



Department of Justice

STATEMENT OF

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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

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

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.

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.

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.

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

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.

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

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.

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

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

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

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.

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

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.

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

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.

§§ 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,”