate, including private mortgage companies and any subsidiaries of such organizations, and whose activities affect interstate or foreign commerce.

The new definitions for "financial institution" and "mortgage lending business" will ensure that private mortgage brokers and companies are both protected by, and held fully accountable under, federal fraud laws, particularly where they are dealing in federally-regulated or federally-insured mortgages. For example, the bank fraud statute, 18 U.S.C. § 1344, prohibits defrauding "a financial institution," and the amendment to this definition would extend the bank fraud statute beyond traditional banks and financial institutions to private mortgage companies. This definition of "financial institution" would also apply to the following criminal provisions: 18 U.S.C. § 215 (financial institution bribery); 18 U.S.C. § 225 (continuing financial crimes enterprise); and 18 U.S.C. § 1005 (false statement/entry/record for financial institution). The new provision would also create enhanced penalties for mail and wire fraud affecting a financial institution, including a mortgage lending business, pursuant to 18 U.S.C. §§ 1341 and 1343. Additionally, expanding the term "financial institution" to include mortgage lending businesses will strengthen penalties for mortgage frauds and would extend the statute of limitations in mortgage fraud cases.

According to the Wall Street Journal, more than 50 percent of sub-prime mortgages made in this country in 2005 were made by institutions that do not currently fall under the bank fraud criminal statute. Changing the definition of "financial institution" to include non-bank lenders will enhance our ability to prosecute criminals under the bank fraud statute who commit fraud involving loans from those companies.

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The nation's current financial crisis has demonstrated how bad mortgages can affect the health of the banking system and the overall economy. Mortgage lending businesses should be held accountable in the same way as traditional financial institutions, given the impact of their businesses on federally-insured and federally-regulated institutions. These provisions will help do that.

Criminalizing false statements to mortgage lending businesses.

Second, subsection 2(c) would expand the prohibition regarding false statements to financial institutions, section 1014 of Title 18, United States Code, to cover false statements made to mortgage lending businesses. Currently, section 1014 applies only to federal agencies, banks, and credit associations and does not extend to private mortgage lending businesses, even if they are handling federally-regulated or federally-insured mortgages. This new provision would ensure that private mortgage brokers and companies are held fully accountable under this federal fraud provision by providing prosecutors with an important tool to charge those who engage in false appraisals.

Amending the Major Fraud statute to include activities relating to TARP funds.

Third, subsection 2(d) of the Act would amend the major fraud statute, section 1031 of Title 18, United States Code, to make explicit that transactions and activities that fall under the Troubled Assets Relief Program (TARP) and the stimulus packages fall within the scope of that provision. The proposed amendment would define the scope of the existing law to criminalize the execution of any fraud scheme with the intent to obtain any grant, contract, subcontract, subsidy, loan, guarantee, insurance, or other form of federal assistance. This would include the

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TARP funds, an economic stimulus, recovery or relief plan provided by the Government, or the Government's purchase of any preferred stock in a company. This amendment would ensure that federal prosecutors are able to use one of our most potent fraud statutes to protect government assistance provided during this economic crisis. We look forward to working with the Special Inspector General for TARP to ensure the integrity of the TARP funds and other economic stimulus and rescue packages.

Amending the securities fraud statutes to include commodities options and futures trading.

Fourth, subsection 2(e) of the Act would amend the securities fraud statute by extending its reach to commodities. Among other things, the amendment would ensure that prosecutions could be brought against anyone engaging in a scheme or artifice to defraud, or to obtain money or property by false or fraudulent pretenses, in connection with a commodity for future delivery, or option on a commodity for future delivery. Currently, the securities fraud statute does not reach frauds involving options or futures, which include some of the derivatives and other financial products that were part of the financial collapse. This amendment helps to fill in an existing gap in the tools available to prosecutors and agents.

Amending the Money Laundering statute to define the "proceeds" of illegal activity.

Fifth, subsection 2(f) of the Act would amend the definition of the term "proceeds" in the money laundering statute to make clear that the proceeds of specified unlawful activity includes the gross receipts of the illegal activity, not just the profits of the activity. The money laundering statutes make it illegal to conduct a financial transaction involving the "proceeds" of a crime; however, the term "proceeds" is not defined. As a result, the courts have been left to define the

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term. For more than 20 years, courts had almost uniformly construed the term "proceeds" to mean "gross receipts" and not "net receipts."

In *United States v. Santos*, 128 S. Ct. 2020 (2008), the Supreme Court ruled that the term "proceeds," as used in the money laundering statute, was ambiguous, and that the rule of lenity required them to define the term as "net profits" rather than "gross receipts." The Court's decision effectively limited the money laundering statute to profitable crimes. Prior to *Santos*, a mortgage fraudster's kickback to a corrupt appraiser for inflating the value of a home could be charged as a money laundering transaction and could provide a legal basis for seizing the transferred money and eventually returning it to the fraud victims. Under *Santos,* a court could conclude that the payment constituted an expense of the fraud scheme and that it therefore could not be charged as "money laundering."

The result is contrary to Congress' intent to target money laundering as envisioned when the statute was enacted more than two decades ago. The proposed legislation would eliminate the uncertainty that has followed *Santos* and would restore a valuable tool to federal prosecutors. Although the Department supports the Act, the Department respectfully submits additional modifications to further strengthen the proposed amendments. The proposed modifications to the Act pertaining to the money laundering statutes are attached as Appendix A.

Amending the Money Laundering statute to apply to tax evasion.

Sixth, subsection 2(g) of the Act would add a new provision to the international money laundering offense, section 1956(a)(2)(A) of Title 18, United States Code, to make it applicable

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to tax evasion. Due to the rapid globalization of the financial system in the last two decades and the development of offshore banking centers, we have seen the development of a troubling growth of income tax evasion that exploits the international funds transfer mechanisms and these offshore centers. In many cases, these tax evasion schemes utilize the same methods and mechanisms as money laundering schemes which involve criminal proceeds. In some, but not all cases, the offshore movement of funds for the purpose of evading income taxes can contribute to the development of offshore centers, and businesses operated by international criminal organizations, that facilitate the laundering of proceeds of drug trafficking and other serious offenses. These activities represent a threat to our financial system beyond the evasion of income taxes.

The proposed amendment to section 1956(a)(2)(A) will address this threat by criminalizing the transfer of funds into or out of the United States with the intent to engage in conduct constituting a violation of our income tax laws. The amendment will not only allow the government to bring civil forfeiture actions against tax evasion funds sent abroad, but will also help U.S. prosecutors enforce forfeiture orders for foreign tax offenses.

Clarifying the Civil False Claims Act

In addition to these revisions to federal criminal statutes, the Act also would add language to section 3729 of Title 31, United States Code, to clarify the scope of liability for civil false claims under the False Claims Act (FCA), which is one of the primary tools used by the Civil Division, along with the U.S. Attorneys' Offices around the country, to deter and recover from those who seek to defraud the Government.

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As the Department's continuing experience reflects, every government agency and program is susceptible to potential fraud, and is therefore in need of the protections afforded by the FCA. The Department therefore supports changes to the FCA designed to eliminate any presentment or federal funds requirements and also recommends that the Committee consider additional modifications to redress the impact of the Supreme Court's recent decision in *U.S. ex rel. Sanders v. Allison Engine*, 128 S. Ct. 2123 (2008). The Department would be happy to discuss with staff these additional modifications. The Department has concerns with some aspects of the Act, however, and would also welcome the opportunity to discuss them with staff.

Additional Resources

Our Nation faces an unprecedented financial crisis. The crisis requires a strategic response to prosecute those responsible for abusing the financial markets, to deter future similar conduct, and to prevent fraud and abuse relating to funds that have been and will be disbursed to help improve the current situation. The Department of Justice has a critical role to play. Federal prosecutors, including those in U.S. Attorneys' Offices around the country, and in the Criminal, Tax, and Civil Divisions of the Department will undoubtedly face an unprecedented demand on their prosecutorial resources through referrals from the FBI, the U.S. Postal Inspection Service, the Special Inspector General for the Troubled Assets Relief Program, and other investigative agencies. To meet these imminent demands and to effectively prosecute the crimes that have come to light as a result of to the current crisis, the Department requires a concomitant increase in resources. The Department has a successful track record in leading groundbreaking nationwide initiatives to target specific criminal activities and, ultimately, the Department's past experience reveals that an investment in a coordinated response and appropriate resources help

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ensure justice is served. Further, such an investment allows the government to recover funds that otherwise may be lost to criminals who may go unpunished. Accordingly, the Department supports the Act's allocation of additional resources for the Department.

Conclusion

We applaud the leadership of this Committee in proposing this Act. It provides important enhancements to key statutes that the Department uses to combat fraud. Additionally, FERA adds crucial reinforcements to strained law enforcement resources that would enable the Department and its partners to advance the pace and reach of the enforcement response. With the tools that the Act provides, the Department will be better equipped to address the challenges that face this Nation in these difficult times and to do its part to help our Nation respond to this challenge.

I would be happy to answer any questions from the Committee.

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Appendix A

1. Proposed Change to section sections 2(e)(1)(B) and 2(e)(1)(C).

At Section 2(e)(1)(B): The language "or a commodity" should be deleted so that the bill reads "by inserting 'any commodity for future delivery, or any option on a commodity for future delivery, or' after 'any person in connection with'"; and

At Section 2(e)(1)(C): The language "or a commodity" should be deleted so that the bill reads "by inserting "any commodity for future delivery, or any option on a commodity for future delivery, or' after 'in connection with the purchase or sale of'".

2. Proposed Change to section 2(f).

We suggest slightly revising the *Santos* fix, at section 2(f), to read as follows:

Section 1956(c) of title 18, United States Code, is amended –

(1) by striking the period at the end of paragraph (8) and inserting "; and"

(2) by adding at the end the following:

"(9) the term "proceeds" means any property derived from or obtained or retained, directly or indirectly, through some form of unlawful activity, including the gross receipts of such activity."

The purpose of the change (from "property derived from . . . **commission of a specified unlawful** activity" to "property derived from . . . **some form of** unlawful activity") is to avoid confusion where "proceeds" is used elsewhere in the statute to describe the knowledge component of the crime (see section 1956(c)(1)). The statute currently requires knowledge that property involved in a transaction represents proceeds of "some form of unlawful activity." The

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requested change does not expand the scope of the statute, because paragraph (a)(1) makes it clear that it applies only to transactions involving proceeds of specified unlawful activity.

3. Proposed Change to section 2(h).

In order to make it clear that "proceeds" has the same meaning in section 1956 and section 1957, we suggest adding the following section 2(h) to the bill:

Section 1957(f) of title 18, United States Code, is amended --

(1) by deleting "and" from the end of paragraph (2);

(2) by striking the period at the end of paragraph (3) and inserting "; and"

(3) by adding at the end the following:

"(4) the term "proceeds" has the meaning given that term in section 1956 of this title."

4. Proposed Change to 2(i).

On the same day it issued *U.S. v Santos,* the Supreme Court issued another decision that has adversely affected federal money laundering prosecutions. In *Cuellar v. United States,* 128 S.Ct. 1994 (2008), the unanimous Court held that certain language in section 1956 –"knowing that the transaction is designed in whole or in part" – requires the Government to prove that a defendant charged with transporting drug proceeds across the border knew the purpose or plan behind the transportation. As the Court stated in the opinion, it is not enough to show how the defendant moved the money, the Government must also prove why he moved it.

The *Cuellar* Court also suggested that Congress could correct this situation by deleting the words "designed in whole or in part" from the statute. We therefore propose that 18 U.S.C.

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§§ 1956(a)(1)(B) and (a)(2)(B) be amended to correct the ambiguous language cited by the Court in *Cuellar*. The following language, which could be added to the bill as section 2(i), would help eliminate ambiguity in international money laundering prosecutions.

Section 1956(a)(1)(B) of title 18, United States Code, is amended to read as follows:

"(B) knowing that the transaction –

"(i) conceals or disguises, or is intended to conceal or disguise, the nature, source, location, ownership or control of the proceeds of specified unlawful activity; or

"(ii) avoids, or is intended to avoid, a transaction reporting requirement under state or federal law,"

Section 1956(a)(2)(B) of title 18, United States Code, is amended to read as follows:

"(B) knowing that the monetary instrument or funds involved in the transportation, transmission or transfer represent the proceeds of some form of unlawful activity, and knowing that such transportation, transmission, or transfer --

"(i) conceals or disguises, or is intended to conceal or disguise, the nature, source, location, ownership or control of the proceeds of specified unlawful activity; or

"(ii) avoids, or is intended to avoid, a transaction reporting requirement under state or federal law,"

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Testimony

United States Senate
Committee on the Judiciary

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Statement of

The Honorable Charles Grassley

United States Senator
Iowa
February 11, 2009

Prepared Statement of Senator Chuck Grassley of Iowa
Senate Committee on the Judiciary
"The Need for Increased Fraud Enforcement
in the Wake of Economic Downturn"
Wednesday, February 11, 2009

Mr. Chairman, thank you for holding today's important hearing on fraud enforcement. It is a timely hearing given the economic downturn and the unprecedented amounts of taxpayer money being expended to shore up the banking industry, retail lending institutions, and efforts to stabilize the housing market. In these times of massive federal financial intervention in the marketplace, we need heightened awareness about how taxpayer dollars are being spent and what controls are in place to ensure they are used effectively and efficiently.

Today's hearing is an opportunity to discuss the important work done by auditors, federal agents, and prosecutors and their efforts to investigate and prosecute those who committed mortgage fraud. The economic crisis that the country is experiencing began with problems that were related to the overleveraged, overpriced, and unsustainable housing bubble. Simply put, the housing market got too big, too fast and there weren't enough controls.

During this same period we've seen a significant amount of government resources used to try and shore up these markets. Like many of the thousands of constituents that I've heard from, I share the concern that these stabilization efforts are risky and need significant oversight. Be it the stabilization of financial institutions and the credit markets, or the nationalization of Fannie Mae and Freddie Mac, taxpayers are on the hook for it. That's why I've been pushing so hard to ensure that whenever Congress has approved more money, we make sure to have watchdogs such as inspectors general overseeing these expenditures. We're here today to discuss what tools and resources are necessary to ensure that these investments are protected.

With so much money in the housing markets, unscrupulous individuals found a marketplace that was lax in regulation and enforcement making it easy to commit fraud. I refer to a chart that is based upon information collected by the Financial Crimes Enforcement Network (FinCEN) at the Department of the Treasury. This chart shows the number of "suspicious activity reports" or SARs, filed by banks related to mortgage transactions. As you can see, the number of these SARs increased dramatically from 1996 to 2007, with over 52,000 of these reports filed in 2007. While suspicious activity reports do not in themselves represent criminal wrongdoing, they are an indicator of potential criminal acts such as mortgage fraud, money laundering, identity theft, or tax evasion.

This hearing isn't limited to mortgage fraud, and we have an opportunity to examine the impact that fraud and abuse are having on our entire economy. As I stated earlier, the problems in our housing market are the root cause of the economic downturn but the impact has been felt across the economy. Each and every American has been impacted whether they've lost a job, whether they owe more on their home than it's worth, or even if they try to purchase a new car. The financial markets have experienced the most dramatic decline, but so have manufacturers, consumers, and small businesses.

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Testimony

When Congress passed the Emergency Economic Stabilization Act in October 2008 and it created the TARP, I pushed to ensure that we had a strong, independent Inspector General and that led to the creation of the SIGTARP. I'm pleased that Neil Barofsky was confirmed by the Senate and is here to talk about his efforts to figure out how TARP money has been spent and to ensure that taxpayer dollars are accounted for.

In a short period of time, Mr. Barofsky has been able to set up a skeleton operation and recently issued his first report to Congress regarding the TARP. This report provides a cumulative review of TARP investments and is a good summation of how the TARP has been utilized thus far. I'll also add that I'm pleased that legislation I cosponsored with Senator McCaskill that clarifies that the SIGTARP has jurisdiction over all the different ways the TARP has expended taxpayer funds, not just direct asset purchases, cleared the Senate last week by unanimous consent. I hope that the House takes up this vital legislation in short order so it can be signed into law. I look forward to asking Mr. Barofsky some questions about what he anticipates finding when he starts to peel back the layers of the onion and see if our investments were worthwhile.

Today, I'm interested in examining the prevention and recovery side of the TARP program and all other efforts to stabilize the economy. Mainly, I want to know what we can do with our criminal laws to deter and prevent wrong doing that may have occurred and I also want to focus on how our civil fraud laws can be used to recover taxpayer dollars in the event they were fraudulently obtained. I think today's panel of witnesses will help shed some light about potential criminal activity that may have occurred in the housing market, economic recovery programs such as the TARP, and other areas the Government is focusing financial resources to help turn the economy around. They will also be able to discuss the danger that unscrupulous individuals pose to a successful recovery. I want to ask our witnesses representing the Department of Justice and the Federal Bureau of Investigation what initiatives they have ongoing and whether they have the tools and resources needed to get the job done and get the bad guys off the street.

This hearing also provides an opportunity to discuss important legislation that Chairman Leahy and I recently introduced that will strengthen existing criminal laws, provide important fraud fighting resources, and strengthen the federal False Claims Act to ensure that taxpayer dollars lost to fraud are recovered. The Fraud Enforcement and Recovery Act of 2009 is timely and necessary to help restore confidence in both the housing and financial markets. It provides federal investigators and prosecutors the tools and resources they need to prosecute and investigate complex financial frauds and also amends the criminal law is a couple important ways.

The bill redefines "financial institution" to include mortgage lending businesses—a category that is currently missing from that definition. It also amends the statute making it illegal to make false statements on a mortgage application to include false statements and appraisals by mortgage brokers and agents. Further, it ensures that economic relief funds and funds from the TARP are included in criminal laws prohibiting fraud against the Government, and adds commodities futures to the securities fraud statute.

The bill also makes two important clarifications to the anti-money laundering laws. First, by defining the term "proceeds" so that a recent Supreme Court decision doesn't limit the ability to go after criminals and drug dealers who launder the proceeds of their ill gotten gains. Second, the bill amends the international money laundering statute to make it a crime to transport or transfer money out of the country to evade taxes.

Finally, the legislation makes important changes to the Federal False Claims Act (FCA). The FCA is the Government's premier tool to recover Government money lost to fraud and abuse. It has recovered over $20 billion since 1986 when it was amended by legislation I introduced. This provision will ensure that the original intent of the FCA adhered to and it will prevent fraudfeasors from evading liability simply by hiring subcontractors. These amendments are not all the necessary fixes to restore the FCA to its original intent that has been eroded by the Courts, but they are necessary to ensure that all the recently expended taxpayer dollars are protected from fraud.

This legislation could not come at a more important time and will help send a message to those who have defrauded homeowners and mortgage lenders and will send an even stronger message to those who are thinking about committing a future fraud. I hope my colleagues will join Chairman Leahy and me in supporting this vital legislation.

I look forward to hearing the testimony from the witnesses and to the opportunity to question them about ways we can strengthen enforcement efforts against those who defraud individual homeowners and government programs, as well as ways we can recovery taxpayer dollars lost to fraud and abuse. I thank the witnesses in advance for their testimony.

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February 11, 2009

The Honorable Patrick Leahy
Chairman
Committee on the Judiciary
United States Senate
Washington, DC 20510

The Honorable Arlen Specter
Ranking Member
Committee on the Judiciary
United States Senate
Washington, DC 20510

Re: Fraud Enforcement and Recovery Act of 2009 (S. 386)

Dear Chairman Leahy and Ranking Member Specter:

We are writing to express our concern about Section 2 of S. 386, the Fraud Enforcement and Recovery Act of 2009 (FERA), which was introduced on February 5, 2009, and is the subject of the February 11, 2009, hearing on "The Need for Increased Fraud Enforcement in the Wake of the Economic Downturn." Our two organizations, the National Association of Criminal Defense Lawyers and the Heritage Foundation are on opposite ends of the liberal-to-conservative spectrum. As such, we often disagree on a wide range of legal issues, but we agree on our analysis of Section 2 of FERA. While we recognize that the press and many members of the public are looking to the federal government for action and vindication of any wrongs inflicted by Wall Street on Main Street, Section 2 of S. 386 would be redundant and risks overreaching.

Among the over 4,450 criminal offenses already in federal law, Congress has already enacted all of the tools prosecutors need (and far more) to prosecute any criminal activity associated with the subprime market or the current financial crisis. In fact, analysis of the federal criminal code demonstrates that the federal government is sufficiently armed to prosecute any criminal conduct that has a federal nexus and may be related to the market crisis.

In making a preliminary assessment of the types of wrongdoing coming to the surface as part of the subprime investigations, Benton Campbell, U.S. Attorney for the Eastern District of New York explained that the current "types of criminal activity are fundamentally familiar" to the criminal conduct his office has seen over the years.[1] If criminality is determined to be a pervasive cause or feature of the market crisis, additional resources in the form of money and manpower for federal, state, and local authorities may be warranted. But as U.S. Attorney Campbell said, the game is still the

[1] Noeleen G. Walder, *Criminal Prosecutions Predicted to Surge Over Financial Crisis*, New York Law Journal (Oct. 9, 2008), *available at* http://www.law.com/jsp/article.jsp?id=1202425138326 (last visited Feb. 10, 2009).

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same and the same tools that have proven reliable and effective in the past, remain in place today.

Prosecutors Have the Tools They Need To Police Financial Markets

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. 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]

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." It would in fact be fair to say that virtually all bank frauds are either mail or wire frauds, as well. 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. In addition, any fraud that "affects" a financial institution carries an increased possible penalty of a $1,000,000 fine, 30 years imprisonment, or both. The maximum federal penalty for attempted murder, by comparison, is 20 years, and the maximum for voluntary manslaughter is 15 years.[4] Unlike the elements of the bank fraud statute, conduct qualifying for the enhanced penalty must only "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.

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[2] Julie O'Sullivan, FEDERAL WHITE COLLAR CRIME: CASE AND MATERIALS 483 (2d ed. 2003).

[3] John C. Coffee, Jr. & Charles K. Whitehead, *The Federalization of Fraud: Mail and Wire Fraud Statutes*, in 1 Otto G. Obermaier & Robert G. Morvillo, WHITE COLLAR CRIME, Business and regulatory offense § 9.01 (2002).

[4] 18 U.S.C. §§ 1112 (manslaughter), 1113 (attempted murder).

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Beyond any potential criminal conduct on Wall Street, federal prosecutors have a multitude of methods for addressing whatever "retail-level" mortgage fraud schemes that have been conducted on Main Street. Overall, the largest area of mortgage fraud activity seems to be on the local level and may be characterized as "white-collar street crime," in that it consists of traditional white collar crime - mail fraud and wire fraud - on an individual and personal level. Thus, prosecutors can use the same tools to prosecute white-collar street crime that they use to prosecute any alleged criminal conduct taking place on Wall Street. The FBI itself recently acknowledged the applicability of the same provisions used for Wall Street - including Chapters 47 (fraud and false statements), 63 (mail fraud), and 73 (obstruction) of Title 18 of the United States Code - to mortgage fraud. The FBI specifically identified nine "applicable Federal criminal statutes which may be charged in connect with mortgage fraud."[5]

According to its own public statements, the FBI is not limited in its means of pursuing allegedly criminal conduct associated with the meltdown of the subprime mortgage market or with the current financial crisis. If, for some reason, certain conduct is beyond the express reach of the bank fraud statute, federal prosecutors have other ways of charging that conduct. Furthermore, conduct that is beyond the jurisdiction of federal prosecutors, as unlikely as that is under current laws, can always be prosecuted on the state and local level. Criminal conduct thus need not go unpunished even if there is no federal statute reaching it - and given the multiple federal statutory authorities currently in place, it would be exceedingly difficult to identify conduct having a constitutional nexus to the federal government that cannot be charged by federal authorities.

Indeed, the case is strong for increased state-level activity, in some instances 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 - and ***not*** the

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[5] Federal Bureau of Investigation, *Press Release: FBI Issues Mortgage Fraud Notice In Conjunction With Mortgage Bankers Association* (Mar. 8, 2007), *available at* http://www.fbi.gov/pressrel/pressrel07/mortgagefraud030807.htm (last viewed Feb. 10, 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] Coffee and Whitehead, *supra* note 3.

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- This subsection is therefore redundant.

Subsection 2(f) - Amending the Money Laundering Statute to Include the Proceeds for Specified Unlawful Activity

- Federal money laundering charges require an underlying predicate offense, which can be prosecuted with or without the money laundering charges.
- Section 2(f) would overrule the Supreme Court's decision in United States v. Santos, No. 06-1005 (U.S. 2008), in which Justice Stevens pointed out that the practical effect of allowing the Government to charge money laundering for the gross receipts of conduct that is being charged as a separate offense would be "in practical effect tantamount to double jeopardy." The Court correctly limited the term "proceeds," as used in the principal money laundering statute, to the profits of a crime, not its gross receipts.
- Before the *Santos* decision, expansive interpretations of "proceeds" fostered inappropriate and unfair use of the money laundering statute to "tack on" additional charges and significantly enhance penalties based on conduct that is virtually indistinguishable from the underlying offense.
- Outside the context of drug trafficking, money laundering charges generally result in sentences far greater than the sentences imposed for the underlying predicate offense itself. The prospect of much higher sentences for essentially the same conduct allows the government to extract plea bargains and forfeitures that might not otherwise be obtained and are often not in the interests of justice.

In sum, the expansions proposed by Section 2 of FERA do not provide the prosecutors with any methods that are not already in their arsenal.

In the mortgage fraud context, the adequacy and severity of these tools is illustrated by the case of Chalana McFarland.[7] For the crimes of "money laundering, bank fraud, wire fraud, and conspiracy to commit such acts as well as obstruction of justice and perjury," McFarland, a first-time offender, is now serving a 360-month sentence (30 years). To the extent that criminal law is capable of deterring financial crimes, such laws are already in place, often resulting in enormous fines and terms of imprisonment that are effectively life sentences.

[7] United States v. McFarland, 255 Fed. Appx. 462, 2007 WL 4142782 (11th Cir. 2007).

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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 expertise 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. Nor does this nation have a nationalized police force.

Section 2 Is Unnecessary and Counterproductive

Considering the many charging statutes that are already available to federal prosecutors, analysis of Section 2 of FERA reveals that it is both redundant and an inappropriate expansion of federal authority, at the expense of state and local law-enforcement operations, based on the thinnest of Commerce Clause jurisdictional hooks. While the purpose of FERA is laudable, that purpose is achieved through the substance of existing federal and state statutory authorities, as well as whatever increased funding and related resources is warranted under Section 3 based on the evidence available to date. Section 2 neither serves that purpose nor accomplishes anything that is not already possible under current law.

Addressing each subsection specifically, for the following reasons we believe Section 2 should be struck:

Subsection 2(a) and 2(b) – Definition of Financial Institution Expanded to Include Mortgage Lending Businesses and Mortgage Backers

- The Mail Fraud and Wire Fraud statutes, 18 U.S.C. §§ 1341 and 1343, reach any fraud perpetrated against a "mortgage lending business" because those statutes already are not limited only to crimes involving "financial institutions." Thus, the enhanced penalty under the mail and wire fraud statutes for "affecting a financial institution" would apply in cases involving a mortgage-lending business.
- The increased possible penalty under these statutes – $1 million fine, 30 years imprisonment, or both – is equal to the penalty for bank fraud.
- Most conduct that would be covered under 18 U.S.C. § 215's expanded definition of financial institution under FERA is already covered under 18 U.S.C. §§ 657 and 666.
- Intrastate conduct that is purely private, without any significant ties to federal money, insurance, assistance, etc., should be left to the jurisdiction of the state and local authorities.

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Subsection 2(c) - False Statements and Appraisals by Mortgage Brokers and Agents in Loan Applications

- The expansion of 18 U.S.C. § 1014 to include any action by a mortgage-lending business is unnecessary because mortgage-lending businesses do not operate in a vacuum. Any false statement made in order to influence any action by a mortgage-lending business is also made in order to influence action by those individuals and organizations all along the line of the financial and real estate transaction.
- Under current federal law, false statements made to a mortgage broker, who then seeks any form of action from a financial institution, would trigger criminal liability. The false statement need only "influence" the financial institution; this wrongful conduct need not be directly "perpetrated against" the financial institution in order to support a conviction under existing federal law.
- Intrastate conduct that is purely private, without any significant ties to federal money, insurance, or assistance, or to federally related or connected financial institutions, should be within the jurisdiction of the state and local authorities.

Subsection 2(d) - Major Fraud Against the Government Amended to Include Economic Relief and Troubled Asset Relief Program Funds

- All frauds associated with funds and assistance the federal government dispenses to address the subprime mortgage meltdown and current financial crisis, including under the Troubled Asset Relief Program (TARP) and related economic relief, can be prosecuted under the existing mail fraud and wire fraud statutes, 18 U.S.C. §§ 1341 and 1343.
- In fact, the so-called major fraud statute, 18 U.S.C. § 1031, that subsection 2(d) of FERA seeks to amend only covers frauds where the value of the services exceeds $1 million. By contrast, the mail and wire fraud statutes are not similarly limited.
- The mail and wire fraud statutes carry substantial maximum penalties that are equal to the major fraud statute's maximum penalties.

Subsection 2(e) - Amending Securities Fraud Statute to Include Commodities Fraud

- Commodities fraud can be prosecuted under, among others, 7 U.S.C. § 13, which provides criminal penalties for fraud, embezzlement, theft, manipulation, and false statements related to commodities, and for willful violations of parts of the Commodity Exchange Act, 7 U.S.C. § 1 *et seq.*, and rules and regulations issued by the Commodity Futures Trading Commission.
- Commodities fraud may be prosecuted under the federal mail fraud and wire fraud statutes, 18 U.S.C. §§ 1341 and 1343.

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- This subsection is therefore redundant.

Subsection 2(f) – Amending the Money Laundering Statute to Include the Proceeds for Specified Unlawful Activity

- Federal money laundering charges require an underlying predicate offense, which can be prosecuted with or without the money laundering charges.
- Section 2(f) would overrule the Supreme Court's decision in United States v. Santos, No. 06-1005 (U.S. 2008), in which Justice Stevens pointed out that the practical effect of allowing the Government to charge money laundering for the gross receipts of conduct that is being charged as a separate offense would be "in practical effect tantamount to double jeopardy." The Court correctly limited the term "proceeds," as used in the principal money laundering statute, to the profits of a crime, not its gross receipts.
- Before the *Santos* decision, expansive interpretations of "proceeds" fostered inappropriate and unfair use of the money laundering statute to "tack on" additional charges and significantly enhance penalties based on conduct that is virtually indistinguishable from the underlying offense.
- Outside the context of drug trafficking, money laundering charges generally result in sentences far greater than the sentences imposed for the underlying predicate offense itself. The prospect of much higher sentences for essentially the same conduct allows the government to extract plea bargains and forfeitures that might not otherwise be obtained and are often not in the interests of justice.

In sum, the expansions proposed by Section 2 of FERA do not provide the prosecutors with any methods that are not already in their arsenal.

In the mortgage fraud context, the adequacy and severity of these tools is illustrated by the case of Chalana McFarland.[7] For the crimes of "money laundering, bank fraud, wire fraud, and conspiracy to commit such acts as well as obstruction of justice and perjury," McFarland, a first-time offender, is now serving a 360-month sentence (30 years). To the extent that criminal law is capable of deterring financial crimes, such laws are already in place, often resulting in enormous fines and terms of imprisonment that are effectively life sentences.

[7] United States v. McFarland, 255 Fed. Appx. 462, 2007 WL 4142782 (11th Cir. 2007).

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Conclusion

Federal investigators and prosecutors alike have publicly stated that they already have the statutory authority they need to pursue whatever criminal activity might be associated with the subprime meltdown and financial crisis. This is not surprising given the vast breadth of conduct that may be prosecuted under the federal mail and wire fraud statutes and many of the other 4,450 criminal offenses in the federal criminal code.

Criminal fraud in all of its forms should be prosecuted and punished. We share your goal of ensuring that conduct that truly is criminal can always be investigated, prosecuted, and punished by the appropriate federal, state, or local authorities. But the fact remains that investigators and prosecutors at all levels of government are sufficiently armed with the tools necessary to accomplish the job.

We commend your Committee for engaging in this hearing and for taking additional steps to debate this proposal and to open it to appropriate amendments. Thorough democratic deliberation is always warranted when Congress is contemplating laws that will deprive Americans of their personal liberty, livelihood, careers, and reputations; and just, well-crafted criminal offenses and penalties cannot be created without such deliberation.

Respectfully,

Kyle O'Dowd /BH
Kyle O'Dowd
Associate Executive Director for Policy
National Association of
Criminal Defense Lawyers

Brian Walsh /BH
Brian W. Walsh
Senior Legal Research Fellow
Center for Legal and Judicial Studies
The Heritage Foundation

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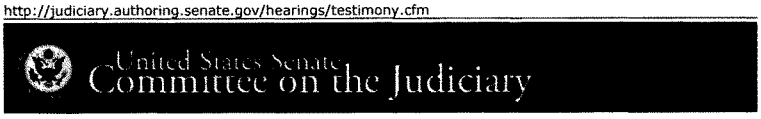

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Statement of

The Honorable Patrick Leahy

United States Senator
Vermont
February 11, 2009

Statement Of Senator Patrick Leahy
Chairman, Senate Judiciary Committee
"The Need for Increased Fraud Enforcement in the Wake of the Economic Downturn"
February 11, 2009

We turn today to the issue of fraud. We need to consider better ways to protect the money being spent to help put the economy on a road to recovery. The Federal Government has already spent hundreds of billions of dollars to stabilize our banking system and will be spending hundreds of billions more. This week the Senate finally approved the American Recovery and Reinvestment Act to provide a boost to the economy and create jobs.

Until this year, the Government has paid too little attention to the mortgage and financial fraud that has so dramatically contributed to the economic downturn. Just as we did after the savings and loan crisis nearly two decades ago, we need to rebuild and strengthen the Justice Department's ability to enforce Federal fraud laws to recover the billions lost in real estate and securities schemes. We also need to prevent these same schemes in the future. We need to ensure against the diversion of money intended to rebuild our economy and provide jobs.

Too many Americans have already lost their jobs and their homes. We learn more and more each day about the causes of this crisis, and it is now becoming clear that unscrupulous mortgage brokers and Wall Street financiers were among the principle contributors to this economic collapse.

As the crisis worsened last fall, I called upon Federal law enforcement to track down and punish those responsible for the financial and mortgage frauds. At today's hearing, we will learn more about the scope of the fraud problem, about how enforcement efforts are progressing, and whether the Justice Department needs new tools and greater resources to root out those responsible for these financial crimes.

Senators from both sides of the aisle are working together to strengthen the Government's ability to fight fraud in these difficult economic times. Last week, Senator Grassley, Senator Kaufman and I introduced the Fraud Enforcement and Recovery Act to provide resources for strengthened fraud enforcement at the Justice Department, the FBI, the Office of Inspector General at the Department of Housing and Urban Development, and the Postal Inspection Service. This bill would also create important new tools for prosecutors to use in their fight against fraud. In addition, Senators Schumer and Shelby introduced a complementary bill calling for additional FBI agents, Assistant U.S. Attorneys, and staff at the Securities and Exchange Commission.

While the full scope of the fraud that triggered this economic crisis is still unknown, we are beginning to learn what went wrong. As banks and private mortgage companies relaxed their standards for loans, approving ever riskier mortgages with less and less due diligence, they created an environment that invited fraud. Private mortgage brokers and lending businesses came to dominate the home housing market, and these companies were not subject to the kind of banking oversight and internal regulations that had traditionally helped to prevent fraud. We are now seeing the results of this lax supervision and absence of accountability.

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In the last two weeks, the Justice Department has announced prosecutions involving more than $100 million lost to mortgage and real estate frauds, and the FBI estimates there may be as much as $2 billion lost to these frauds each year. Just last year in Vermont, a crooked mortgage broker was convicted of defrauding homeowners and banks of over $1 million in deals related to more than 200 homes in Vermont and upstate New York.

The problem is not limited to mortgage frauds. Home mortgages were packaged together and turned into securities that were bought and sold in largely unregulated markets on Wall Street. As the value of the mortgages started to decline with falling housing prices, these securities unraveled. Unfortunately, some on Wall Street were not honest about these securities, leading to more fraud, and victimizing investors nationwide.

All of this fraud has contributed to an unprecedented collapse in the mortgage-backed securities market. In the past year, banks and financial institutions in the United States alone have suffered more than $500 billion in losses associated with the sub-prime mortgage industry. Some of our Nation's largest financial institutions collapsed as a result. And that is not to mention the Madoff scandal, which included what is reported to be a $50 billion Ponzi scheme.

We must give law enforcement agencies the tools and resources they need to root out fraud so that it can never again place our financial system at risk. Ordinary Americans, who bear the brunt of this financial downturn, deserve to know that their Government is doing all it can to hold responsible those who committed fraud in the run-up to this collapse and to prevent future fraud, particularly with so much taxpayer money at risk.

Our witnesses this morning are Deputy FBI Director John Pistole, and Rita Glavin, the Acting Head of the Justice Department's Criminal Division. We also welcome Neil Barofsky, the new Special Inspector General for the Troubled Assets Relief Program. Mr. Barofsky, you have a tremendously important charge to protect and oversee the billions being spent on behalf of taxpayers through the TARP program. I look forward to working with you all to restore our nation's capacity to enforce effective anti-fraud laws.

# # # # #

STATEMENT OF

JOHN PISTOLE
DEPUTY DIRECTOR
FEDERAL BUREAU OF INVESTIGATION
UNITED STATES DEPARTMENT OF JUSTICE

BEFORE THE

UNITED STATES SENATE
COMMITTEE ON THE JUDICIARY

HEARING ENTITLED

"THE NEED FOR INCREASED FRAUD ENFORCEMENT IN THE WAKE OF THE ECONOMIC DOWNTURN"

PRESENTED

FEBRUARY 11, 2009

Good morning Mr. Chairman and Members of the Committee. I want to thank you for the opportunity to testify before you today about the Federal Bureau of Investigation's (FBI) efforts to combat mortgage fraud and other financial frauds. Much the same as the Savings and Loan (S&L) Crisis of the 1980s crippled our economy, so too has the current financial crisis. Many of the lessons learned and best practices from our work during the past decade, such as the Enron investigation, will clearly help us navigate the expansive crime problem currently taxing law enforcement and regulatory authorities.

In the late 1980s and early 1990s, the United States experienced a similar financial crisis with the collapse of the savings and loans. The Department of Justice (DOJ), and more specifically the FBI, were provided a number of tools through the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) and Crime Control Act of 1990 (CCA) to combat the aforementioned crisis. As stated in Senate Bill 331 dated January 27, 2009, "in the wake of the Savings and Loan crisis of the 1980s, a series of strike forces based in 27 cities was staffed with 1000 FBI agents and forensic experts and dozens of federal prosecutors. That effort yielded more than 600 convictions and $130,000,000 in ordered restitution."

However, today's financial crisis dwarves the S&L crisis as financial institutions have reduced their assets by more than $1 trillion related to the current global financial crisis compared to the estimated $160 million lost during the S&L crisis. Mortgage and related corporate fraud were not the sole sources of the current financial crisis; however, it would be irresponsible to neglect mortgage fraud's impact on the U.S. housing and financial markets.

As former FBI Assistant Director Chris Swecker testified in 2004 before the House Financial Services Sub-Committee: "If fraudulent practices become systemic within the mortgage industry and mortgage fraud is allowed to become unrestrained, it will ultimately place financial institutions at risk and have adverse effects on the stock market. Investors may lose faith and require higher returns from mortgage backed securities. This may result in higher interest rates and fees paid by borrowers and limit the amount of investment funds available for mortgage loans."

He also noted that the FBI supported new approaches to address mortgage fraud and its effects on the U.S. financial system, to include:

- a mechanism to require the mortgage industry to report fraudulent activity, and
- the creation of "Safe Harbor" provisions to protect the mortgage industry under a mandatory reporting mechanism.

What has occurred has been far worse than Assistant Director Swecker predicted. Mortgage fraud and related financial industry corporate fraud have shaken the world's confidence in the U.S. financial system. The fraud schemes have adapted with the changing economy and now individuals are preyed upon even as they are about to lose their homes. But what is mortgage fraud?

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Although there is no specific statute that defines mortgage fraud, each mortgage fraud scheme contains some type of material misstatement, misrepresentation or omission relied upon by an underwriter or lender to fund, purchase or insure a loan.

The FBI delineates mortgage fraud in two distinct areas: 1) Fraud for Profit; and 2) Fraud for Housing. Fraud for Profit uses a scheme to remove equity, falsely inflate the value of the property or issue loans relating to fictitious property(ies). Many of the Fraud for Profit schemes rely on "industry insiders", who override lender controls. The FBI defines industry insiders as appraisers, accountants, attorneys, real estate brokers, mortgage underwriters and processors, settlement/title company employees, mortgage brokers, loan originators, and other mortgage professionals engaged in the mortgage industry.

Fraud for Housing represents illegal actions perpetrated by a borrower, typically with the assistance of real estate professionals. The simple motive behind this fraud is to acquire and maintain ownership of a house under false pretenses. This type of fraud is typified by a borrower who makes misrepresentations regarding the borrower's income or employment history to qualify for a loan.

The FBI compiles data on mortgage fraud through Suspicious Activity Reports (SARs) filed by financial institutions and through the Department of Housing and Urban Development (HUD) Office of Inspector General (OIG) reports. The FBI also receives complaints from the industry at large.

While a significant portion of the mortgage industry is void of any mandatory fraud reporting and there is presently no central repository to collect all mortgage fraud complaints, SARs from financial institutions have indicated a significant increase in mortgage fraud reporting. For example, during Fiscal Year (FY) 2008, mortgage fraud SARs increased more than 36 percent to 63,173. The total dollar loss attributed to mortgage fraud is unknown. However, 7 percent of SARs filed during FY 2008 indicated a specific dollar loss, which totaled more than $1.5 billion. Only 7 percent of SARs report dollar loss because of the time lag between identifying a suspicious loan and liquidating the property through foreclosure and then calculating the loss amount.

One proposal informally discussed within the FBI is the creation of a mandatory reporting mechanism (beyond the current SAR requirements, which only depository institutions are required to file) to allow industry insiders to be the front line in preventing mortgage fraud. Zero tolerance within the industry combined with a mandatory system of reporting fraudulent activities to the Treasury Department's Financial Crimes Enforcement Network (FinCEN) and made available to the FBI and HUD would be a major step forward in addressing the practice of mortgage fraud.

Based on current and past investigations, the FBI has recognized that the financial industry is susceptible to a number of vulnerabilities through industry insiders and other individuals involved in loan and finance transactions. However, the FBI recognizes that the term "industry insiders" can be interpreted very broadly, and many mortgage finance-

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related entities are either loosely or completely unregulated at the state or federal level. FBI would like to work with FinCEN to expand the exercise of their statutory authority under the Bank Secrecy Act (BSA) to consider the implementation of SAR and anti-money laundering program requirements on some of the businesses and professions that currently fall outside the scope of SAR reporting. A vigilant industry combined with this reporting stream, when made available to the FBI and HUD, would be a major step forward in addressing the practice of mortgage fraud.

Fraud Trends

The current financial crisis has produced one unexpected consequence: it has exposed prevalent fraud schemes that have been thriving in the global financial system. These fraud schemes are not new but they are coming to light as a result of market deterioration. For example, current market conditions have helped reveal numerous mortgage fraud, Ponzi schemes and investment frauds, such as the Bernard Madoff alleged scam. These schemes highlight the need for law enforcement and regulatory agencies to be ever vigilant of White Collar Crime both in boom and bust years.

The FBI has experienced and continues to experience an exponential rise in mortgage fraud investigations. The number of open FBI mortgage fraud investigations has risen from 881 in FY 2006 to more than 1,600 in FY 2008. In addition, the FBI has more than 530 open corporate fraud investigations, including 38 corporate fraud and financial institution matters directly related to the current financial crisis. These corporate and financial institution failure investigations involve financial statement manipulation, accounting fraud and insider trading. The increasing mortgage, corporate fraud, and financial institution failure case inventory is straining the FBI's limited White Collar Crime resources.

Although there are many mortgage fraud schemes, the FBI is focusing its efforts on those perpetrated by industry insiders who are part of organized enterprises engaged in mortgage Fraud for Profit. Industry insiders are of priority concern as they are, in many instances, the facilitators that permit the fraud to occur. The FBI utilizes SAR data to help identify fraud schemes perpetrated by insiders. However, SAR data does not capture suspicious activity identified by the entire mortgage industry. Requiring the entire industry to report suspicious activity would give us a more complete data set to exploit. The FBI is engaged with the mortgage industry in identifying fraud trends and educating the public. Some of the current rising mortgage fraud trends include: equity skimming, property flipping, mortgage identity related theft, and foreclosure rescue scams.

Equity skimming is a tried and true method of committing mortgage fraud and criminals continue to devise new schemes. Today's common equity skimming schemes involve the use of corporate shell companies, corporate identity theft and the use or threat of bankruptcy/foreclosure to dupe homeowners and investors.

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Property flipping is nothing new; however, once again law enforcement is faced with an educated criminal element that is using identity theft, straw borrowers and shell companies, along with industry insiders to conceal their methods and override lender controls.

Identity theft in its many forms is a growing problem and is manifested in many ways, including mortgage documents. The mortgage industry has indicated that personal, corporate, and professional identity theft in the mortgage industry is on the rise. Computer technology advances and the use of online sources have also assisted the criminal in committing mortgage fraud. However, the FBI is working with its law enforcement and industry partners to identify trends and develop techniques to thwart illegal activities in this arena.

Foreclosure rescue scams are particularly egregious in that fraudsters take advantage and illegally profit from other individuals' misfortunes. As foreclosures continue to rise across the country, so too have the number of foreclosure rescue scams that target unsuspecting victims. These scams include victims losing their home equity or paying thousands of dollars in fees, and then receiving little or no services, and ultimately losing their home to foreclosure. The FBI is again working with our law enforcement and regulatory partners along with industry partners to target, disrupt and dismantle the individuals and/or companies engaging in these fraud schemes.

Proactive Approach to Financial Frauds

The FBI has implemented new and innovative methods to detect and combat mortgage fraud. One of these proactive approaches was the development of a property flipping analytical computer application, first developed by the Washington Field Office, to effectively identify property flipping in the Baltimore and Washington areas. The original concept has evolved into a national FBI initiative which employs statistical correlations and other advanced computer technology to search for companies and persons with patterns of property flipping. As potential targets are analyzed and flagged, the information is provided to the respective FBI field office for further investigation. Property flipping is best described as purchasing properties and artificially inflating their value through false appraisals. The artificially valued properties are then sold at a higher price to an associate of the "flipper" at a substantially inflated price. Often flipped properties go into foreclosure and are ultimately repurchased for a fraction of their original value.

Other methods employed by the FBI include sophisticated investigative techniques, such as undercover operations and wiretaps. These investigative measures not only result in the collection of valuable evidence, they also provide an opportunity to apprehend criminals in the commission of their crimes, thus reducing loss to individuals and financial institutions. By pursuing these proactive methods in conjunction with historical investigations, the FBI is able to realize operational efficiencies in large scale investigations.

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In December 2008, the FBI dedicated resources to create the National Mortgage Fraud Team at FBI headquarters in Washington, D.C. The Team has the specific responsibility for all management of the mortgage fraud program at both the origination and corporate level. This Team will be assisting the field offices in addressing the mortgage fraud problem at all levels. The current financial crisis, however, has required the FBI to move resources from other white collar crime and criminal programs in order to appropriately address the crime problem. Since January 2007, the FBI has increased its agent and analyst manpower working mortgage fraud investigations. The Team provides tools to identify the most egregious mortgage fraud perpetrators, prioritize pending investigations, and provide information to evaluate where additional manpower is needed.

Partnerships

One of the best tools the FBI has in its arsenal for combating mortgage fraud is its long-standing partnerships with other federal, state and local law enforcement. This is not a new tool employed by the FBI. Collaboration, communication, and information-sharing have long been a proven solution to the nation's most difficult crimes. In response to a growing gang problem, for example, the FBI stood up Safe Streets Task Forces across the country. In response to crimes in Indian Country, the FBI developed the Safe Trails Task Force Program. In response to this new threat, the FBI stood up Mortgage Fraud Task Forces across the country.

Presently, there are 16 mortgage fraud task forces and 39 working groups in the country. With representatives of federal, state, and local law enforcement, these task forces are strategically placed in areas identified as high threat areas for mortgage fraud. Partners are varied but typically include representatives of HUD-OIG, the U.S. Postal Inspection Service, the Internal Revenue Service, FinCEN, the Federal Deposit Insurance Corporation, as well as State and local law enforcement officers across the country.

While the FBI has increased the number of agents around the country who investigate mortgage fraud cases from 120 Special Agents in FY 2007 to 180 Special Agents in FY 2008, this multi-agency model serves as a force-multiplier, providing an array of resources to adequately identify the source of the fraud, as well as finding the most effective way to prosecute each case, particularly in active markets where fraud is widespread. We are pleased to report that the model is working.

Last June, for example, we worked closely with our partners on "Operation Malicious Mortgage" – a massive multiagency takedown of mortgage fraud schemes involving more than 400 defendants nationwide. That operation focused primarily on three types of mortgage fraud: lending fraud, foreclosure rescue schemes, and mortgage-related bankruptcy schemes. Among the 400-plus subjects of "Operation Malicious Mortgage", there have been 164 convictions and 81 sentencings so far for crimes that have accounted for more than $1 billion in estimated losses. Forty-six of our 56 field offices around the country took part in the operation, which has resulted in the forfeiture and/or seizure of more than $60 million in assets.

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In addition to the effort placed in standing up mortgage fraud task forces, once a month the FBI is one of the DOJ participants in the national Mortgage Fraud Working Group (MFWG), which DOJ chairs. The MFWG represents the collaborative effort of multiple Federal agencies and facilitates the information sharing process across the aforementioned agencies, as well as private organizations. Together, we are building on existing FBI intelligence databases to identify large industry insiders and criminal enterprises conducting systemic mortgage fraud. The FBI is also a member of the President's Corporate Fraud Task Force which is comprised of investigators from the Securities and Exchange Commission, the Internal Revenue Service, the U.S. Postal Inspection Service, the Commodity Futures Trading Commission, and the Financial Crimes Enforcement Network. The purpose of the Corporate Fraud Task Force is to maximize intelligence sharing between membership agencies and to ensure the violations related to corporate fraud are appropriately addressed.

The FBI also participates in the Corporate/Securities Fraud Working Group, a national interagency coordinating body established by DOJ to provide a forum for exchanging information and discussing violation trends, law enforcement issues and techniques. In addition, since April 2007, FBI headquarters personnel have met with representatives from the Securities and Exchange Commission once a month to coordinate the respective Corporate Fraud inventories focused on the current financial crisis and to share intelligence.

Industry Liaison

In addition to its partners in law enforcement and regulatory areas, the FBI also continues to foster relationships with representatives of the mortgage industry to promote mortgage fraud awareness. The FBI has spoken at and participated in various mortgage industry conferences and seminars, including those sponsored by the Mortgage Bankers Association (MBA).

To raise awareness of this issue and provide easy accessibility to investigative personnel, the FBI has provided contact information for all FBI Mortgage Fraud Supervisors to relevant groups including the MBA, Mortgage Asset Research Institute, Fannie Mae, Freddie Mac and others. Additionally, the FBI is collaborating with industry to develop a more efficient mortgage fraud reporting mechanism for those not mandated to report such activity. This Suspicious Mortgage Activity Report (SMARt Form) concept is under consideration by the MBA. The FBI supports providing a "safe harbor" for lending institutions, appraisers, brokers and other mortgage professionals similar to the provisions afforded to financial institutions providing SAR information. The "Safe Harbor" provision would provide necessary protections to the mortgage industry under a mandatory reporting mechanism. This will also better enable the FBI to provide reliable mortgage fraud information based on a more representative population in the mortgage industry.

Lenders are painfully aware that fraud is affecting their bottom line. Through routine interaction with FBI personnel, industry representatives are aware of our commitment to

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address this crime problem. The FBI frequently participates in industry sponsored fraud deterrence seminars, conferences and meetings which include topics such as quality control and industry best practices to detect, deter, and prevent mortgage fraud. These meetings play a significant role in training and educating industry professionals. Companies share current and common fraud trends, loan underwriting weaknesses and best practices for fraud avoidance. These meetings also increase the interaction between industry and FBI personnel.

Additionally, the FBI continues to train its personnel and conduct joint training with HUD-OIG and industry on mortgage fraud. As a training model, the FBI seeks industry experts to assist in its internal training programs. For example, industry has assisted training FBI personnel on mortgage industry practices, documentation, laws and regulations. Industry partners have offered to assist the FBI in developing advanced mortgage fraud investigative training material and fraud detection tools.

Conclusion

Mr. Chairman, the FBI remains committed to its responsibility to aggressively investigate significant financial crimes which include mortgage fraud. We will continue to work with the Office of Management and Budget, and the Congress to ensure that adequate resources are available to address these threats. To maximize our current resources, we are relying on intelligence collection and analysis to identify emerging trends to target the greatest threats. We also will continue to rely heavily on the strong relationships we have with both our law enforcement and regulatory agency partners.

The FBI looks forward to working with you and other members of this committee on solving this serious threat to our nation's economy. Thank you for allowing me the opportunity to testify before you today. I look forward to taking your questions.

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