



# **Department of Justice**

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**STATEMENT OF**

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UNITED STATES DEPARTMENT OF JUSTICE**

**BEFORE THE**

**UNITED STATES HOUSE OF REPRESENTATIVES  
COMMITTEE ON FINANCIAL SERVICES**

**HEARING ENTITLED**

**“FEDERAL AND STATE ENFORCEMENT OF FINANCIAL CONSUMER  
AND INVESTOR PROTECTION LAWS”**

**PRESENTED**

**MARCH 20, 2009**

Good morning Mr. Chairman, Ranking Member, 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 is vastly greater than 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 billion lost during the S&L crisis. Mortgage and related corporate fraud were not the main 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 the FBI's former Assistant Director for the Criminal Division 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 the Assistant Director predicted. 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?

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 residence 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 and shares information pertaining to mortgage fraud through its national and regional working groups as well as 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 attributable to mortgage fraud is unknown. However, seven percent of SARs filed during FY 2008 indicated a specific dollar loss, totaling more than \$1.5 billion. Only seven 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. As of February 28, 2009, there were 28,873 mortgage fraud SARs filed in Fiscal Year 2009.

Based on past and current investigations, the FBI recognizes that the mortgage 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-related entities are either loosely or completely unregulated at the state or federal level. The Department of Justice would like to work with the Department of the Treasury’s Financial Crimes Enforcement Network 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 an 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 schemes, Ponzi schemes and investment frauds, such as the Bernard Madoff 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 FBI mortgage fraud investigations has risen from 881 in FY 2006 to more than 2,000 in FY 2009. In addition, the FBI has more than 566 open corporate fraud investigations, including 43 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 only captures suspicious activity identified by those industry actors who choose to voluntarily report it. 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.

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 identity-related 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.

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 mortgage fraud 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 18 mortgage fraud task forces and 47 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, 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 254 Special Agents, as of February 28, 2009, 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.

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 agencies, as well as to 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 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, 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.

### **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.