



Department of Justice

STATEMENT OF

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**JUDICIARY COMMITTEE
UNITED STATES SENATE**

ENTITLED

**“MORTGAGE FRAUD, SECURITIES FRAUD, AND THE
FINANCIAL MELTDOWN: PROSECUTING THOSE
RESPONSIBLE”**

PRESENTED

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Good afternoon Chairman Leahy, Ranking Member Sessions, and Members of the Committee. I want to thank you for the opportunity to testify before you today about the FBI's ongoing efforts to combat significant financial crimes.

As we all know, financial fraud, to include mortgage, corporate, and securities frauds, were not the primary sources of the current financial crisis; collectively however, these frauds have significantly impacted the U.S. housing and financial markets.

Mortgage Fraud continues to pose a significant threat to lenders, investors, residential real estate values, and the U.S. economy. The FBI delineates Mortgage Fraud into two distinct areas: 1) Fraud for Profit; and 2) Fraud for Housing. Fraud for Profit generally employs schemes to remove equity, falsely inflate the value of the property, or issue loans relating to fictitious properties. 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, on the other hand, represents illegal actions perpetrated by borrowers, typically with the assistance of real estate professionals. The simple motive behind this fraud is to acquire and maintain ownership of a residence under false pretenses. This type of fraud is typified by a borrower who makes misrepresentations regarding the income or employment history to qualify for a loan, which the borrower would otherwise not qualify for. Although generally not as sophisticated as Fraud for Profit schemes, Fraud for Housing has played a large role in the decline of residential real estate values since unqualified buyers defaulted on loans they would otherwise not have obtained but for their fraud.

The FBI compiles data on Mortgage Fraud through Suspicious Activity Reports (SARs) filed by financial institutions through the Financial Crimes Enforcement Network (FinCEN), and through reports generated by the Department of Housing and Urban Development (HUD) Office of Inspector General (OIG). The FBI also receives and shares information pertaining to Mortgage Fraud through its national and regional working groups, as well as complaints from the industry at large.

Mortgage Fraud, however, is just one component of the recent financial crisis, which has left trillions of dollars of losses in its wake as the Dow Jones Industrial Average fell to 6,547 in March 2009 from its high of 14,164 in October 2007. Throughout the past decade, a flourishing market developed for the securitization and sale of assets such as mortgages by financial institutions and other entities who were seeking to alleviate risk, increase cash flows and profit from these complex financial products. As underwriting requirements began to erode, sub-prime assets began to make up the majority of asset backed securities. In 2007, the markets for sub-prime asset backed securities began to collapse, which has been credited as one of the primary causes of the financial meltdown. In the wake of this historic economic calamity, the FBI has and will continue to investigate criminal allegations related to the activity that contributed to the financial crisis using all available tools at our disposal.

Since the financial meltdown in the fall of 2007, the FBI has effectively combated significant financial frauds on various fronts. For example, we have more than 2,100 pending Corporate and Securities Fraud investigations across the country, many with losses exceeding \$100 million, and several with losses over \$1 billion. The FBI has prioritized its efforts to combat the most

egregious Corporate and Securities Fraud offenders, which resulted in 460 convictions in Fiscal Year (FY) 2009.

Financial Fraud Trends

It is no secret that the financial crisis caused severe damage to both the financial markets and investor confidence. The crisis not only revealed new fraud schemes, such as material misrepresentations in the marketing of asset backed securities, but also exposed established fraud schemes which had been thriving in the global financial system, such as, Ponzi schemes. These schemes, both old and new, highlight the need for law enforcement and regulatory agencies to be ever vigilant, and work closer together, to identify financial fraud both in boom and bust years.

Securities Fraud - High Yield Investment Fraud/Ponzi Schemes

High Yield Investment Fraud schemes have many variations, all of which are characterized by offers of low risk investments, guaranteeing an unusually high rate of return. Victims are enticed by the prospect of easy money, and a fast turnaround.

The most common form of these frauds is the Ponzi scheme, which is named after early 20th century criminal Charles Ponzi. These schemes use money collected from new victims, rather than profits from an underlying business venture, to pay the high rates of return promised to earlier investors. This arrangement gives investors the impression there is a legitimate, money-making enterprise behind the fraudster's story; but in reality, unwitting investors are the only source of funding.

Another type of High Yield Investment Fraud is Prime Bank Investment Fraud. In these schemes, victims are told that certain financial instruments such as notes, letters of credit, debentures, or guarantees have been issued by well-known institutions such as the World Bank, and offer a risk-free opportunity with high rates of return. Perpetrators often claim unusually high rates of return and low risk are the result of a worldwide secret exchange open only to the world's largest financial institutions. Victims are often drawn into Prime Bank Investment Frauds because the criminals use sophisticated terms, legal looking documents, and claim that the investments are insured against loss.

As the financial crisis expanded, drying up investment funds and causing investors to begin seeking returns of their principal, investment fraud schemes began to unravel. In FY 2009, the FBI realized a 105% increase in new High Yield Investment Fraud investigations when compared to FY 2008 (314 as opposed to 154), many with losses exceeding \$100 million. Many of the Ponzi scheme investigations have an international nexus, and have affected thousands of victims. The most significant of these, the \$64 billion Ponzi scheme perpetrated by Bernard L. Madoff, resulted in the longest prison sentence in the history of financial crime – 150 years. Similarly, both, Robert Allen Stanford of Houston, Texas, and Thomas Petters of Minneapolis, Minnesota, have been charged in alleged billion dollar Ponzi schemes. Petters was recently found guilty by a jury in Minnesota of 20 counts of fraud and other federal offenses. The FBI continues to aggressively investigate this criminal threat, and currently has more than 1,500 related Securities Fraud investigations.

Insider Trading

The FBI proactively investigates Insider Trading schemes, using all available tools to remove the most egregious offenders from the financial markets. A recent highlighted success came with the indictments and subsequent arrests related to allegations of Insider Trading within Galleon Group, a prominent Hedge Fund, located in New York City. To date, fourteen individuals have been arrested and the investigation is ongoing. The FBI continues to work closely with the U.S. Securities and Exchange Commission (SEC) on such matters, in a parallel law enforcement and regulatory effort to ensure fairly operated financial markets. Lack of regulatory oversight and transparency in the Hedge Fund industry makes this industry susceptible to various types of Securities Fraud and insider trading, and creates challenges to law enforcement. In addition, fraud committed by Hedge Funds poses a serious threat of substantial losses due to the fact Hedge Funds are typically highly leveraged.

Corporate Fraud

As the lead law enforcement agency investigating Corporate Fraud, the FBI has focused its efforts on cases which involve accounting schemes, self-dealing by corporate executives, and obstruction of justice. The majority of Corporate Fraud cases pursued by the FBI involve accounting schemes designed to deceive investors, auditors, and analysts about the true financial condition of a corporation. Through the manipulation of financial data, the share price of a corporation's stock remains artificially inflated based on fictitious performance indicators provided to the investing public. In addition to significant financial losses to investors, Corporate Fraud has the potential to cause immeasurable damage to the U.S. economy and investor confidence.

The FBI has observed a rise in Corporate Fraud schemes and trends, such as, the failures of prominent financial institutions partly caused by the recent collapse of the Sub-Prime market, the falsification of accounting records to obtain government funding through the \$700 billion Troubled Asset Relief Program (TARP), and misrepresentations regarding the risks and valuations of complex financial instruments (e.g., credit default swaps and mortgage backed securities). Over the last five years, Corporate Fraud investigations have increased by 78 percent; to more than 590 open investigations.

Numerous corrupt executives, and accounting fraud schemes, have also been exposed as more companies experience liquidity and cash flow problems, as evident in recent investigations to include the Deferred Prosecution Agreement obtained against Beazer Homes; and the recent trial of Thomas Petters. As a result of economic difficulties facing many U.S. corporations, it is anticipated that some companies will continue to commit various accounting frauds, in an effort to hide their true financial condition, from the public, until the economic crisis has ceased.

Securities Fraud – Market Manipulation

Market Manipulation, or "Pump and Dump," schemes are based on the manipulation of lower-volume stocks purchased on small over-the-counter markets. The basic goal of Market Manipulation fraud is to artificially inflate ("pump") the price of penny stocks so the conspirators can sell ("dump") their shares at a large profit. The "pump" involves recruiting unwitting investors through false or deceptive sales practices, public information, or corporate filings. Many of these schemes use "boiler room" methods where brokers, who are bribed by the conspirators, use high pressure sales tactics to increase the number of investors and, therefore, raise the price of

the stock. Once the price of the targeted shares reaches a certain point, the perpetrators "dump" their shares at a huge profit and leave innocent investors with significant losses. These schemes generate an estimated \$6 billion in losses each year, and have the ability to significantly impact investor confidence.

One recent trend seen in Market Manipulation cases involves "computer intrusion." Computer intrusion for the purpose of Market Manipulation often includes a criminal hacking into victims' personal online brokerage accounts and using the accounts to purchase shares of a penny stock to inflate its price. As in normal Pump and Dump schemes, once the price of the stock reaches a certain point, the perpetrators dump their own shares and walk away with a large profit.

The FBI employs a number of proactive techniques to target Market Manipulation perpetrators, and currently has 109 such cases. In FY 2009, 62 individuals were charged in Market Manipulation schemes following FBI investigation.

Foreclosure Rescue Scams

Foreclosure rescue scams are particularly egregious because fraudsters take advantage and illegally profit from the misfortune of others. As foreclosures continue to rise across the country, so have the number of foreclosure rescue scams targeting unsuspecting victims. These scams include victims losing home equity; or paying thousands of dollars in fees in exchange for little or no services. In many of these cases, victims ultimately lose their home to foreclosure. The FBI is again working with our law enforcement, regulatory, and industry partners to target, disrupt, and dismantle the individuals, and/or companies, engaging in these fraud schemes.

Proactive Approach to Financial Fraud

The FBI has implemented innovative and proactive methods to detect and combat Mortgage Fraud, and other significant financial frauds. Foremost, is the development of the Financial Intelligence Center (FIC). The FIC was established on 09/14/2009, with resources appropriated by Congress, through H.R. 2346, Supplemental Appropriations Act, to the FBI to investigate Mortgage Fraud, Predatory Lending, Market Manipulation, and other financial frauds. The FIC is currently staffed with one Supervisory Intelligence Analyst (SIA), eight Staff Operations Specialists (SOS), and six Intelligence Analysts (IA). In FY 2010, the FIC should be fully operational with a total staffing level of 58. The FIC's mission is to provide tactical analysis of intelligence data, data sets, and databases, by using evolving technology and data exploitation techniques, to create targeting packages to identify the most egregious criminal offenders, and to enhance current criminal investigations. In addition, the FIC responds to requests by FBI field offices to complement the field's resources to identify emerging economic threats. The FIC also provides training to the field to assist with identifying the most egregious criminal enterprises.

The Department of Justice's Criminal Division is initiating a Mortgage Fraud Initiative that will utilize, among other tools, the FIC's analysis in the prosecution of its cases.

Another proactive approach was the development of an analytical computer application to identify property flipping transactions, first developed by the FBI's 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 demonstrating patterns of alleged illegal property flipping. As potential targets are analyzed and flagged, the information is

provided to the respective FBI field office for further assessment. Illegal Property flipping is described as purchasing properties and artificially inflating their value through false appraisals. The artificially valued properties are then sold to an associate of the “flipper” at a substantially inflated price. Quite often the property is “flipped” within 30 days, but sometimes the “flip” occurs on the same day as the original purchase. Typically, illegally 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. These investigative measures not only result in the collection of valuable evidence, but also provide an opportunity to apprehend criminals in the commission of their crimes, thus reducing losses to individuals and financial institutions.

In December, 2008, the FBI dedicated resources to create the National Mortgage Fraud Team (NMFT), at FBI headquarters in Washington, D.C. The NMFT, which has responsibility for management of the FBI’s Mortgage Fraud program, serves as a veritable fusion center. Through program guidance, oversight, training, and information sharing, the NMFT provides the tools necessary to identify the most egregious Mortgage Fraud perpetrators, prioritize pending investigations, and ensure that Mortgage Fraud efforts are both threat-based and intelligence driven.

Partnerships

Some of the best tools in the FBI’s arsenal for combating financial frauds are its long-standing partnerships with federal, state and local law enforcement and regulatory agencies. Collaboration, communication, and information-sharing have long been a proven solution to the nation’s most complex 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 the recent wave of financial crimes, the FBI stood up Mortgage Fraud Task Forces across the country. Currently, there are 16 Mortgage Fraud task forces and 61 working groups nationwide. 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 – Criminal Investigative Division, FinCEN, the Federal Deposit Insurance Corporation (FDIC), and the U.S. Secret Service, as well as, state and local law enforcement offices.

As of October 31, 2009, the FBI has nearly tripled the number of Special Agents in the field, who investigate Mortgage Fraud cases, from 120 in FY 2007, to 354 Special Agents. This multi-agency task force model serves as a force-multiplier, providing an array of resources to adequately identify the sources of the fraud; allowing agencies to share investigative expertise; and increases jurisdictional avenues, allowing task force members to find the most effective way to prosecute each case, particularly in active markets where fraud is widespread. We are pleased to report that model is working.

In October, 2009, for example, the FBI coordinated closely with our federal, state, and local law enforcement partners in “Operation Bad Deeds” – a massive multi-agency takedown of Mortgage Fraud schemes in New York State. In all, 41 defendants were charged with fraudulently obtaining \$64 million in residential mortgages on more than 100 properties. Among those charged were six lawyers, seven loan officers, three mortgage brokers, one accountant, and a residential property appraiser.

A Mortgage Fraud Surge was initiated in January 2009 in the Middle District of Florida, and was completed on October 31, 2009. The Surge resulted in charges being filed against more than 100 persons, involved allegations concerning more than \$400 million in mortgage loans procured by fraud, and included more than 700 properties. Participating in the Surge were FBI Jacksonville, FBI Tampa, as well as several other state and federal law enforcement agencies.

In addition to our efforts to create Mortgage Fraud task forces across the country, the FBI participates on both the national Mortgage Fraud Working Group (MFWG), and the national Bank Fraud Working Group (BFWG). The MFWG and BFWG, chaired by the DOJ Fraud Section, represent a collaborative effort of multiple federal agencies; and facilitate the information sharing process across agencies, as well as to private organizations. Working in partnerships, the FBI is building on existing FBI intelligence databases to identify industry insiders and egregious criminal enterprises conducting systemic Mortgage Fraud.

In order to most effectively combat the threats of Corporate and Securities Fraud, the FBI has partnered with numerous external agencies to form 37 Corporate Fraud and/or Securities Fraud Working Groups across the country. These working groups, such as the DC Metro Corporate Fraud Working Group, enhance cooperation and information sharing, and provide a venue where the FBI can meet with our partners, e.g. SEC, to discuss current trends, threats, and the progress of selected ongoing investigations. In addition, the FBI works closely with the Special Inspector General for the TARP (SIG-TARP) to guard against fraud in the \$700 billion TARP. The FBI is currently conducting several joint investigations with the SIG-TARP. Further, the FBI participates on the Term Asset-Backed Securities Loan Facility (TALF) Task Force. The TALF is a Federal Reserve program through which the Federal Reserve Bank of New York makes loans, which are secured by collateral in the form of asset-backed securities. These loans are typically made to Hedge Funds and other investment groups, and are vulnerable to fraud.

The FBI is a member of the newly formed Financial Fraud Enforcement Task Force (FFETF) recently announced by Attorney General Holder, which replaced the President's Corporate Fraud Task Force. The new task force is comprised of more than 20 agencies, including the SEC, the Commodities Futures Trading Commission (CFTC), the Department of Treasury, the FDIC, and HUD. The purpose of the Financial Fraud Enforcement Task Force is to maximize intelligence sharing between member agencies and to ensure that significant financial crimes related to the financial crisis and economic recovery efforts are appropriately addressed.

The FBI also participates in the Securities and Commodities Fraud Working Group, a national interagency coordinating body established by the DOJ Fraud Section to provide a forum for exchanging information, discussing violation trends, legal developments, law enforcement issues, and investigative techniques. In addition, FBI Corporate Fraud and Securities Fraud program managers frequently meet with their counterparts at the SEC's Home Office in Washington, D.C. to discuss threats, emerging trends, pending investigations, and to share intelligence.

Industry Liaison

In addition to its partners in law enforcement and regulatory areas, the FBI 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), the American Bankers Association, and the BITS Financial Services Roundtable (a consortium of financial institutions).

To raise awareness of this issue and provide easy accessibility to investigative personnel, the FBI has provided contact information of the FBI's Mortgage Fraud Supervisors to relevant groups, to include the MBA, Mortgage Asset Research Institute (MARI), Fannie Mae, Freddie Mac, and others.

Lenders are painfully aware how fraud affects their bottom line. Through routine interaction with FBI personnel, industry representatives are aware of our commitment to 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, load 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, and industry views of laws and regulations. Industry partners have offered to assist the FBI in developing advanced Mortgage Fraud investigative training material and fraud detection tools.

Likewise, the FBI makes considerable investment in industry liaison for our Corporate Fraud and Securities Fraud programs. We not only bring in industry experts to train FBI personnel, such as, the Financial Industry Regulatory Authority (FINRA), but FBI personnel also frequently attend meetings and conferences set up by such industries as part of our effort to foster relationships and proactively gather information.

Conclusion

Mr. Chairman, the FBI remains committed to its responsibility to aggressively investigate significant financial crimes. 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 and egregious offenders to ensure we 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, in solving this serious threat to our nation's economy. Thank you for allowing me the opportunity to testify before you today.